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The weakest link in corporate IAM

In many areas intellectual asset management processes inside the business community are working well. However, when it comes to IP there are still a number of important lessons to learn

By **Mary Adams** and **Peder Hofman-Bang**

Intellectual asset management – IAM. It is the name of the magazine you are reading. It is the name of a discipline you probably advocate. In many of your minds, IAM is associated with intellectual property (IP), those intellectual assets that enjoy specific legal and financial protections. However, IP is actually just one component of the average company's full intellectual asset portfolio. And based on the experience of the companies in our community, IP management is the most neglected and the weakest of the corporate IAM processes.

This article is based on the evaluation of the IAM of more than 430 companies over the past 10 years using the IC Rating™ (ICR) methodology. ICR was developed in Sweden and is used by a network of consultants around the world. The approach assesses the strength of corporate intellectual asset portfolios and management. We recently pulled together the results from the 10 years of these ratings and spent some time distilling the lessons they teach.

There are two striking points of interest to readers of this magazine. First, 90% of the companies in this sample did not see enough value in their intellectual property to even bother evaluating it. Second, among the 10% of companies that did rate intellectual property and IP management (roughly 40 companies), this

component of IAM received the lowest rating of all the categories of intangibles.

IAM defined

One of the challenging characteristics of the field of intellectual assets is its lack of universally accepted definitions. So before providing detail on this study, it is important to clarify how we look at IAM. Our analytical framework comes from the field of intellectual capital. This identifies three major categories of intangibles:

- Human capital – the intellectual capital that goes home at night. The two major categories of human capital are employees and managers.
- Relationship capital – this includes all key external relationships for a business, including customers, suppliers, outsourcing and financing partners. This kind of capital also includes organisational brand and reputation.
- Structural capital – this includes all knowledge that stays behind when employees go home at the end of the day. There is significant structural capital in today's organisations, including recorded knowledge, processes, software and, of course, intellectual property.

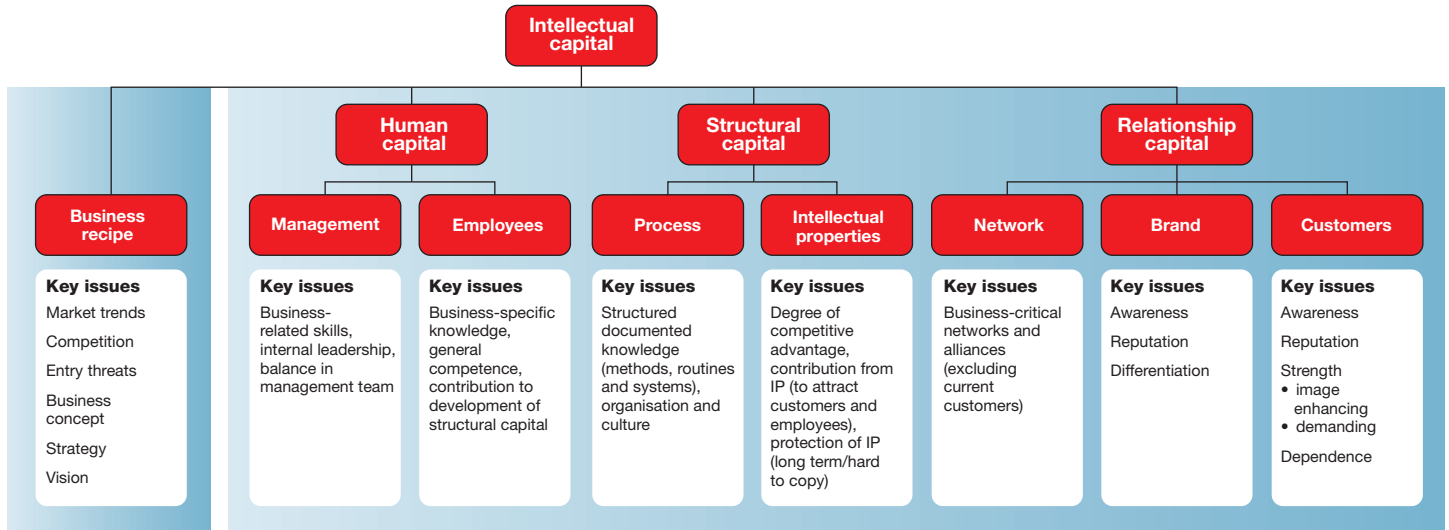
As can be seen in Figure 1, our approach also examines a fourth category: business recipe. This includes both the market opportunity available to the organisation and its strategy to exploit the opportunity.

