Using Corporation Intangibles Information to Make Investment Decisions in the Background of Globalization

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ABSTRUCT: This exploratory paper has attempted to use case studies to probe the role non-financial corporation intangibles information plays in professional investors' equity investment decisions. Cross market analysis is made to compare the usefulness of intangibles information in different cultures and financial systems.

It was found that corporation intangibles information was used in both domestic and foreign equity investment decisions as supplement information to financial reporting. Objective and subjective (impressionistic) information on corporation intangibles was used in major investment decision phases such as search, valuation, hold, buy and sell and contributed to earnings estimates, company valuations and to JFI confidence in their valuations. Corporate intangibles information widened JFI information sets, improved judgments and increased chances of 'getting lucky'.

Compared with domestic investment, international investors first of all have to tackle the devil of such information's uncertainty problem and knowledge problems which are two main barriers to intangibles information usage especially in emerging markets. The uncertainty problem and knowledge problem originated from culture difference have great influence on the information access and information interpretation. Foreign investors' relative advantage (disadvantages) to local investors in the developed information markets is different from that in the emerging information markets. Investors' relative positions in different information markets have an effect on their use of intangibles information.

This paper may inform regulation making as the issue of regulation on intangibles information disclosure is all the more pertinent in consideration of accelerating globalization and international equity investment. This paper provides insight into the value relevance of intangibles information in complex international investment, and may serve as a basis for further theoretical and empirical research.

Acknowledgement: We would like to thank the fund managers who participated in the interview in this study. Also thanks to the participants in the 3rd Workshop on "Visualizing, Measuring, and Managing Intangibles and Intellectual Capital",2007, University of Ferrara, Italy and the symposium of "Society for Social Management Systems — Infrastructure and Environment 2008", Kochi University of technology , Japan for their comments for this paper. We especially would like to express our gratitude to Professor Ulf Johanson, Professor John Holland and assistant professor Leif Linnskog for their advice on this paper

1. INTRODUCTION

The recent two decades have witnessed two trends in the world economy. The first is the shift of economy from industrial and manufacturing capability based one to knowledge and idea based one. This trend has expanded the horizon of the theory and practice of finance and created anxieties and uncertainties among investors. The second is the globalization of the world economy where not only business has gone beyond the border of one country, but also financial activities are expanded to world wide range. The former is represented by the flouring of international companies and international competition, while the latter has spurred the burgeoning of information market and international accounting convergence.

One of the considerations exploited in this paper is that the practice and theory of finance are based on information (Wilhelm and Downing 2001). The conventional financial reporting provides important information for investors in the past. This reporting model has its roots in the industrial revolution of the last century. It was effective for a manufacturing based economy. The fact that new economy matches on with globalization have changed the information needs of investors. Information that is (1) forward looking; (2) directly linked to a revenue steam; (3) standardized; (4) hard to manipulate legally; (5) internationally comparable are thought to be needed by international investors.

The convergence of international accounting standards has improved international comparability of financial information. However, it has not satisfied the increasing demand for forward looking information. The forward looking information on the companies' value drivers, trends, risks and uncertainties are thought to be helpful to investors for assessing the capacity of the company to generate future revenue. However, it is far beyond our current understanding how these companies intangibles information are used and what role they are playing in the investment. Especially, when institutional investors as key players in the financial market believe that not all markets are efficient and are going around the world looking for arbitrage opportunities, information is at a premium (Clark et al. 2007). In the background of globalization, problems of how institutional investors view the role that corporation intangibles information plays in different financial environments and in different markets of both developed and emerging markets, whether and/or how intangibles information is used by investors in foreign equity investment decisions remain largely a terra incognita in research waiting to be explored.

The current research is an exploration of the above questions based on case studies of one representative Japanese institutional investor which is well-known for active investment policies and investment efforts in both domestic and foreign markets, and well experienced with both developed and emerging foreign markets.

The following parts of the paper are organized as follows: section two is a brief description of research questions and research method; section three is literature review, section four discusses the construction of interview questions; section five is responses and analysis of the interviews; and section six is the conclusion.

2. RESEARCH QUESTIONS AND METHOD

2.1 Research questions

The research questions of this paper can be described as falling into three broad categories: 1) How institutional investors understand corporation intangibles information in complex international equity portfolio investment; 2) How they use such information, if they use it at all, in the investment decision process; and 3) What are the factors that influence the usage of intangibles information by fund managers.

How do fund managers understand intangibles in different markets?

Compared to prior research on individual markets, the current research tries to explore intangibles information usage in complex international markets, which can be divided into two types – developed markets and emerging markets-- according to their market features. Developed markets are characterized by their relatively mature social and legal system and highly developed economy, while emerging markets by their high risk and high growth potential.

In the meanwhile, the role of Intangibles in the value creation of companies may differ with different social system, industry structure and scale of companies. IT and services industries, for instance, obviously relies more on intangibles than manufacturing industries. In addition, the components of intangibles, such as human resources, management, relationship with company group in different business environments, may in all likelihood be different in their respective contribution to the value creation process. When it comes to international equity portfolio investment, how fund managers view Intangibles in different markets is apparently an important research question to explore.

How do fund managers use intangibles in international equity portfolio investment process?

Prior research on fund managers' use of intangibles information in the domestic equity portfolio investment process indicates that such information is certainly used in the investment decision process (Holland, 2003). However, such research is limited to an individual domestic market, which belongs to developed markets. When the portfolio is expanded to include more foreign market equities, covering both developed markets equities and emerging markets equities, questions like whether the investment process changes with the increasing complexity of portfolio, whether fund managers' use of intangibles information will change accordingly and how intangibles information is used by fund managers also become of critical importance.

