The emphasis on intangible assets: Has it gone too far?

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In recent times, many management gurus have emphasised the importance of building strong intangible assets. Several articles on the subject have appeared in both business magazines and serious management journals. The essence of the argument is that companies should build competencies in areas such as design, supply chain management and brand building and leave the 'dirty' job of constructing and running factories to contractors. Indeed, the stellar performance of companies like Cisco and Enron in the 1990s, provided strong support for this argument. Now, ironically, the virtues of the 'hollow' corporation do not look as solid as earlier. On the other hand, the good old 'smoke stack' companies, with their physical assets, look safer to investors, even if they do not offer superlative returns.

In their enthusiasm to propound the virtues of intangible assets, what consultants and academics have conveniently forgotten is that our daily lives, both in the workplace and home, are dominated by physical goods. The brush and paste with which we start the day, the morning coffee we have, the breakfast, lunch and dinner all involve 'tangible' items. We ride to the office in 'physical' vehicles. A modern office consists of 'physical' assets such as chairs, tables, workstations, air conditioners and coffee vending machines. True, we do consume services such as internet access, banking, courier and haircuts. But if we carefully reflect, we would realise that we consume much more of goods than services. This argument is applicable to both developing and developed countries. It is true that in developed countries, services account for a major portion of the GDP. But this does not imply that physical goods are less important. It only means, physical production has shifted to low wage locations. Today, developed countries focus on making goods of an acceptable quality available rather than actually manufacturing them. The point to note is that someone has to manufacture goods. The entire world cannot operate on a 'virtual' paradigm!

When Enron decided to move out of electricity generation into electricity trading, it was leaving the production of electricity to others. Enron thought it was being smart. Before its recent collapse, Enron was known to be very arrogant towards the bigger companies in the energy industry, which owned a lot of physical assets. Former Enron CEO, Jeff Skilling once commented (Fortune, December 24, 2001) on old economy companies, "These big companies will topple over from their own weight." Today, Enron has toppled but many of these old economy companies still exist! Moreover, companies like Cisco, which have been considered the ultimate experts in strategic outsourcing were left clueless when the US technology sector recently went into a slowdown. This forced them to take massive writeoffs.

A point which many consultants have overlooked is that it is usually much easier to evaluate the quality of physical assets than of intangible ones. Physical assets can be valued with a fairly high degree of accuracy at book value, market price or replacement cost. But valuation of intangible assets like brands involves several assumptions, which often turn out to be wrong. Moreover, the accounting practices of companies built around intangible assets are often controversial. For example, AOL capitalised its advertising expenditures for several years arguing that they were capital investments. The dividing line between expenditures, which will yield a one time benefit and those which will yield benefits over a period of time is extremely thin. In the case of the 'smoke stack' companies on the other hand, accounting practices can be much more transparent. It is a real pity that many of the so called new economy companies have received applause from the analysts for their sleek reporting on glossy paper, more than for any radical disclosures or greater transparency.

It is time to take the brick and mortar companies more seriously. These companies may not look that glamorous. They may also not achieve super normal growth rates. But they are safer bets. They have physical assets like real estate and plant equipment, which cannot evaporate even if the markets crash! They can be sold for cash. And cash is the ultimate hedge against risk. But intangible assets such as corporate reputation can vanish overnight if things go wrong. This is exactly what has happened with many of the new economy outfits. So, has the time come to say “Three Cheers” to the brick and mortar companies?

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