Skroupa, C.P., 2017

NOV 1, 2017 @ 11:10 AM 4,436

How Intangible Assets Are Affecting Company Value In The Stock Market

Christopher P. Skroupa, CONTRIBUTOR
I focus on the intersection of government, Wall Street & main street. **FULL BIO**

Intangible values are increasing the total market value of companies.

David Post leads the Sustainable Accounting Standards Board's (SASB) team of sector analysts. The team is responsible for working with issuers, investors and other stakeholders in a rigorous research, analytics and consultation process to identify current and emerging financially material ESG risks and opportunities among 79 industries. Financially material ESG risks and opportunities, which the team defines in terms of industry-specific metrics, are designed to be low cost to issuers and help enable investors and issuers to make effective capital allocation decisions. This research supports the SASB Standards Board's technical agenda and influences the content of the disclosure standards, advancing SASB's core mission.

Post has been an equity portfolio manager and research analyst for over twenty years, during which time he led the equity research departments of two multi-billion dollar AUM firms. He has researched, invested in and visited companies in nearly all sectors. This experience gives Post a strong background to help the research team identify non-financial topics and metrics, which are material to investors, issuers and other stakeholders.

Christopher P. Skroupa: What's the importance of intangible value in regard to overall company value?

David Post: Intangible values are very, very important. They are increasing the total market value of companies. Intangible values have a direct correlation with intangible assets, and can be significantly impaired by their mismanagement. Years ago, tangible assets were the primary driver of company value – think Graham & Dodd – while intangible assets were a small component of corporate value, largely thought of as reflecting the value of brands.

Today that's no longer the case. Intangibles have grown from filling 20% of corporate balance sheets to 80%, due in large part to the expanding nature, and rising importance, of intangibles as represented by intellectual capital vs. bricks-and-mortar, research and development vs. capital spending, services vs. manufacturing, and the list goes on. Conventional accounting methods haven't necessarily evolved to measure the value of intangibles as effectively as they do tangible capital. This is not to say intangible assets cannot be measured simply because they have different characteristics than tangible assets. The Sustainable Accounting Standards Board believes intangible assets do require different methods to assess, but that their impacts are still tied to a company's financials. The long-term value of a firm's total assets – including intangibles – is driven by a series of short-term corporate actions and long-term decisions. We think of decisions about ethical pharmaceutical marketing, responsible consumer lending, oil and gas greenhouse emissions, airline labor relations or restaurant food safety – all SASB sustainability topics – as affecting tangible and intangible assets and long-term corporate value.

Skroupa: How have intangible values impacted performance over time?

Post: Well, that's the question. We know that intangibles have been increasingly taking up shares of corporate balance sheets, ergo they're likely to be large drivers of a company's stock market value. However, their impact on the books is often less direct or apparent. For example, employee training looks like a cost in the short-term, but if it leads to process quality improvements, which in turn improves customer satisfaction, you're eventually going to see the needle move on revenues, market shares and elsewhere. Until there's a market standard for measuring these impacts, our assessment of performance on intangibles will be incomplete.

The SASB's rigorous process of identifying material sustainability issues fits well with the evolving environment as it considers both tangibles and increasingly important intangibles. We have identified a set of material, industry-specific, market-informed sustainability issues in 79 industries which are decision-useful for investors and cost-effective for companies to report. Our standards represent a minimal set of typically five issues and thirteen associated metrics per industry to characterize a company's sustainability. An increasingly recognized 2015 Harvard study titled "Corporate Sustainability: First Evidence on Materiality" demonstrated a 22-year substantial outperformance among companies who ranked high on material sustainability factors.

The authors used the SASB standards to classify companies and categorize issues. Others are looking to reproduce this study with their own sustainability data and our Materiality Map, so we will see if there is confirming research. The outperformance in the Harvard study was so significant as to suggest that material sustainability factors have yet to be even modestly reflected in market values. One might say that material sustainability factors offer a large opportunity to grab alpha before it becomes beta.

Skroupa: How can companies measure intangible value accurately?

Post: It's a great question, and the answer is: It depends. It depends on how intangibles are drivers of value in their industry.

For example, in a consumer-facing industry, it might be through supply chain relationships. In technology, it might be through intellectual capital. In pharmaceuticals, it might be through patents or processes. That's why the SASB standards are industry-specific. Interestingly, a large portion of companies already report on the SASB topics in their SEC filings. Specifically, our analysis showed that nearly 70% of the 10 largest companies in 79 industries disclose information on at least three-quarters of the SASB disclosure topics for their industries. The fact that companies report on the SASB topics says they agree with us that our topics are material, and of interest to investors.

Unfortunately for investors, more than half of this disclosure is boilerplate, which is essentially useless, while another 30% or so is company tailored narrative, which isn't much more helpful. Even in the 15% or so of sustainability disclosures where companies report metrics in a good-faith effort to provide decision-useful information to investors, the numbers are seldom comparable across companies. The SASB provides a voluntary set of standards which companies may use to report comparable, decision-useful information to investors and to track their own progress over time and relative to competitors. A win-win for investors and for companies.

Skroupa: What work have you been doing to help companies and investors integrate intangible values into their decision-making?

Post: It's become a cliché in business to say, "You can't manage what you can't measure," but it's a cliché because it's true. That's why we're working on providing a set of tools to help measure what matters. The SASB built its set of industry-specific, material sustainability topics and associated metrics from 2012-'16. We believe investors need to narrow down the mountain of frequently immaterial sustainability data to a minimum set of material, decision-useful topics and associated metrics.

We've spent the last year consulting with hundreds of investors, companies and subject matter experts, and meeting with our independent Standards Board, to update the SASB's provisional standards. We kicked off a 90-day public comment period on October 2, which is the final step in our journey to deliver market-informed sustainability standards in the first half of next year. We invite all comers to get involved in shaping our standards and the future of investing during the SASB public comment period.

Christopher P. Skroupa is the founder and CEO of Skytop Strategies, a global organizer of conferences.