What are the factors that influence fund managers' use of intangibles information in international investment decision process?

The use of intangibles information in the international equity information decision process obviously involves more factors than that in domestic equity portfolio investment process. Foreign developed markets and foreign emerging markets are often widely different in their cultures, their institutional systems, and the maturity of their markets. Even if fund managers do consider intangibles information useful, and would like to use such information, whether fund managers are able to get the necessary information they need and whether they are able to adequately interpret such information can be a critical factor that influences their use of intangibles information.

Prior research on home bias explored some factors that may cause information asymmetry. Besides those that may cause deficiencies in financial information disclosure, cost, langue, culture, distance and etc are given as possible factors contributing to information asymmetry. While cost, distance and etc pose constraints on information access, factors like language and culture also influence information interpretation by fund managers. Which factors contribute more to information asymmetry, therefore, should be examined.

In other words, in emerging markets and developed markets, foreign investors may suffer from a kind of information disadvantage or enjoy a kind of information advantage compared with domestic investors. The information disadvantage foreign investors suffer from or the advantage they enjoy may greatly influence their use of intangibles information and their investment decision. Therefore, in order to determine whether the relative position of foreign institutional investors in the information market leads to their bias in information usage and investment, the current research will also try to explore what position fund managers feel they may have in both emerging markets and developed information markets .

2.2 Methodology

This research is based upon interviews with fund managers of top Japanese institutional investor company A which is characterized by the active investment policy and investment efforts both in domestic, foreign developed markets and foreign merging markets. Cross market analysis is made to explore whether and how use of intellectual capital information by institutional investors is influenced by cultures, financial environments in different markets. Though the number of interview is limited, our ambition is to contribute to the theory building. The next step to be performed in future research is to elaborate on the preliminary theory and then to test the theory.

3. LITERATURE REVIEW

In this section, a detailed literature review based on which our research questions are posed and interview guide are made will be made on the theoretical discussion of value relevance of intangibles information and empirical studies on the investors' using corporation intangibles information in forecasting, valuation and their investment decision process and value creation process in individual markets. In addition, literature on emerging markets investment will be reviewed and summarized.

3.1 Understanding value and value relevance of qualitative intangibles information

Qualitative information includes all non-qualitative information in a broad sense. In this paper, this concept is confined to company specific qualitative information which focuses on company value creation activities and company business strategy, but excludes outside environment such as regulation environment, macro-economic environment.

The usability of qualitative information is greatly dependent on whether it is value relevant or not. To understand the concept of value relevant information for the capital market participants, we should have a clear perception of what "value" means. "Value" means different in the perspective of accounting and that of finance. According to the concept proposed by Mouritsen(Mouritsen, 2003), if we try to grasp the concept of value in a stationary manner, in conventional accounting, value is constructed by a disciplined, rule-based manipulation of business transactions that made up book value by assigning entries as expenses or assets; or as liabilities, revenues or capital. But from a perspective of finance, the value is dependent on a justified forecast of earning capabilities and cash flow projections. Focusing on the possible net present value of the firm's cash flows, shareholder value is created as increments to the firm's capital market value. Based on this interpretation,

Gu and Lev(Gu, 2001) value intangibles on this basis, but obviously the resulting value is highly dependent on the firm maintaining a stable earning-generating ability. It is obviously intangibles have become more important value driver.

If we try to understand value from dynamic perspective, Mouritsen (2003) suggests that the knowledge and value are interconnected. Knowledge grows in firms, new opportunities surface all the time, and therefore somehow it makes little sense to say that the future is a set function of the past. Mouritsen and other researchers argue that the value of intellectual capital is in itself a process of value creation. Value therefore means not only to measure or calculate value, but to understand the creation and development of value (Guthrie, 2001); Mouritsen *et al*., 2002a; Petty and Guthrie,2000). From this aspect of view, value relevant information should include all the information concerning value, value creation and development.

In accounting literature, relevance is defined as "the capacity of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present and future events or to confirm or correct prior expectations (SFAC No.2). For capital market participants, specially, fund managers and analysts, the value relevant information is one of the decisive factor that influence their accuracy of forecast earning, and future cash flow, whether it is qualitative or quantitative. From the dynamical concept of value, it is indicated by Popper (1972) that it is impossible to arrive at one finite and set value of intellectual capital, since the knowledge connecting with value is to grow and it is difficult to predict its growth and development. The attempts to understand intangible assets from the conventional perspective of accounting and to measure, record it in numbers as under the conventional accounting mechanism is in vain. Therefore, most of the intangibles are not included and recognized in the financial statements

3.2 Intangibles information and investment decision process

For capital market participants, especially fund managers and analysts, value relevant information is one of the decisive factors that influence the accuracy of their forecasts of earnings and future cash flow and their evaluation of company stocks.

3.2.1 Forecast accuracy and information

The literature of forecasts provides some evidence on the co-relationship between the accuracy of forecast and intangibles information. Some researchers have attempted to find whether information on capitalized intangible assets contributes to the accuracy of forecast. For example, Matolcsy (2006) finds that firms that capitalize a higher proportion of their underlying intangible assets tend to have higher analyst following, and enjoy more accurate earnings forecasts relative to firms that capitalize a lower proportion. In other settings such as the United States, where most intangible assets are unrecognized, research shows that analysts tend to make larger errors in their earnings forecasts for firms with higher underlying intangibles (Barron et al., 2002; Demers 2002)).

