

LEXIS NEXIS CONFERENCE

Sydney, 11 August 2004

“ARE WE PLAYING THE WORLD GAME?”

***Global Governance for SME's in
Technology Sector***

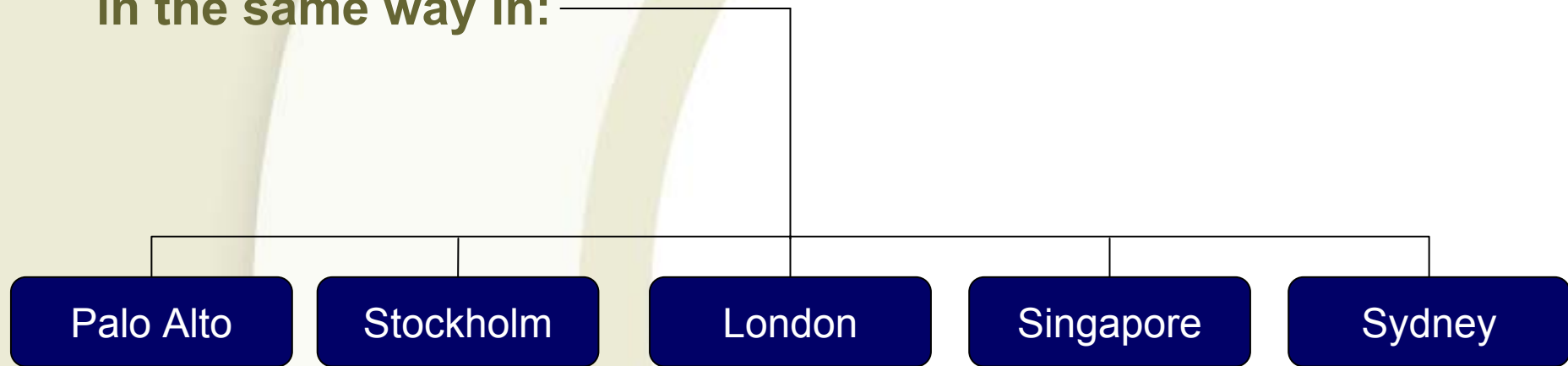
John Kenny

Kenny & Co

Solicitors

Brisbane

>> Is a Technology SME being (governance) structured in the same way in:



> largely, NO

> why not, given that their common governance issues are global

> what's to be gained by comparing these models?

>> Order of Presentation

> Core Proposition

> What is Governance?

> Why

- is Governance important to Tech SME's?
- is Tech SME Sector important?
- should Professionals care about convergent governance?

> Six issues

> Four Governance platforms

- IPR
- Accounting
- Business Models
- Legal Models

> Conclusions

>> Core Proposition

**Is there Global Convergence for Governance Practices
for Tech SME's**



- > Disparate Convergent Global Governance in Tech SME Sector invites deeper analysis / debate

>> **What is Corporate Governance?**

> **Practical Systems to manage SME's:-**

- set commercial objectives and manage stakeholders relationships:
 - contributions
 - revenue
- manage risk
- encourage innovation and effort
- ensure accountability and reward

> **Manifestation of post modernist capitalist integrity – reasoned consistency – operational standardisation**

>> Why is Governance Critical to Tech SME's?

- > **Governance improves position of all stakeholders in the Tech SME sector**
- > **Facilitates (venture) capital investment / confidence : synchronize promoter, inventor requirements**
- > **Determines the cost of capital**
- > **Enhances risk assessment (minimize likelihood of problems & simplistic analysis)**
- > **Facilitates global competition and enables benchmarking**
- > **Rewards skill of promoters and risk taking / optimize performance and accountability**
- > **Timely and balanced picture of all material matters**

>> Why is Tech SME Sector Important?

- > **The pivotal source of “New Economy” is USA in early 90’s**
- > **Continuing as positive incubator of tech entrepreneurial growth / majority of domestic governance issues**
- > **Largest / mainstay market sector for speedy, innovative, responsive development of new:-**
 - technologies
 - entrants to replenish failure rate
 - Business Models
 - Governance Models
- > **SME Section – “Lifeblood of an Economy” increasing global significance (WIPO)**
- **No apparent lessons emerge from Tech Wreck April 2000 – what / why did it happen – Absolute retreat surrender from Governance Fundamentals?**

>> Why should IP Professional Sector care about Comparative Tech SME Governance?