This last category is important in itself as an intangible asset. However, in the ICR process, business recipe is also used to provide context and a yardstick for the other IC components. For example, it would be hard to come up with a universal definition of strong human capital.

Intangible Asset Finance Society

This article is sponsored by the Intangible Asset Finance Society's Secretariat. The objectives of the Society (www.iafinance.org) are to increase the visibility, transparency and value of intangible assets. through education, advocacy and the promulgation of standards. The Secretariat of the Society is concerned with broad market and managerial issues that impact on intangible asset value at an operational level. The authors use the term intellectual capital for what the Society generally refers to as an intangible asset. *IAM* magazine, a Globe White Page Ltd publication, is the media partner of the Society. *IAM* magazine publishes in each issue a contribution from the Society on a noteworthy intangible asset finance matter. Visit the Society at www.iafinance.org.

Figure 1. Intellectual capital defined



However, if an organisation defines its business recipe – and the competencies and experience needed to support it – it becomes possible to measure the strength of its human capital by asking the question: “To what degree does the current level of [this competency] in the organisation support its ability to deliver on its business opportunity and strategy?” The answers to these and similar questions enable a highly effective rating of the strength of an organisation’s intellectual capital.

IAM assessment sample

Using this approach, ICR evaluates the current effectiveness, the outlook and the risk exposure of an organisation’s full IC portfolio. The data is developed through detailed interviews with the most knowledgeable stakeholders of the organisation, one-third of whom are internal and two-thirds of whom are external. The interviews include both objective questions (asking for a rating on a scale from one to eight) and subjective follow-up questions. The output is reported using a scale similar to that used for bond and risk ratings (AAA to D). The final report analyses these letter grades as well as anonymous excerpts of stakeholder comments.

To date, more than 430 ratings have been performed. The rated organisations are concentrated in Europe, Japan and, to a lesser extent, India, Australia and the Americas. As one might imagine, the rated organisations have been concentrated in services and intangibles-intensive industries such as distribution and telecom (see Figure 2). Nevertheless, there have also

been many ratings performed in tangibles-intensive industries such as manufacturing, food and infrastructure.

This mix changed over time. In its early years, demand for ratings was led by companies in information technology, including consultants, communications, outsourcing, hardware and software businesses. In recent years, however, the kinds of company seeking ratings have diversified to include distribution, telecom/media and business services of many kinds. Examples of these companies include Hitachi, Nissan, Tata Group, Goodyear, Ericsson, TeliaSonera, SEB and Nordea, to name a few.

Overall findings

Figure 3 summarises the full database of ratings performed through to late 2008. In practice, the individual results of ratings tend to show striking differences among the various categories of intellectual capital. The average of all ratings is, as would be expected, more tightly grouped. To demonstrate the differences between the rating averages, Figure 3 indexes the data against the average score of BB.

Ordering the ranking of components from highest to lowest shows that the results fall neatly into order by category, as seen in Figure 4. We were frankly surprised by this finding. There is no overlap between questions that lead to the rating of each component. Nevertheless, the average scores of each component in a category are bunched together; it seems clear that there is an overall strength or weakness that runs through all the components of a category.

Figure 2. Companies in IC rating sample

Retail and distribution	38%
Telecom, media, entertainment	23%
Business services, health, education	22%
Manufacturing	5%
Natural resources	3%
Food, beverage and agribusiness	2%
Utilities and infrastructure	2%
Financial institutions	2%
Public sector/non-profit	2%

The high overall human capital rating may be related to the sample. All the companies in this group chose to undertake an IC assessment, which could be considered cutting-edge management activity. That may indicate a level of vision and influence of the management team that is translated into the high ratings from the stakeholders. There is also some degree of self-selection. It is unlikely that a management team with serious deficiencies or weak relationship networks would seek to have stakeholders participate in this kind of evaluation. Thus, it is safe to say that the sample includes management teams that are generally confident.

Beyond the averages

These results do not mean that the companies in the sample are perfect in terms of their human and relationship capital. In fact, there are numerous examples of outlying scores that provoke breakthrough thinking.