Orie and his colleagues (Orie E. Barron et al., 2002) examined the association between firms` intangible assets and various properties of information contained in analysts' earnings forecasts. They empirically demonstrated that the earnings forecasts for firms with higher levels of intangible assets tend to contain relatively more information about future earnings. They refer to this kind of information as private (idiosyncratic) information. Analysts will supplement firms` financial information by placing greater relative emphasis on their own private (or idiosyncratic) information when producing their earnings forecasts for firms with significant intangible assets.

Orie and others further demonstrated that the higher the firm` s level of intangible assets, the higher the degree to which the mean forecast aggregates private information. In the later version of their research paper, they presented empirical evidence to support their assumption that current earnings are less useful than analysts` forecasts for predicting future earnings for intangibles-intensive firms relative to other firms.

Though Demer (Demers, 2002a) criticizes Orie et al.'s research, saying that their tests were less than well-designed and without factoring in other sources of firm-specific information such as voluntary disclosure, and that their empirical measure did not distinguish "information" from "uncertainty " and therefore it is difficult to arrive at conclusions regarding the marginal impact of analysts in improving the information reporting system for high intangibles, she recognizes that Orie and others contribute to our knowledge and understanding of the role of financial analysts as information intermediaries who may augment the arguably deficient reporting system for firms with high levels of intangibles vis-à-vis other firms.

Clement (Clement, July 1999) assumes that an analyst` s portfolio complexity is likely to be co-related with forecast accuracy since the heavy load of larger portfolios tend to make the analysts devote less attention to each individual firm. He also suggests that forecast accuracy is positively co-related with analysts' experience. He uses the number of firms and industries as proxies for the portfolio complexity.

3.2.2 Using intangibles information in valuation

As for the role intangibles information plays in valuation, Johnson (2002) reviewed literature on valuing the securities of knowledge-based companies. Investors usually try to approximate the future benefits with models based on dividends, earnings, and book /market value of assets which can be provided by the accounting system. Yet, common accounting practices, such as expensing rather than capitalizing R&D, the reluctance to recognize human resources and other intangibles, deflate the net income and book value of high-tech innovative companies. In addition, quite a lot of knowledge-intensive companies cannot provide fundamental data such as dividends and earnings, for many of them are negative, and their book value of assets is small. These problems have led to some alternative ways of assessing value.

According to Johnson (2002), rules developed by investors for selecting technology securities are classified into four groups: 1) identifying industry leaders, 2) making use of the portfolio effect, 3) searching for alternative values for fundamental variables, 4) searching for alternative models. The first and second group of rules adopted are not formal techniques. And it is based more on investors' own philosophy. The third group of approach is based on quantitative analysis. And the fourth group of approach – the search for alternative models provides new perspective in valuation which takes into consideration factors other than those stated in financial reporting. For example, A common way to assess the relative value of internet companies is to measure their activity statistics such as the number of visitors to the website ('site hits' or 'reach') and length of stay of each visitor (‘stickiness’).

Others such as Trueman (2000), Demers and Lev (2000) conclude that a combination of financial statement variation and a set of other variables (e.g., number of unique visitors to a website, stickiness, and customer loyalty) help to better valuate companies. Amir and Lev (1996) claims that on a stand-alone basis, financial information is largely irrelevant for the valuation of cellular phone companies. However, when combined with non-financial information, and after adjustments are made for the excessive expensing of intangibles, some of these variables do contribute to the explanation of stock prices. This finding demonstrates the complementary co-relationship between financial and non-financial information. In the meanwhile, it indicates that the traditional focus of accounting research on the former is overly restrictive and may lead to unwarranted conclusions.

3.2.3 Intangibles information in the process of investment decision process

While a lot of quantitative research try to find the co-relationship between valuation and intangibles, forecasts and intangibles, qualitative research has also shed light on whether or/and how intangibles information is used by capital market participants in their decision-making process. For example, Holland and Johanson (2003) attempted a bird's-eye view of the dynamic mechanism of portfolio investment process and utilization of information by the capital market participants.

According to Holland (2000, 2003), in the fund managers’ hierarchical value creation process, there is a core set of value drivers including top management qualities (stars vs. team qualities), coherence and credibility of FM strategy (active vs. passive, internal vs. external, retail vs. pension fund strategies etc), fund management pay (base vs. bonus, sing vs. group) schemes, and shareholder-value-based FM performance systems. As these value drivers differ, as will the incentives and behavior of utilization of information in the investment decision be. In the horizontal value creation process, information, fund managers, funds, as well as the value drivers described above hierarchical process are inputted.

In the horizontal value creation process, qualitative and quantitative information, fund managers, funds, as well as the value drivers described in the above hierarchical process are inputted. Then the inputted materials are used in the portfolio decision process and information processing and decisions. Finally output decisions such as return, risk, liquidity, disclosure, advice and etc. are made (see Figure 1 in APPENDIX.).

In Holland & Johanson (2003), once the case fund managers acquired a knowledge advantage concerning the role of intangibles in the corporate value creation process, they were in a position to analyze macro and competitive changes in the company’s environment, and to access their effect on the company and the likely corporate response. Qualitative data on human, structural, and relational capital was combined with publicly derived and internal source of quantitative data to create a new basis for adapting and re-estimating numbers such as the size of valuation variables, their likely changes and the sensitivities of such estimates.

