

# **THE ROLE OF INTELLECTUAL CAPITAL IN THE ERM SYSTEM**

## **A view from Vietnamese SMEs**

- I. Approach method of the Study**
- II. Real circumstances of the case study: SMEs' Management system in Vietnam and its Intellectual capital matter.**
- III. Further study**

### **I. APPROACH METHOD:**

Recently, there have been many risk cases occurring all over the world such as Lehman Brothers and Benard Madoff raising the question of “What is the best way to foresee and control risks for a Corporation/ Enterprise?”. Even; for developed countries like the US, the problems are increasing, leading to huge losses so that the issues are still really hot ones for not only entrepreneurs but also for businessmen and policy makers as well.

In Vietnam, a developing economy, many issues have directly and indirectly had an impact on the growth and development of SMEs demanding consideration, study and research by not only Vietnamese Government but also the enterprises themselves. As a result, the main problem of SMEs in general, as we believe, is that their management mechanisms do not effectively work as a steering wheel for all operations, business activities, through forecasting, assessing, making regulations, guidance and decisions. Those management systems are not strong enough in both of internal control aspects and enterprise risk skills as well, apart from in-adequate direction and supports from Governmental bodies and other related partners.

In addition, while Intellectual capital now is taking an important role in corporate market value, most Vietnamese SMEs are not much aware about the matter and have no strategies for incoming challenging business conditions. Over the past three years, the number of enterprises, which have been listed in the Vietnam Stock Exchange, is rapidly booming. But the question how to correctly evaluate the market value of those companies is a hot one, not only to Vietnamese researchers, but also for professionals, investors all over the world.

Therefore, from both the researches done by worldwide professionals, investors and Vietnamese SMEs' situation itself, the author wishes to point out some suggestions to enhance ERM system of Vietnamese SMEs, especially in the aspect of efficient and effective using Intellectual Capital.

## **II. CASE STUDY: SMEs' Management system in Vietnam**

In general, Vietnamese SMEs are facing several main difficulties as follows:

### **1. Difficulties from the business environment:**

- The legislation system is still under development and improvement, some policies and mechanisms are not stable at both national and provincial levels, causing difficulties to firms in realizing them in practice. The course of administrative reforms has made a number of changes but it seems to be slow, inconsistent that causes difficulties for the start of and operations of business firms.
- The system of business registration is inconsistent at all levels, from the center to local ones: there are offices of business registration at the provincial level, under DPis, at the district level, it is attached to the division of finance and planning that lacks both staff and funds for undertaking assigned tasks. Therefore, there is limitation in supervision over the details declared in the business registration certificates and over the operations of firms, delay in discovering and addressing problems of firms in the operations and in cases of law breaking.
- Most of SMEs are of small scale in terms of capital, backward technologies, lack of conditions for expanding their businesses, hiring qualified experts. Though there have been efforts made by local governments, there are still discriminations against firms of different economic forms (SOEs, non-SOEs, and FDI ones) in relation to land, business space credits, that lead to small scale and lack of investments for expanding production and renovating technologies.
- Lacking in the linkage and cooperation between large-scale firms and SMEs results in low quality, effectiveness and competitiveness of firms.
- Most of business managers have not gone through formal training but relied on their experience, and as a result, there is limitation in their managerial work and this affects their effective

implementation of laws, policies in doing their business.

- Lacking adequate attention and concern about skill training of workers in SMEs. Most of workers in SMEs learn from their family members or technicians they work together in the firms. Therefore, their innovation, enthusiasm and creativeness for improvements of samples, designs of products are not high.