In terms of employees, we recall one organisation whose assessment showed the highest set of scores around the current level competencies exhibited by its employees. But the very bottom set of scores among all the questions (and all the categories of its IC) were for future preparation around employee competencies – its business was changing and its employees were not ready for the change.

In the management component of the rating, we often see teams receiving higher ratings for their ability to make decisions and communicate externally. But this is often offset by lower ratings related to internal communications, feedback and involvement, and creating an effective culture.

In terms of process, current effectiveness is usually higher than renewal. This often implies that the management team is comfortable with its current success and not worrying as much as it should about the future – we see this pattern for both highly successful companies and those facing more significant challenges. Another important pattern frequently seen is organisations pursuing incremental improvements as opposed to innovations that lead to significant breakthroughs in product development, processes and/or business recipe.

In branding, high awareness is often offset by low differentiation. And strong customer relationships many times turn out to be with customers that do not provide the profitability and strategic future that the organisation seeks.

The bigger story

There is a richness to the individual stories of companies in this sample. But pulling back to the overall results, it appears that there is another overarching story. The rankings from high to low of the IC categories tell the story of a search for new business models in the knowledge era. Moving down the list from human to relationship, business recipe and structural capital corresponds to the journey faced by modern managers from the most to the least familiar concepts and assets in the modern enterprise. The degree of difficulty increases as one moves along the spectrum towards structural capital, including intellectual property.

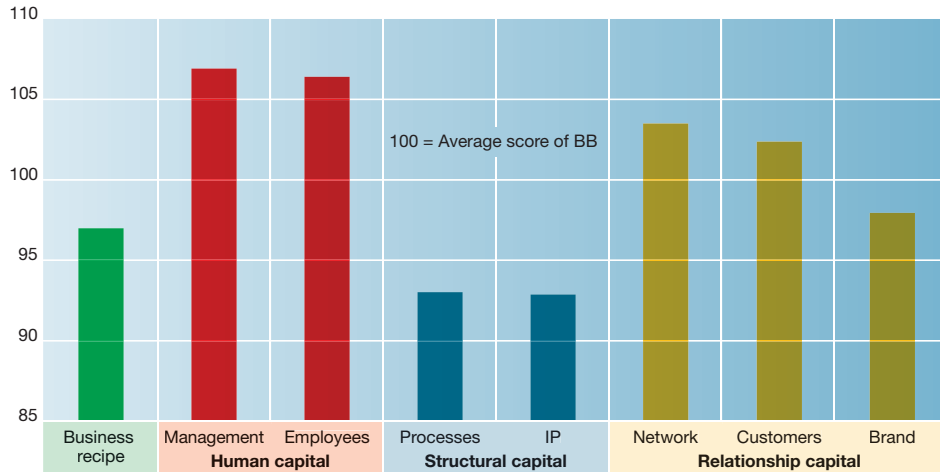
In general, the work done by employees and managers has changed over time. Today, most workplaces have growing numbers of knowledge workers. However, the presence of human capital – employees and managers – in the workplace is not a novelty. Although there is surely room for improvement, most companies have processes in place for understanding and managing their workforce. There are new challenges related to the unique nature of knowledge work. However, based on the experience in this sample, it is clear that there are greater challenges in the other categories of IC.

The next category is relationship capital. This, too, has always been a fundamental part of business. Customers, suppliers, financiers, media and regulators have always been critical to the operation of a business. The knowledge economy has led to new challenges brought on by increased outsourcing and the growing importance of networks, such as the central value of Google's user network to its overall success. Nevertheless, as with human capital, most companies have established ways of dealing with their network of customers, suppliers and partners.

But the increased pace of change in markets, technologies and business models is creating conditions for which many companies are not ready. Competitive position is one of the lowest overall scores for companies in the database. Here, there may also be some influence of self-selection. Most companies that choose to undergo an assessment process have some concerns about the future. The relatively low ranking of business recipe may reflect the fact that these companies are looking for change and finding that it is not easy.

This leaves us with structural capital. Knowledge and process have always been a part of business. However, in the past, it was

Figure 3. Average ICR score – all industries



usually possible to see, touch and feel these assets in the form of production lines, design drawings and delivery networks. Today, most processes occur inside computers, servers and virtual networks spread across the globe. Discrete processes and pieces of knowledge can be harder to see.