3.3 intangibles information and information asymmetry in international investment

The process of institutional investors going around the world to look for investment opportunities is in a sense a process of fund managers and analysts competing for information. As globalization marches on, previously simple information asymmetry in one domestic market has expanded tremendously, involving more players (such as foreign investors), and more layers (such as information asymmetry between domestic and foreign institutional investors, as well as between domestic companies and foreign investors).

3.3.1 Information asymmetry as one of the determinants of home bias

In international investment decisions, home bias (investors' preference of their home market equities in spite of possible high returns provided by foreign equities investment) remains a puzzle that has attracted quite a lot of research interests. Home bias research has found that information asymmetry is one of determinants of bias in equities holdings (Aggarwal, Klapper, & Wysocki, 2005; Ahearne, Griever, & Warnock, 2004; Coval, 1999; M. Grinblatt & Keloharju, 2001; Suh, March 2005).

Ahearne and others tested extant hypotheses of the home bias in equity holdings by US investors, using high quality cross-border holdings data and quantitative measures of barriers to international investment (Ahearne et al., 2004). They found that the effects of direct barriers to international investment [1], even when statistically significant, are less economically meaningful in predicting investors' decisions than information asymmetries that are due to the poor quality and low reliability of financial information in many countries.

Suh (2005) studied the home bias patterns in international portfolios which are recommended by global financial institutions. The evidence from his analysis suggests that home bias can arise from unobservable factors such as information asymmetry and investor optimism. Cooper and Kaplanis (Cooper & Kaplanis, 1994) suggest that international capital markets are segmented not only by costs and restrictions, but also by other informational imperfections.

Quality of financial reporting, disclosure behavior, language, distance and cultures are considered factors that may cause information asymmetry. The shared linguistic and cultural background of investors and investee companies are assumed to help the investors better understand the intangibles of the company, a process that may play an important role in value creation. Another paper by Grinblatt, al. et (M. Grinblatt & Keloharju, 2001) documents that investors are more likely to hold, buy, and sell the stocks of Finnish firms that are located close to them, that communicate in their native tongue, and that have chief executives from their cultural background. The influence of distance, language, and culture is less prominent among the most savvy investment institutions than among both households and less savvy institutions.

Quality of financial reporting, disclosure, distance and so on can be regarded as important factors that influence investors' information access, while the other factors like language, cultural background of fund managers and analysts may be thought as factors that have an effect on investors' ability to interpret such information. A company's intangibles, which contributes to its value creation (and such contribution depends more on the environment it is embedded), can only be better understood within its social and cultural context. Therefore, as intangibles play an increasingly important role in the economy, a legitimate question arises of whether the information asymmetry caused by intangibles information access and processing has become a greater handicap for foreign investment decision makers.

3.3.2 Mixed evidence on the information advantages of domestic and foreign investors

A lot of researches have been made to examine the performance of foreign investors. However, evidences are mixed. For instance, Kang and Stulz((Kang & Stulz, 1997) using annual data for 18 years, find no evidence that foreign investors outperform domestic investors in Japan. Hau(Hau, 2001a), using trade data, shows that distance from Frankfurt disadvantages proprietary traders trading in German stocks. Coval and Moskowitz (Coval & Moskowitz, 1999), using only U. S. Stock returns, provide evidence that investor location matters in that mutual fund managers are better at picking stocks of firms that are close to where they are than stocks of firms from a more distant location. Grinblatt and Keloharju (Grinblatt & Keloharju, 2000)and Sea(Hau, 2001a) holes(Seasholes, 2000) argue that as a result of their better access to expertise and talent, foreign institutions should be smarter than local institutions.

Choe et al. (Choe, 2001) examine whether domestic investors have an information advantage over foreign investors because they have access to private information about individual stocks using a dataset of all trades on the Korea stock Exchange. They show that the private information advantage of domestic investors can represent a substantial disadvantage for active foreign investors. Though foreign investors may be more sophisticated, they may lose out to domestic investors who have private information when they trade. This private information is likely to be more important in countries where insider trading is more likely to occur.

However, Dvorak (Dvorak, 2005) investigates foreign or domestic investors' information advantage in the Indonesian stock market and find that in the long run, foreign investors have better performance which is assumed to be lead by their experience and expertise rather than inside information. This long run good performance is thought to be evidence of that that foreign institutional investors are better at exploring the real value of companies. However, not all foreign institutional investors outperform local investors, only investors of the developed countries outperform in the long run.

3.3.3 Relative information position of domestic and foreign investors

How to understand the above mixed evidence on the relative information advantage of domestic or foreign investors? We'd better consider the relative information position of domestic investors and foreign investors in two different types of information markets—developed markets and emerging markets.

Morck(Morck, Yeung, & Yu, 2000) examine the stock price synchronicity and their research suggest that less firm specific information is produced in emerging markets. In Chan and Hameed (Chan & Hameed, 2006), the analysis results based on emerging markets demonstrate that poor information disclosure and lack of corporate transparency increases the cost of collecting company specific information, so that security analysts generate their earnings forecasts based mostly on macroeconomic information.

This lack of firm-specific information in emerging markets can be attributed to a number of factors. First, there is little enforcement of the few regulations that relate to information disclosure in emerging markets. Second, there is a low degree of voluntary disclosure and corporate transparency. Third, many companies in emerging markets are group affiliated or family owned, and it is difficult to collect reliable information on such companies. Though in recent years, according to the "Disclosure survey 2003" by World Federation of Exchanges, the disclosures in emerging markets have been improved greatly, information asymmetries between local investors in emerging market and foreign institutional investors information still exist.