## **2. Difficulties from the management style of Vietnamese enterprises:**

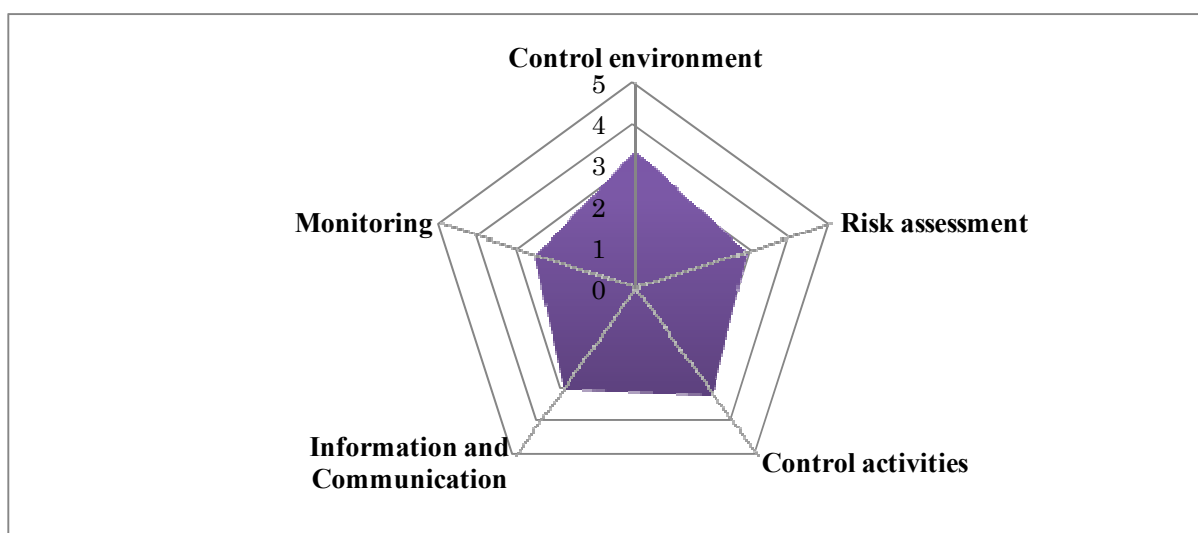
- As many Vietnamese SMEs now are changed/ transformed from former SOEs with the remaining old management teams, who are almost inactive, lack modern knowledge in management skills. The facts showed that, in some respects, it is “*a new tout in an old horn*” and many enterprises are neither not ready for economics integration or brave in making business decision nor active and creative in making strategies for their enterprises’ business development.
- On the other hand, SMEs set up by an individual or a group of investors; are managed mainly by impulsive experiences of management teams from predecessors, or from family members, without proper training with updated modern knowledge in new business environment and in circumstances of economic globalization.
- Mode of enterprise management is lacking long-term strategies, still short-term based and contingent upon short-term profit targets to satisfy investors’ or higher management’s expectation.
- Lacking of in-depth investment in professional skills, proper R&D or information and experience exchange with other enterprises, which came from developed countries with long-life experiences in the same industry and superior management skills.
- Some Government’s policies intervene in enterprises’ business. For example, the 30% limit of foreign investment in one enterprise leads to its ineffective and inefficient management. In addition, some of SMEs with old, backward management style are not willing to open for foreign investment as they are anxious about sharing enterprise management power.

## **3. Result from survey on the management system of Vietnamese SMEs:**

Through the author's survey and interviews with top management members of 19 Vietnamese enterprises, an overall assessment of the management system of those companies as well as of Vietnamese enterprises in general could be summarized by following exhibit:

The evaluations of enterprises were based on considering current situation of 5 components of COSO I – Internal control system, with several expansions of risk management aspects with the highest point for each component is 5.

