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The Intangible (But Very Real) Market Opportunity for Consultants

By Mary Adams

You are familiar with Peter Drucker's writings on knowledge work. You got through The World is Flat last year. You know that we are moving to a global, knowledge-based economy where success is no longer about access to raw materials, machinery and factories. Today it's about a new kind of raw material that helps businesses build knowledge and innovation. But what makes up this new raw material of success and innovation? How do companies figure out if they have what it takes to succeed? Where will the information come from? ...The answer to these questions can and should come from management consultants. We have both an opportunity and an obligation to help guide our clients to success in this quickly changing world.

The Shift

One of the simplest ways of illustrating the shift to a knowledge economy is to look at the stock markets. Thirty years ago, there was a tight correlation between a company's stock price and the book value of its assets. Today, only 20% of the stock price of the S&P 500 companies can be explained via their balance sheet book value. Most people don't think about the implication of this discrepancy because it has been so long since we had a useful balance sheet and we forget why it exists.

Ever since merchants in 15th century Venice started using financial statements, income statements have been used to keep score on past operations. Balance sheets have been used to detail the resources with which a company will build its future. If you were a merchant, your balance sheet showed what you had in inventory and what you paid for it—so it also gave a great view into your potential earnings for the coming year. If you were a manufacturer, your balance sheet also showed your investment in plant and equipment, again a good indicator of your future potential.

Today, balance sheets cannot give this type of view of a company's potential because the most critical resources in the knowledge economy don't qualify for accounting treatment. What are these intangible resources?

- Human Capital – Includes both employees and managers.
- Structural Capital – Knowledge, including intellectual property, know-how, processes, systems and software.
- Relationship Capital – Brands and relationships with customers, and external partners such as suppliers, distributors and development partners.

Today, even an “industrial” company like GE, intellectual capital is more important (GE’s book value is around 30% of its stock price). Intellectual capital drives innovation, earnings, growth and competitive advantage across every sector of our economy. There is information about these resources scattered across most companies. HR groups track personnel. Marketing and sales own information about the customers. And so on. But none of these items appear in a consolidated report.

The Gap

Can you imagine a merchant without an inventory report, having to sell product without knowing the quantity or price of goods he owns? Yet this is the position that most corporate leaders are in today. They lack basic consolidated information about their most important resources: *Do we have the right people, network, knowledge to meet our goals? Are we positioned for continued innovation? Where are we at risk?* Boards of directors, investors and analysts are in the same boat. They are forced to analyze the future potential of a company with incomplete and inconsistent information. This information gap leads to vague statements by corporate leaders such as:

- *We have great people*
- *We have the best technology available*
- *Our IP is a core advantage*
- *We have close relationships with our customers*

How do companies get away with this—especially in a time where U.S. corporations are obsessing about Sarbox compliance and regulators are demanding ever more exact reporting? Why don’t stakeholders demand that management back up its statements with real information? Frankly, because very few people are aware of how to provide objective information about intangible resources. Luckily, the field of intellectual capital is coming to the rescue.

Early writers about intellectual capital (IC) included Tom Stewart, now the Editor of the *Harvard Business Review*. IC has since become a separate field of management studies. There is an academic journal dedicated to the subject (*Journal of Intellectual Capital*). The AICPA has joined an international consortium that has an initiative around performance measurement approaches related to intellectual capital. A new degree program at a management school in

England is focused on performance management, also an outgrowth of the field. (Information on these and other initiatives is available on the web at www.icknowledgecenter.com.)

The Solution

The research and work coming out of the IC world is helping to shed light on how to assess these valuable but intangible resources. Although the field of IC is still developing at a fast pace, there is already a strong set of recommendations that come from the literature on how to create good inventory approaches for intellectual capital. These principles include:

- **Look at IC as a portfolio** – Information in silos is not nearly as valuable as a single presentation that shows the relative strength and weakness of each of the components of the entire portfolio.
- **Assess, don't measure** – It is more important to assess adequacy of resources than to count them (would you rather know a headcount or whether the company has the right mix of employees to deliver on their strategy?)
- **Use a broad sample** – Assessing implies that you are tapping into subjective judgments. Don't rely on just a handful of sources.
- **Tap into both internal and external knowledge** – One of the biggest mistakes many management teams make is relying exclusively on internal judgments. External sources bring greater objectivity and perspective to any analysis.
- **Use consistent criteria** – The value of data is increased if you can compare it across divisions, companies and across time.

A good system also looks beyond where the company is today to also analyze improvement efforts and highlight areas of risk. A standardized system such as IC Rating™, also gathers information about competitors at the same time that information is gathered on the company itself.

So who is in the best position to create this type of assessment and inventory? Analysts don't try—it's not their job. And, until they get better information, they will continue to focus primarily on earnings. Accountants can't do it—their ability to track intangible assets is extremely limited under today's standards. Most managers can't do it—they don't have the right kind of internal reporting and lack objectivity. That leaves the door open to the consulting industry.

The Consulting Opportunity

Today, it is often said today that many companies have less of a need for consultants because management education has become so pervasive.

Companies have indeed formed strong internal competencies in common management tools developed during the industrial era. This is not the case when it comes to intellectual capital measurement and management. IC is an area where consultants can make a huge difference for their clients and, frankly, for the growth of their own businesses. Take the time to learn more about the field of IC. Consider developing competence in IC assessment and inventories. Position your clients' (and your own) businesses for success in the 21st century.

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