In emerging markets, companies have different business models and different business environments from those in advanced countries. The difference in language, culture, and social system and market characteristics made it harder for international investors to interpret the information on intangibles and the possibility of the company to achieve its objective. This may lead to more sever home bias, especially bias towards emerging market equities.

Frenkel and Menkhoff (2004) analyze the potential information asymmetries between local investors in emerging market and foreign institutional investors. They argue that as information is opaque, the relative position of outsiders- and among them foreign institutional investors—is weakened. Consequently, the competitive advantage of institutional investors, i.e. how they compile and use information, can not be fully realized but can even turn into a disadvantage compared to local investors.

They analyze the foreign institutional investor` s role in emerging markets and make proposition as that the market entrance of comparatively less informed foreign institutional investors dilutes the average level of information in the market and thus lowers the information quality of financial prices.

It is a critical assumption that compare to local investors of emerging markets, foreign investors are technologically superior. They have better ability to process information as is shown in the following figure. An additional assumption is that some information about emerging economies is always better available locally as is always the case in opaque markets where data need accompanying information. If information is not based upon personal contacts with a good track record, any reliance on anonymous sources of information requires that its quality be confirmed in some other way. In developed markets, laws, accounting rules and etc. perform this task. But in emerging markets, the information is based more on personal experience. Put differently, emerging markets are characterized by a lower amount of reliable and publicly available information. So it seems foreign institutional investors have more information disadvantage. (see figure 2, Frenkel & Menkhoff 2004).

(For figure 2 Please see in APPENDIX.)

4. CONSTRUCTION OF INTERVIEW

The interview guide was constructed on the basis of prior research summarized in the above literature review and includes 4 parts correspondent with the research questions.

A. The first group of questions-- To explore how fund managers view intangibles and intangibles information in emerging markets and developed markets respectively.

1). Do you think in emerging markets, corporation intangibles are of the same importance as those in developed markets ？ Do you take into consideration intangibles of companies of emerging markets in your investment decision process? Are your information needs different depending on whether you deal with emerging markets or developed markets?

2). What scales of company do you prefer to invest in, large scale or small and medium scale? Why? Is there any difference in information access when valuating different scales of companies?

3). What industry in emerging markets and developed markets do you prefer to invest in? How do you value the company with higher intangibles?

B. The second group of questions — To find out how intangibles/Intangibles information is used in portfolio international investment decision process

4) Is there any difference between domestic investment process and foreign investment process? If there is any difference, what is it? When do you use intangibles information if you do use them?

5) Is fundamental analysis of the same importance in domestic and foreign investment processes, in merging markets and developed markets? Is there any difference in fundamental analyses in developed markets and foreign markets?

6) How do you choose companies of emerging markets in your screening process? The same way as you do in developed markets? Do you consider their Book value/ market value ratio in this stage?

C. The third group of questions – To examine factors that influence intangibles information usage by fund managers.

7). Do you use the same type of information in domestic and foreign investment decision making taking into consideration that the cost of acquiring information in different markets are different？

8).How do you think about the quality of accounting information in emerging markets and developed market? Do you think that the difference in accounting information quality will cause difference in corporation intangibles information needs? Do you think disclosure in emerging markets and domestic markets is of the same reliability? How can you get the information you think is important but not disclosed?

9). Do you invest for long-term profit or short-term profit? Any difference in investment purposes in different investee countries, emerging markets and developed markets?

10) Do you think, as a foreign investor in a foreign investment market, you are at a disadvantage in information (intangibles information) access? People often say that in emerging markets, local investors have an advantage in terms of insider information. What do you base your investment decisions on? Where do you think your advantage is in information process and in investment?

11) Do you use sell or hold recommendation provided by investee country analysts?

12) Do you think you have more technical advantage in gauging corporation value through analyzing the intangibles of a prospective company?

D). The last group of questions — To explore fund mangers' needs for intangibles information disclosure

13) Do you think that more intangibles information should be disclosed for foreign investors? Why?

5. RESPONSES AND ANALYSIS

About questions in part A

In responding to question 1, the fund manager does not regard intangibles in emerging markets as of the same importance as they are in developed markets.

"I personally don't think that intangibles contribute much to the company value creation in emerging markets. It is in high-tech industries such as media-related industry, IT industry, rather than in traditional industries, that intangibles play an important role. However, in emerging markets, the market value of these industries is not very large. Therefore, in fact, intangibles are more important in developed markets such as European and US markets than in emerging markets."

The interviewee added that in a more general sense, company A does value intangibles in its investment process. However, whether intangibles information is used or useful in the equity price calculation or prediction depends on specific cases. In other words, it depends on the particular situation of a specific investee country and a specific investee company. Investors or sell-side analysts in European and US markets highly value intangibles, while investors in Asian countries seldom, if ever, take intangibles too seriously. Even if prices of Asian securities reflect intangibles information, intangibles are not so highly valued. The fund manager provided some examples by way of explanation.

The fund manager pointed it out that the problem of how to understand Intellectual assets is intertwined with the social system in which the intangibles are embedded. The difference in culture, custom and institution makes it impossible to arrive at a uniform conception and measurement of intangibles. "*Such differences are very difficult to valuate by using possibility model. Therefore, intangibles information can only be used as a reference. It is hard to use it in* *investment judgment."*

As for emerging market companies, fund managers tend to pay special attention to qualitative information. For instance, when they evaluate a Chinese listed company, they will pay special attention to the relationship with its company group (even though sometimes a company group consists of only one listed company), its government affiliation, in order to predict the company's future business development. But it is hard to valuate this kind of relationship.