**Exhibit 1: Overall evaluation of Vietnam enterprises' management system**

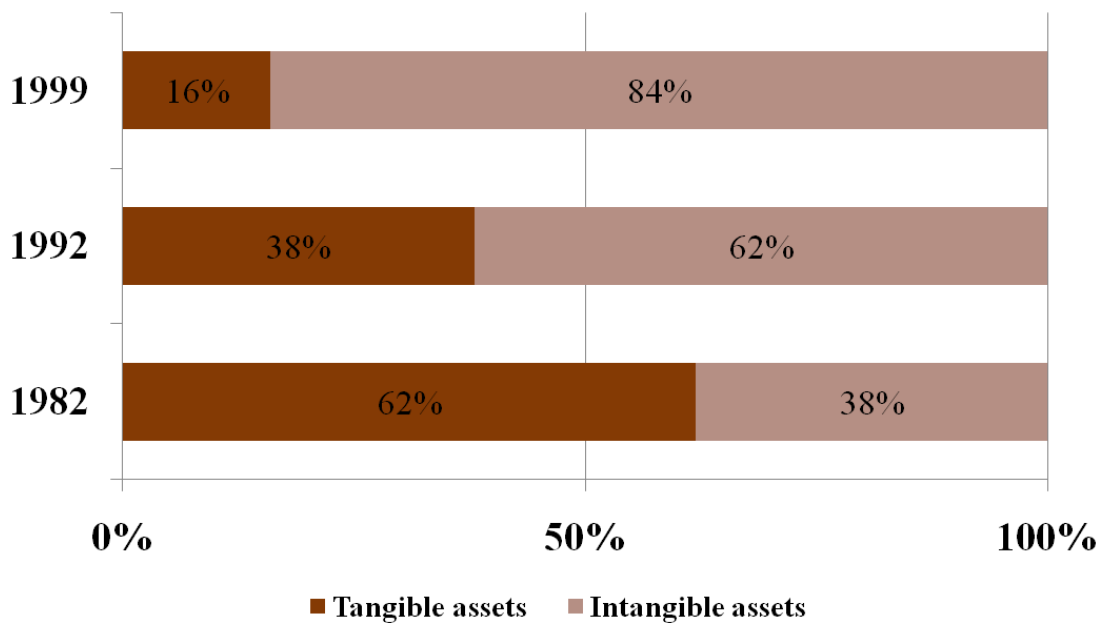


As identified by many surveys, Vietnamese SMEs' management style and culture are strongly influenced by the past conditions of the nation's demand economy, lacking modern and customer-oriented features. The report with its structural questionnaires collects feedbacks from top management members of 19 Vietnamese SMEs, combining with the result from another survey of group financial professionals, providing an overall picture of management style and culture in Vietnam enterprises. From situation perspectives, the author has systemized weaknesses and backwardness in the current management systems, serving for further comparative analysis.

#### 4. Facts about Vietnamese SMEs' Intellectual Capital matter:

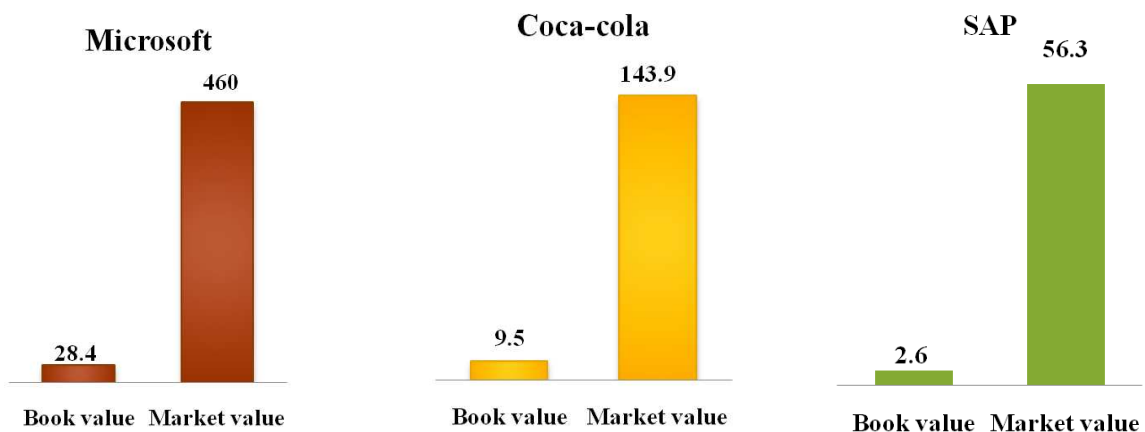
It was recorded that, the proportion of Intellectual Capital is increasing rapidly through the following chart:

**Exhibit 2: Development of the value of intangible assets as a percentage of total market value of S&P 500 companies between 1992 and 1999**



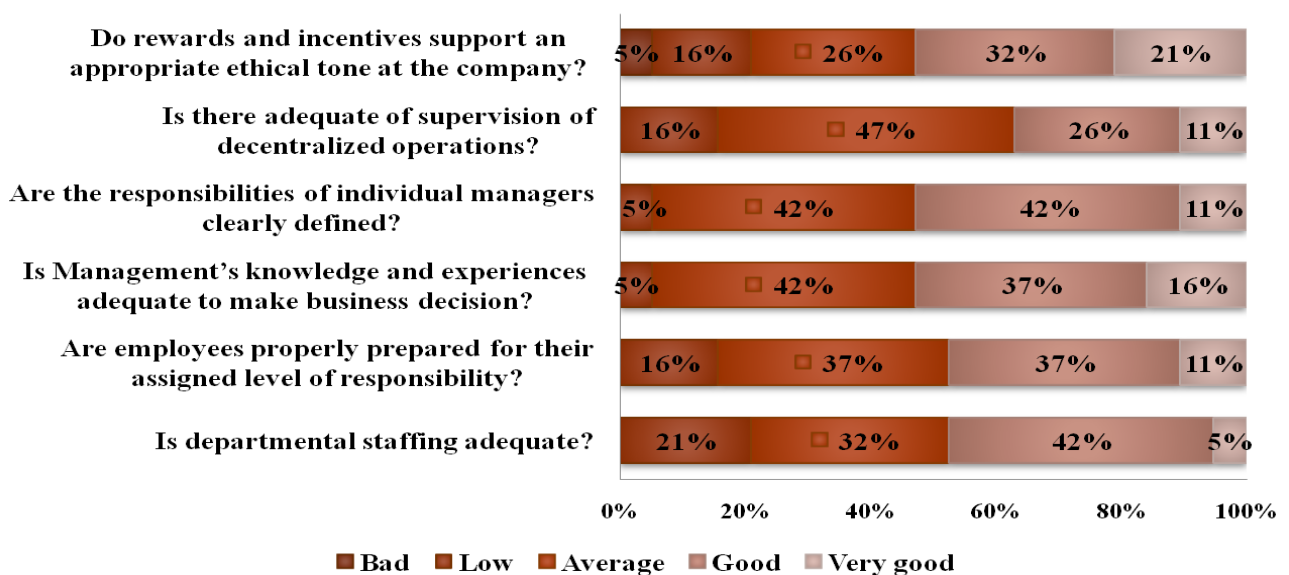
And also, in the new business circumstance, one enterprise's market value is mostly given from its Intellectual capital, not from Intangibles capital. Following 3 famous Companies give the evidence of that condition:

