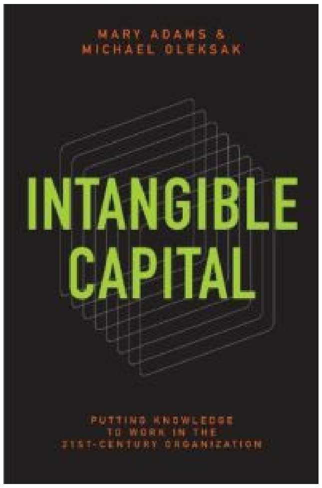

Book Intangible Capital

Putting Knowledge to Work in the 21st-Century Organization

Mary Adams and Michael Oleksak
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Recommendation

Management consultants Mary Adams and Michael Oleksak shine a spotlight on "intangible capital" (IC) and explain how companies can succeed by quantifying and leveraging IC. Intangible capital includes "human capital, relationship capital, structural capital and business recipe." The authors outline IC and describe how intangible capital has come to comprise 70% of most companies' valuations. *BooksInShort* highly recommends this book to CEOs, CIOs, and all executives and managers who want to understand the true heart of their businesses.

Take-Aways

- In the 21st-century economy, the most valuable resource is knowledge.
- "Intangible capital" (IC) represents 70% of the value of most companies.
- Your firm's IC consists of "human capital, relationship capital, structural capital and business recipe."
- Most organizations do not understand how to quantify IC.
- Companies that package their knowledge as value to others make huge profits.
- When your firm's knowledge solves a problem, that knowledge's value is directly proportional to the number of people who would pay to solve that problem.
- Companies that profitably leverage knowledge are "knowledge factories."
- To track your IC, note exactly what its components cost your firm.
- Networks of employees, customers, strategic partners and other stakeholders reflect the bottom-up business style, replacing the conventional, top-down business approach.
- Manage knowledge workers as conductors guide an orchestra. Avoid outdated command-and-control methods.

Summary

How Is Your Knowledge of Your Company's Knowledge?

In today's information economy, intangible assets – employee expertise, intellectual property, reputation, brand, business processes, networks and innovative brio – comprise much of a firm's value. Still, executives focus more on measuring their conventional assets. While this effort remains essential, such assets make up only about 30% of most companies' total valuation.

> "Our economy has made a fundamental shift from industrial to knowledge production."

Such insularity ignores the fact that most successful modern businesses are "knowledge factories." Thriving businesses transform basic knowledge into efficient, scalable processes that produce value for their customers. That is "intangible capital" (IC). Most companies cannot describe these crucial assets or list their necessary components. CEOs pride themselves on knowing, and being able to quantify, every aspect of their businesses, yet most executives depend on intuition to assess their priceless IC.

An Invaluable Resource

Knowledge is a critical business resource. Strategically managed, your company's knowledge should become a money-earning asset, as Google and Microsoft demonstrate daily. No matter what product or service your firm delivers, you are in the knowledge business. Knowledge is a commodity. However, your company's knowledge does not decrease when you sell it. For example, a software firm doesn't diminish its stock of knowledge when it sells or licenses software to users. Indeed, the value of your product rises as more customers use it and you implement user-suggested improvements.

> "Every company today has an invisible production facility, a knowledge factory, where it converts raw knowledge into scalable and repeatable processes that create value for its customers."

Knowledge has no limits. Businesses sell knowledge products: books, films, maps, and so on. They also sell knowledge expertise: management consulting, investment, legal or accounting services, as well as their own specialized knowledge in a way that no one else can match, such as Apple's iPod.

Knowledge Assets

Knowledge consumers expect to access data for no charge. And, indeed, Google provides billions of free searches worldwide. Most savvy, profit-oriented companies figure out how to monetize their content. And, indeed, Google earns $20 billion in annual advertising revenues.

> "Knowledge is the critical resource in today's economy."

Google's knowledge solved a problem for consumers: how to make rapid, focused Internet searches. Google solved another problem for advertisers: how to reach consumers as they perform specific Internet searches. The value of knowledge-based problem solving is directly proportional to the number of people who pay to solve it.

> "Seventy percent of the value of the average company today is intangible and depends on invisible assets like personal networks, company reputation or capacity to innovate."

To make money, knowledge company executives must understand their firms' core competencies, the particular problems they solve for their customers, and the reasons their customers choose them and not their competition. As a knowledge company manager, ask yourself: What value are you creating for your customers? And, "how do you get paid for creating" it? To answer, learn the nature and extent of your knowledge assets, which take four forms:

1. **"Human capital"** – Your employees' knowledge delivers value to your customers. Your employees are an invaluable organizational asset. What they know is far more important than what your company owns.
2. **"Relationship capital"** – Your customers and your partners provide crucial business relationships that depend on knowledge assets. You should know their business and they should understand yours. Trusted partners can assume responsibilities formerly handled by employees because they know how your company works. Your "brand and reputation" are also part of your relationship capital. As former General Electric (GE) CEO Jack Welch said: "Your main constituencies are your employees, your customers and your products."
3. **"Structural capital"** – "Culture, organizational knowledge, intellectual property (IP) and processes" comprise your organization's "infrastructure of the knowledge factory."
4. **"Business recipe"** – Your business recipe includes your "knowledge raw materials," which suggest your potential sales opportunities and how you will exploit them.

The Knowledge Factory

Your business is a knowledge factory, where the raw material of what you know becomes something of lasting value to your customers. To better understand the knowledge factory, create a visual model of your business; Lego blocks are useful tools for this excercise. Include your organizational capabilities. Attach your relationships and procedures. Show your revenue streams and how they link to your "processes, competencies and relationships." Depict your products, human capital, relationship capital and structural capital.