"In emerging markets, information from sources other than annual reports is always to be checked and corroborated. Such information can be useful in the estimation of companies' future performance, e.g. future cash flow and future accounting profit. It can be used in fundamental estimation and used as a valuation base. But it is of little value in predicting or calculating security prices."

As for the second question the fund manager said that the scale of a prospective company is not a decisive factor in his management decision on whether to invest in it or not. However, as small-and-mid-scale(SM) of companies tend to have more growth potential, such companies are more likely to be valuated positively. "*However, the potential of companies in emerging markets, as well as emerging companies in developed markets, should be valued against the background of globalization. In global competition, local companies of emerging markets do not necessarily win the battle in competition with global companies. Measures to deal with this kind of global competition and measures to deal with possible risks should be confirmed by talking with the management vis-à-vis. Information on the potential of the investee companies, the competition environment, and the ensuing risk should be secured through meetings with companies."*

In responding to question 3, the fund manager made detailed explanations about both emerging markets and developed markets. In developed market investment, sectors are divided by the fund manager into international sectors which include energy, material, technology, and etc. and non-international sectors which include retail, public service and etc. Companies of the international sector can be compared across the border, while companies of non-international sector can not, as their profit rates and valuation depend more on the features of the country, the business system, the degree of freedom of the markets that they belong to.

In emerging markets, it is impossible to make cross-border sector comparison because there is no such international sector. When an emerging market equity portfolio is constructed, country allocation is firstly decided, then, sectors and companies of that country are decided. When investing in an emerging market, the unique condition of that market, the unique condition of that sector, country risk, and the liquidity of the market should be weighed.

About questions in part B

As for question 4, the interviewee said that there is almost no obvious difference in domestic investment process and foreign investment process, except for the fact that foreign equity investment is more complicated because it involves foreign currencies. Risk management should take into consideration the country risk, the exchange rate risk and other related risks. Portfolio is constructed by bottom-up stock selection approach, which is based on company performance trends analysis and stock valuation.

The investment process itself does not change much compared with that of domestic equity investment decision.

The response to question 5 shows that company A considers fundamental analysis equally important in domestic equity investment decision making as in foreign equity investment decision making. However, the construction process of emerging market equity portfolio is different from that of the portfolio which mainly consists of equities of developed markets in sector allocation. Just as what is stated in the response to question 4, company value and competition capacity of companies in international sectors are compared across the border and the comparisons of companies in non-international sectors of developed markets and of emerging markets are made within the border. Intangibles such as management capability, their relationship with the government are important indicators used to help the fundamental estimation.

As for question 6, in the case of company A Asset Management, there are several of products. Each of the products has different screening process in stock selection. The portfolios which are constructed by the interviewee fund manager consist of European equities, US equities and Asian including Japanese equities. They are high return international equity portfolios. Therefore, in each market, stocks with returns higher than the average return will be screened in. In the meanwhile, market liquidity is taken into consideration because of the feature of the funds he is using. Other quantitative indicators such as the performance of the past years, BPS, payout ratio are also used in the screening process. Five hundred companies out of about 3000 companies will be screened in, in which only 1/3 will be involved in the portfolio after the fundamental analysis.

The investment decision process per se apparently changes little as it moves from domestic investment to international equity investment. So there is not much difference in using information on ICs/intangibles in the investment process as explored by Holland and Johanson (2002, 2003). Objective and subjective (impressionistic) information on corporation intangibles, was used in major investment decision phases such as search, valuation, and hold, buy and sell and contributed to earnings estimates, company valuations and to JFI confidence in their valuations. Corporate intangibles information widened JFI information sets, improved judgments and increased chances of 'getting lucky' （Holland et al. 2007）. The only difference may be that additional risks concerning the foreign equities are involved in the risk management. The emerging market equities investment process is a little different from that of developed market investment process in sector selection. But the difference in sector selection apparently has little influence on intangibles information usage. There is also some difference in scale preference. As small and mid-scale of companies in emerging markets are regarded as having high growth potential, ICs/ intangibles draw more attention when analysts try to use such information to help determine the future development of prospective investee companies. While they do so, they tend to check and recheck such information for reliability, and they do not use such information to calculate the stock price.

As for questions in part C

As for question 7, the responses include four points:

(1) Company A paid for large amount of cost to get the necessary information

which may be private otherwise;

(2) Overseas research cost increases with the increase of the needs for international equity portfolio investment (statistically, the accumulated overseas investigation cost is not as much as Japanese investigation cost);

3) Compared with European and US institutional investors which are well-experienced thanks to their long history of investment endeavors, Japanese institutional investors lag behind; and

4) High Cost in information collection is not necessarily concurrent with good investment performance.

The interviewee fund manager gave a detailed explanation of the fourth point. What causes the difference in cost is the speed of obtaining information. "The more promptly the information is obtained, the more it will cost. However, the high speed in getting the information does not necessarily lead to good investment decision." Good investment performance depends on investment style. In the short run, investors can get information which is not reflected in the market price yet. In this case, high cost leads to high speed in information collection and thus to good performance. However, as mentioned above, the fund manager thinks that short-term investment strategy will not necessarily lead to long-term benefits. Company A's investment style is value investing. Therefore, investors' performance depends more on their investment experience and fundamental research. Even if investors get the same information, different ways they interpret the information will result in different performances. Especially in emerging markets, high cost does not necessarily bring about high quality of information.