**Exhibit 3: For "intangible capital" companies, market value can exceed book value by up to 20 times**

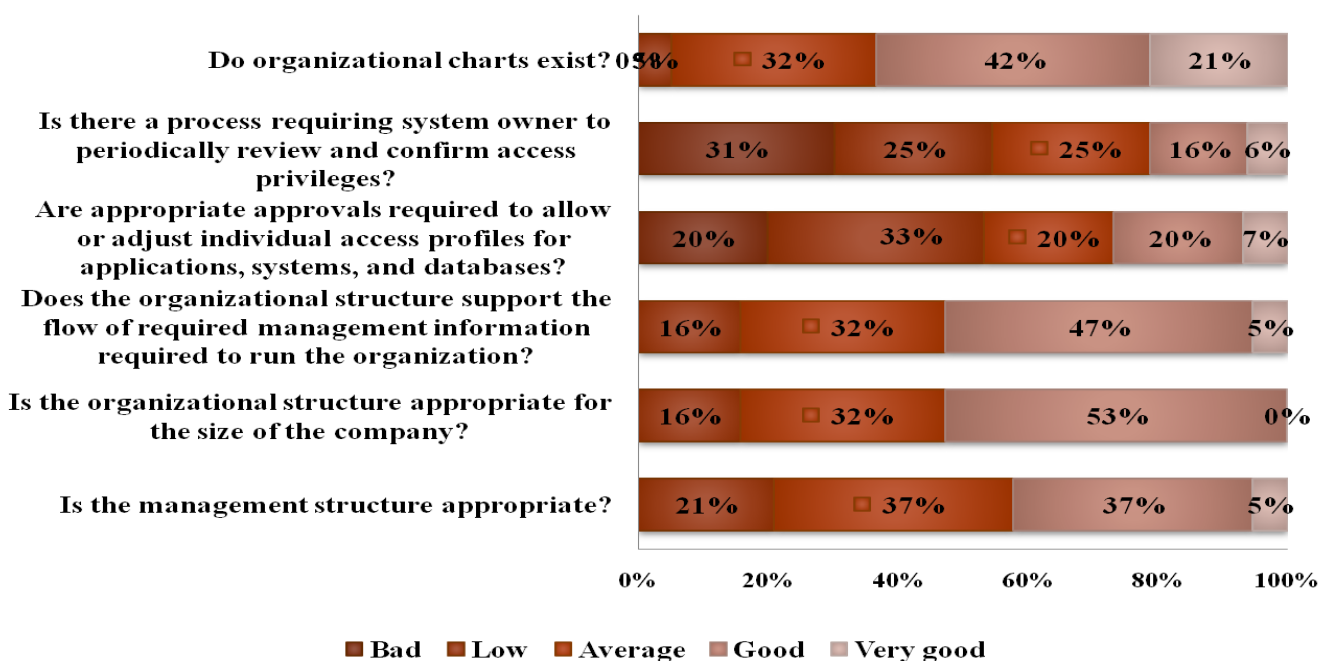


However, the matter is not seriously under consideration by Vietnamese Enterprises, which is clearly expressed through the author's surveys:

**Exhibit 4: Human Capital Management in Vietnamese SMEs**



**Exhibit 5: Structural Capital Management in Vietnamese SMEs**



### **III. FURTHER STUDY PLAN:**

The author's previous study has stopped at: "Some proposals to enhance the ERM system for SMEs in Vietnam." in which, only Human Capital and Structural Capital was considered. However, Intellectual Capital comprises other important components, which re: Partner Capital and Customer Capital. Therefore, the following tasks should be taken in the further study:

1. Evaluate roles of Partner/ Customer Capital in the ERM System.
2. Relationship between Enterprises' Competitive capacity and Intellectual Capital
3. What should Vietnamese Enterprises do to get most benefit from its Intellectual capital as value driver?
4. How to get the highest value – extraction by using Intellectual Capital?

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