> Governance Landscape determined by:

- law and regulations,
- voluntary adoption and debate
- market forces

> IP professionals have a critical role to play – no common cross disciplinary purpose yet identified in Australia

> Australian governance landscape tend to be myopically distinctive / divisive / exclusive:-

- Venture Capitalist
- Patent Attorneys
- Lawyers
- Planners
- Accountants

(i.e. allowed IAS 38 in without even a whimper)
all four (4) groups

> we can all:

- innovate / adapt corporate governance practices to meet new demands / grasp new opportunities
- provide/define SME Tech governance in sector we all service
- determine stakeholder landscape in “New Economy” sector (we must participate in and enhance debate)

- > **now some Sectors starting to wake up to Cross Disciplinary Dimension of Governance**
- > **why should we criticize accountants for IAS 38 / distrust of IPR when:**
 - our (Federal) Court does not provide encouragement on (patent) enforcement,
 - our Patent Office has no view on this issue, and
 - obvious our National Competition sector is suspicious of, antagonistic to, IPR framework
- > **isolation / absence of cross disciplinary dialogue / debate**
- > **inefficiencies in (different) professional cylinders bleed into each other**
- > **governance links macroeconomic and structural issues and will influence:-**
 - the rollout of “Clever Country”; and
 - Comparative Australian performance internationally

>> **Why encourage International Governance Convergence?**

- > **Commercial Risks in Technology SME Sector so overwhelming – recognized global solutions are critical to Governance Modes**
- > **No current international local / international IP ISO standard, as yet**
- > **Initiate dialogue re: Governance between**
 - Companies within market sectors;
 - Regions – is a deal in Melbourne, Sydney, Brisbane the same?;
 - governance stakeholders – lawyers, accountants, venture capitalists, planners;
- > **Comparative Global Benchmarking is inherently profitable as a Governance management exercise – US / Australian Free Trade Agreement – convergence of Governance Platforms?**
- > **Encouraging Enhanced understanding & commercial effectiveness possible by developing / comparing common Governance indices**

>> (6) Common Elements for International SME's

- > generally (startup after) R & D
- > IPR as main asset / business engine
- > need to reflect / enhance IP value in Accounts
- > must anticipate / will need (Venture) capital
- > aggregation of individual talent / contribution of Promoters / Stakeholders
- > statistically, high risk of failure – Promoters need to manage Risk



Largely, all Tech SME's face these Common Challenges ≡ Common Governance

>> 4 Convergent Global Governance Issues for Tech SME's

A. AVAILABILITY OF IPR / ENFORCEMENT

B. FINANCIAL REPORTING OF IPR

C. BUSINESS MODEL

D. LEGAL MODEL

- Management
- Relationships
- Risk
- Exit
- Assets
- IPR

>> Intellectual Property Rights (Yes)

➤ Original Conventions

➤ World Trade Organization (WTO); Agreement on Trade Related Aspect of IPR (TRIPS) (1993)

➤ World Intellectual Property Organization (WIPO) initiatives for international IPR protection

- Recording and Performance: Rome (1961)
- Competition and Industrial: Paris (1967)
- Copyright in Literature and Artistic Works: Berne (1971)
- Integrated Circuits (1989)

- Uniform levels of IPR for products/services
- Strong effective secure enforcement standards
- Dispute resolution re compliance



- Most detailed multilateral agreement on IPR yet negotiated
- Trade now  knowledge based – facilitate international standards for entrepreneurship under WTO

- PCT on Patents
- Madrid Protocol on Trade Marks
- Hague Agreement on Industrial Designs
- Trade Related Investment Measures (TRIMS)
- Regional Programs for obtaining IP protection for entire region with single application.
- EU patents / trade mark
- African – patent / trade mark / design
- Eurasian Patent Office
- Benelux Trade Mark and Design
- Arab Patent Office - patents

>> IPR Sector

>Governance Practices through

- WTO
- WIPO
- Multilateral treaty system
- **Strong and well publicized / marketed**
- **Consolidating global framework of institutions**
- **Evolving constantly**
- **Standardization – rule based : New World (IPR) Order**



- **Requires globally monitored entrepreneurial practices**
- **Demands governmental / standardized debate**

**Pervasive
standardised
global IPR
Governance
standard –
overwhelms other
three areas**

>> Accounting Practices (probably)

Long Australian experience
In booking intangibles @
revalued amounts – ED49
failed to gain sufficient
conscious in early 90's



Criticism over Australia Acc
standards on IP inferior to
International standards
especially USA