As for question 8, the fund manager believes that as the process of convergence to international accounting standards pushes on, there is less and less difference in accounting. But there are still wide differences left in the footnote. This is what should be paid attention to by fund managers in active investment. In emerging markets, there is less information contained in the footnote. And footnote may tell us an important story about the company. Besides, in emerging markets, there is quite a lot of information not available in the financial statements. Financial data and those behind financial data should be fully assessed. The information other than disclosed in financial statements should be verified so that its reliability can be established. The sell side analyst will closely watch for any change in the investee companies' situation.

About question 9, the interviewee confirmed that they adopt long term strategy. Though fund managers may be pestered with complaints from their customers that their short-term performance is not so good, they still invest on long-term basis. The same is true of both emerging markets and developed markets. Especially in emerging markets investment, long term strategy is more important than in developed markets, though it may seem anti-intuition as the securities price fluctuation is more severe in the emerging markets. The reason is said to be that as short-term fluctuation is associated with high risk, investors from developed countries invest in emerging markets for the high economic growth capability of the investee company and the accompanying high return. This goal can be achieved in the long run.

Another question was asked before the fund manager turned to reply the next question. The inserted question was, "How do you look at speculation in emerging markets, as it is widely perceived that there is more hot air than real investment in emerging markets." This question was asked because the present researchers wanted to prove the fund manager's view on speculation. Fund managers' view on speculation and their fundamental analysis based upon it may in some ways reflect something that influences their motivation and their efforts to explore the intrinsic value of a prospective investee company which might fail to show up in its financial statements.

The interviewee fund manager responded that he thought that speculation is connected with investment environment. In the long run, the noise which is beyond fundamental estimation statistically brings about no advantages. It is more profitable to make long-term fundamental analysis and long-term investment. It is easier for companies in emerging markets than companies in developed countries to boost the nominal profits. This is regarded as a big motivation to invest in emerging markets.

As for Question 10, the interviewee said that there is a perception gap between local investors and foreign investors because the local investors can better understand what other local people think about the products and/or services and they have access to more sources of information and more data. It is not only the language, but also the culture difference that may hamper the information from being adequately understood. The culture behind the language may not be interpreted accurately. "Even if the conversation or information can be translated into English, the second hand information contains less juice than the original one. This is a big disadvantage for foreign investors"

"As for the important information which is not disclosed, we will ask for it directly from the investee company or those who enjoy a close relationship with the company, or its rivals, competitor companies, competitor investors. However, we will confirm the reliability of the information from such sources for ourselves. Compared with developed markets, it takes more time and energy to verify information other than financial data".

The interviewee while responding to question 11 said, "We will not change our investment decision only for the native sell side analysts' recommendation." He pointed it out that in both emerging and developed markets the sell recommendation is much less frequent than the buy and hold recommendation. If sell side analysts provide a sell recommendation, it will be considered no more than an investment recommendation to value investors.

In the response to question 12, the interviewee admitted that maybe local Chinese investors have an advantage in information access. (It was the interviewee who volunteered the example of Chinese investors.) But as far as investment experience and technology is concerned, Japanese investors are superior to Chinese investors. "Local Chinese institutional investors proposed to tie up with us. But after some research, we found they are inferior in fundamental analysis and stock analysis technology and experience. Then we respectfully declined their proposal." When asked about India, the interviewee said that India is one of the British Commonwealth of Nations, whose securities markets have been greatly influenced by the United Kingdom. Therefore, the Indian market is more mature and more similar with European markets.

Out of the four problems, that is, uncertainty problem, knowledge problem, ownership problem, and management problem of intangible information (Johanson ,2002), the problem of uncertainty was most frequently mentioned by fund managers in their explanations as the barrier to properly evaluate ICs/intangibles in emerging markets. As for the knowledge problem, the cultural background of fund managers is regarded as one of the most decisive factors which influence their understanding of ICs/ and intangibles, while other problems of such as ownership or management problem were not mentioned. These inherent problems are tough and are apparently not to be easily solved.

The inherent problem of ICs information processing and cultural factors results in different positions occupied by foreign investors and domestic investors in international information markets. Though foreign investors are able to access information via direct contact with management or other related parties, it seems that they get less information for the lack of cultural background and inferiority in linguistic ability. It is not the information, but the background of information that is decisive in judgment. The uncertainty problem of information on ICs/intangibles makes it more difficult for the foreign investors to find information sources. And second-hand information translated from the original information tends to be a watered-down if not downright distorted version. Therefore, generally speaking, it is not only information itself, but also the context in which information is embedded which poses a challenge to foreign investors in both emerging markets and developed markets, and the challenge to them is especially tough in emerging markets.

As for questions in part D

As for the last question, the interviewee gave a response which is different from those that other researchers found in prior research. He said he thinks that to obtain information more quickly does not help to get excess returns. "It is hard to keep out-performance in the long run by this way. Development of information technology reduces information gap and any advantage people could get from it before. The more information is provided, the more likely added value that can be obtained by effective and efficient interpretation. Therefore, the more intangibles information is disclosed, the better."

However, he admitted that Information perspective gap still exists. China in Japanese media, for instance, looks quite a different from how it looks like in local Chinese media. Information about Japanese companies or Korean companies obtained though European or US media is different from such information Japanese or Koreans have. Therefore, it is very important to check and take into consideration divergent sources of information in order to get a more valid and reliable picture.

The development of information communication technology has narrowed the information gap between domestic and foreign investors. It is not the information, but interpretation of information that counts. While information that makes stock prices fluctuate in the short run does not necessarily help secure long-term profits, the information that reflects the intrinsic value and growth potential is valuable nonetheless. Therefore, the more disclosure of information, the more effectively and efficiently the IC/intangibles information can be interpreted.