> "You are already in the knowledge business whether you know it or not."

Innovation can occur in new products or services, markets, or processes; it's a "systemic phenomenon" that springs from leveraging your firm's knowledge and IC. A sound process for innovation should include: "idea generation," the ability to come up with new concepts; "selection," choosing which ideas to pursue; "development," getting the idea up and running; and "commercialization," how to support your idea with "marketing, sales, operations and finance.

> "A huge amount of the value of knowledge in most organizations is not isolated and individually identifiable – it exists as a system."

Build your knowledge factory on these solid business principles:

- **"The knowledge factory is greater than the sum of its parts"** – Your company's maximum worth and usefulness derives from combining every knowledge asset.
- **"Ownership of the knowledge factory is dispersed"** – Your company does not own all its knowledge factory components. Some elements are yours for only a period of time, such as human capital.

- **"Power in the knowledge factory flows down...and up"** – Previously, companies controlled the "means of production" and did not cede power to employees. Today, employees provide most of the knowledge your company requires, so employees now have more control.
- **"The knowledge factory is held together by reputation, not control"** – Your standing helps sustain the loyalty of your employees and knowledge partners.
- **"The knowledge factory runs on information technology"** – IT formats, controls and grants access to the knowledge economy.
- **"The knowledge factory is a business"** – The information economy can revolutionize "energy, transportation, housing and food production." But the knowledge factory remains a commercial, self-interested entity.

Manage like a Conductor

Your knowledge factory is essentially a group of networks, so manage horizontally, across its "knowledge base." Consider the orchestra conductor who gracefully keeps all the musicians on the same page and playing at the same pace. Substitute "manager" for "conductor" and "knowledge workers" for "musicians" to find the ideal management paradigm for the knowledge economy. Today's managers must concern themselves with five primary areas: "people, resources, learning, standards [and] context."

> "A great orchestra is not composed of great instrumentalists, but of adequate ones who produce at their peak." (management guru Peter Drucker)

Traditional organizational charts don't mean much these days. Networks matter more because access flows from the bottom up and from the top down. Map your company's networks. Create a schematic that shows how work gets done. To engineer your networks for maximum efficiency, focus first on your key business goals, "and then the technology and platform."

Tracking Expenditures for Intangible Capital

The most important question is not about IC value. Instead, just as you do with tangible assets, focus on how much you must spend to operate your intangible capital. Account for the costs of your intangible capital on an annual basis. To get a handle on your IC, consider these items:

- **Human capital** – The costs of finding and recruiting talent, plus the cost of training and "staff development."
- **Structural capital** – The internal expenditures for building processes and the external expenses for hiring process development consultants, or for "software development for internal systems, knowledge management systems, research and development, [and] costs associated with acquisition or documentation of rights such as licenses, brands, copyrights and patents."
- **Relationship capital** – The outlays for promotion, marketing, branding, developing consumers, building supplier and outsourcing connections, and acquiring "product or quality certifications [and] outsourcing partner development."

> "The principal way that you should manage your reputation is by getting everything else right."

Standardized accounting will not help track your intangible capital. Balance sheets and income statements offer no line on which to note intangibles. This is a primary reason why financial statements provide so much less utility today. Companies spend a great deal on intangibles, approximately $1 trillion in the year 2000 alone. And while current accounting methods don't reveal your IC, people intuitively understand its great value. To illustrate, in a recent Ernst & Young survey of more than 700 mergers and acquisitions, tangible assets represented "only 30% of the purchase price[s]." The remaining 70% covered the acquired companies' intangible assets. Despite the challenges of quantifying intangible assets, they possess substantial value in the marketplace. Always include an "intangible capital expenditure report" with your other financial reports. Useful ratios you can develop include "intangible intensity," which contrasts your "intangible versus tangible capital expenditures," and "growth return," which explains the ratio of investments in intangible capital and company growth.

Assessment

Listing your primary knowledge assets or creating a visual model of your knowledge factory will not fully leverage your IC. To go a step further, institute an "intangibles assessment" that completely explains your knowledge components. Present your human, relationship and structural capital as bedrocks of your strategic planning, and demonstrate how these elements work with your business processes. To help measure or quantify your intangible capital, conduct surveys that will help you value these assets. A typical question might be, "On a scale from 1 to 10, how would you rate this asset?" Your survey also should refer to business recipe issues. For example, you might ask respondents to rate employees' competencies on specific aspects of executing your business. When you develop your performance management system, include ways to evaluate "key performance indicators" (KPIs). Inventory your intangible capital and track your IC investments. Ensure that your IC components meet your organizational needs. Never embark on strategic planning without understanding the role of your IC.

> "Even though the knowledge factory is intangible, the money you spend to build and maintain it is very real – so are the results you yield from it."

Because reliable information about intangible capital can be elusive, external stakeholders may feel that those elements of your operation are hiding in a "black box." That misunderstanding only makes your company's reputation and relationship capital all the more important. Follow three rules to manage your corporate reputation: "Do things right, be proactive" and "be transparent." Distribute the information you develop about your "intangibles data set" to your primary stakeholders, including, for example, your inventory and investments in intangibles, the model of your knowledge factory, the appropriate KPIs and all pertinent "assessment and operational performance data."

> "Intangible capital is the new factory."

In today's knowledge economy, financial bottom-line data and reports are no longer sufficient, especially for contemporary "intangible capitalists." To become a charter member of this emerging group, start making your intangible capital tangible.

About the Authors

Management consultants **Mary Adams** and **Michael Oleksak** are the co-founders of Trek Consulting.