IAS38/AASB 138 (adopted over 3
years, little debate)

Specific prohibitions on booking
revaluation of Intangibles:

- No booking internally generated goodwill, brands, masts, databases, research expenditure;
- Enforced amortization over max 20 years – no residual value
- No active revaluation
- Booking, if at all, at cost of purchased assets
- All R & D expensed
- Applied retrospectively



- \$60-90 million asset write off
- 5% assets of public companies (Ernst & Young 99)
- Profit reduction by 40% by dismissing current amortization practices

>> Why Accounting Practices (probably)

Fundamental alteration on Australian governance standards for booking intangibles



Introduce Consistency of financial reporting between Entities (esp. Internationally)

- Dismiss prior Australian Approach, ED49, CPA Submissions
- Sends message that intangibles lack integrity as an asset – contradicts legal position and other stakeholder groups (IPR position)
- Apparent automatic adoption – little public debate – within Australian IP community – Chartered Accountants rule, ok!
- IP not a “Real Asset”, rather an Expense
- Potentially undermine relevance of “balance sheets” for Tech SME’s.



- Did Australia lose its chance in ED49 to produce first OECD standard for Tech SME’s / intangibles

>> Business Model - NO

➤ **MACRO LEVEL (YES)**

- **WTO members**
 - emphasis on product innovation / quality and cost
 - convert globalization challenges = strategic advantage
 - consider global demand / supply
- **New managerial skills**
 - teams
 - competitive intelligence
 - R&D skills
 - benchmarking
- **Requires Integration of multilateral trade agreements with domestic governance**
- **Export focus**
 - (1997 USA – 2/3 of US exports < 20 employees)

➤ **MICRO LEVEL (NO)**

- **Business model is determinative of IPR / Legal Models : critical and sequentially important**
- **No recognised / endorsed convergent model for technology SME success (ie sufficient to support Venture Capital investment)**

>> Legal Models - NO

- > **Given convergent peculiar aspects of Tech SMEs / VC requirements, a specific Tech SME global model required by statute BUT no current global network of SME legislative models (close corporation)**
- > **What are the distinguishing features for Tech SME legal model:-**
 - Risk management – 97% failure rate – use of Phoenix companies, securities within groups
 - Specified scope to define fiduciary duty / IP transfer internally
 - Careful constant allocation of IPR from Participants
 - Definition of Contribution as basis for participation in project
 - Exit provisions
 - Decision making and administrative issues – Info Management



Each aligns with predictable reasonable requirements of Venture Capital Community re: investee business

>> Legal Models

- > **Tech SME's have common, specific structural issues (outside Corporations Law)**
 - Scope of Business – fiduciary duty, venture capital application, ownership of IP
 - Risk Management – 97% failure rate – Phoenix Companies, security within group
 - Contribution of Specified – Required talent
 - Exit Mechanics
 - Constant allocation of IPR – Information Management

- > **Specific Tech SME model required – no global close corporation network exists – otherwise Construction of Shareholder Agreements is necessary**

>> Convergent network of Global Close Corporation Stat Models

YES

NO

USA
(1981)

South Africa
(1984)

Namibia
(1988)

Rhodesia
(1994)

UK
(1981)
Report

Australia
(1989)
close
corporation
act / never
protocol

New Zealand
(1984)
no need

- **less than 10 shareholders**
- **no directors**
- **partnership – fiduciary duty + limited liability**
- **retain negotiable equities**

Legal Global Model
for Tech SME's

No brainer – why
rejected / ignored?

Shareholder
Agreements

>> Conclusion

- > **Credible Convergent Global Governance Landscape still critical for Tech SMEs – clearly inadequate**



> **MACRO LEVEL**

Where competitive jurisdictions lobby for Tech SME opportunities / players (Victoria and Queensland)



> **MICRO LEVEL**

- all previous reasons
- absolution for Tech SME promoters if diligently followed notwithstanding overwhelming likelihood of failure

BUT

Only IPR Sector through WTO / WIP enshrines -

- strong architectural values pro IPR
- effective platforms constantly monitored /debate



Other three (3) areas sadly lacking

- > **All other sectors in disarray : No legal / business uniformity – absolute negativity of IAS38**
- > **Governance convergence only possible by constant, monitored, multilateral debate between all Sectoral participants**
- > **Currently,**
 - Economic
 - Social
 - Legal
 - Cultural

circumstances and regional / sectoral players who develop / follow their own practices without accountability of constant international comparison and debate : except IPR Sector