6. Conclusion

The purpose of the present study is to venture a crude theory on the relationship between international investment decision and intellectual capital information that is to be further elaborate, refined and tested later on. While it was never intended to be a definitive study in any sense, some tentative conclusions may be drawn hereby from the study.

Compared with the research on individual markets, research on intangibles information usage in international investment markets is more complicated. This current research found that intangibles information does get used in the international equity portfolio investment decision process, and in almost the same way as in domestic investment. While intangibles information is used to help valuation and forecast estimation, it is of little help in calculating securities prices.

Uncertainty problem and knowledge problem (Johanson 2002) are two main barriers to intangibles information usage, especially in emerging markets, while the other two problems are relatively less important. Uncertainty problem and knowledge problem originate from cultural and social system differences between markets.

Though Chan and Hameed(2006) argue that poor information disclosure and lack of corporate transparency increase the cost of collecting company-specific information, securities analysts generate their earnings forecasts based mostly on macroeconomic information. Cost is apparently not a decisive factor that defines information search and usage. Company A believe stock selection is the most important source of excess returns, and are willing to pay higher and higher cost for overseas investment. Only that company A does not think high cost necessarily leads to good performance.

As for relative positions of domestic investors and foreign investors, the relative disadvantage in information apparently depresses information demand and investment in emerging market. If investors find it too difficult to follow a prospective investee company, they will change course and pursue other investment opportunities. Compared with developed markets investors' advantages in technology and experience, their disadvantages in information access seem to have greater impact on their information usage.

Prior research on individual markets shows that institutional investors prefer much of intangibles information not to be disclosed to the public so that they may keep an information advantage (Holland 2003). But investors' relative positions in the information market and investors' long-term investment strategy obviously determine their attitudes toward information disclosure. As investors occupy an inferior position in information access and a relative superior position in information processing, they tend to demand more information be disclosed.

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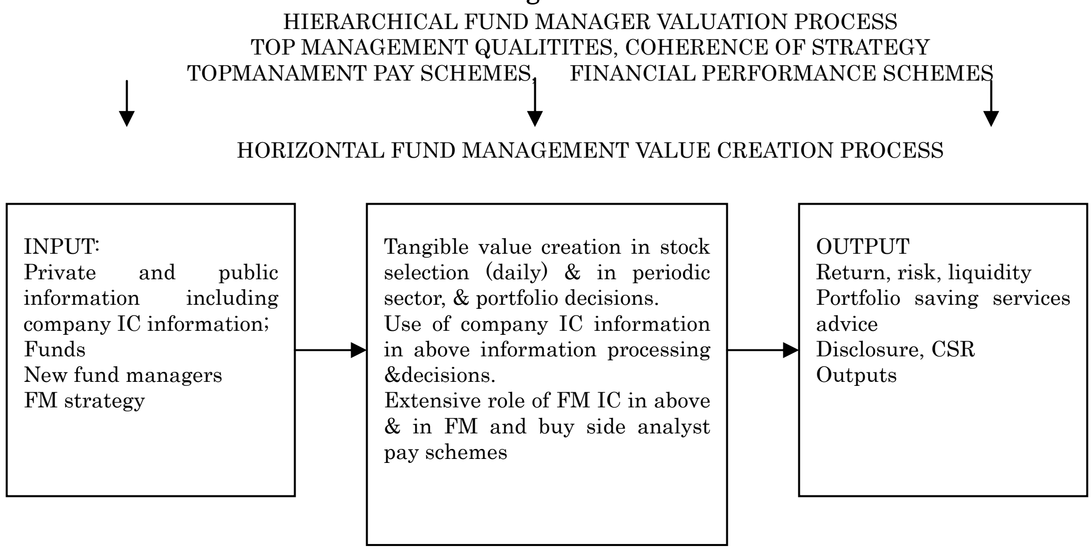
APPENDIX

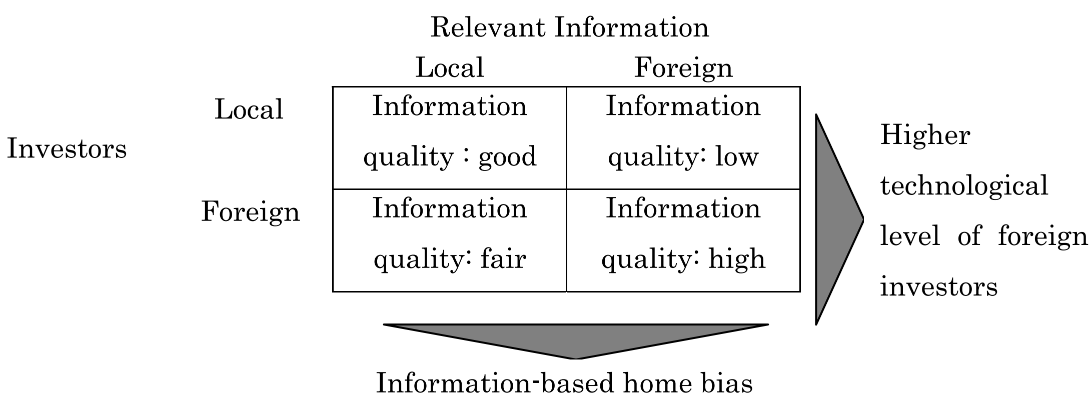
Figure 1



Source: Holland J. and U. Johanson (2003), p.472.

Figure 2

Heterogeneous Distribution and Quality of Information in Open Emerging Markets



Source: Frenkel, M. and L.Menkhoff (2004), p.1280.