The special challenges of structural capital

It can be argued that structural capital is the factory of the knowledge era. IP and processes are the way that knowledge is captured and institutionalised, and the way that value is created for customers. Systems at Fedex and UPS for delivery, route planning and package handling are all structural capital that makes each person in the organisation smarter. Wal-Mart’s sourcing and supply systems are a significant part of its competitive advantage. Patents held by companies such as Microsoft and IBM protect their intellectual property and provide significant licensing revenues.

Today, even manufacturing companies are more about process than they are about production. The story of the Boeing 787 is about how Boeing has pushed more and more of the design and production of the plane out to its suppliers. Boeing is defining itself by its design coordination and assembly process, rather than its manufacturing capability.

So why has structural capital had the lowest rankings in our community? The following digs deeper into the ratings of the two key components of structural capital: process and intellectual property.

Process capital

The ICR tool examines all the core

processes of a business including accounting, marketing, sales, operations, knowledge management and innovation. Thus, the rating of this category is an average of the scores of the individual processes. An interesting way of clarifying the overall results is to look at the highest and lowest average scores. In the process category, the strongest ratings were for: effectiveness of accounting systems; efforts to improve organisational structure continuously; and efforts to improve production processes continuously.

The weakest scores in process are interesting in the light of the discussion above about the greater challenges for managers to deal with knowledge and technology within current management paradigms. The three weakest scores were for: processes for documenting knowledge; processes for employee education; and processes for acting on employee ideas and improvement suggestions.

These weaknesses tell the story of some of the challenges of a knowledge-era company. Knowledge management as a widespread discipline is just a decade or so old. While employee education and improvement suggestions are not new phenomena, their low scores indicates that there is still much work to do in this area. Human capital is a critical part of intellectual capital; employee development and innovation efforts are no longer nice to have – they are must-haves to ensure the future strength of an organisation’s intellectual capital.

Intellectual property

Intellectual property is the one component of IC that is optional in the ICR process. During the set-up of a rating, one of the

Figure 4. Caption ranking of average ICR scores (from high to low)

Rank	Component	Category
1	Management	Human capital
2	Employees	Human capital
3	Network	Relationship capital
4	Customers	Relationship capital
5	Brand	Relationship capital
6	Business recipe	Business recipe
7	Process	Structural capital
8	Intellectual property	Structural capital

conversations with management is about the organisation's IP. In our experience, most management teams do not think their intellectual property is particularly important or valuable. One past case was an organisation that focused on its events business, but saw no value in the rights they held to a huge library of recordings from years of past events. Another included a consulting company that relied on the shared knowledge of its people and network, but did not see this as a strategic asset. In both of these cases, the organisations chose not to include IP in the rating process.

This kind of thinking led 90% of the companies that have been rated over time to exclude assessment of their IP. Nevertheless, there is a sample of roughly 40 companies that have included IP in their ICR, which contains interesting lessons. Among these companies, the top three scores related to IP were for: efforts to develop existing IP; IP contribution to attracting customers; and IP contribution to company expansion.

These strengths seem to imply that the 40 organisations in the IP sample are doing a good job, on average, of leveraging their IP to support the growth of their business. However, the lowest scores show the limits of this benefit: market share of IP; ability to protect IP; and degree of threats from substitutes.

These weaknesses together paint a picture of the downside of IP. Although this class of intangibles enjoys a special level of legal protection, this protection is far from a guarantee of success. All three of these low-scoring factors involve more than just legal issues. They are strategic issues.

Many times, the best protection for IP comes from a robust strategy and ecosystem built around the IP. This is where the perspective of the field of intellectual capital is especially helpful. IC can be seen as the net of human,

relationship and process capital that surrounds IP, that puts it into operation and, especially, that makes it harder to duplicate. Filing for IP protection requires a company to disclose the design of the property itself. It does not, however, require disclosure of the design of organisational and intellectual capital factors that help the company maximise the value of the IP. Most companies lack a disciplined way to describe, measure, communicate and leverage this intellectual capital context. This lack of discipline can lead to lost opportunities and failure to capitalise fully on known opportunities.

Lessons for managers of intellectual assets

What does all this mean for managers of intellectual assets? There are a number of themes that stand out from the experience of our community which provide lessons for those of you trying to improve IAM in your own organisations:

- Start with an inventory – many organisations have inventories of their intellectual property. That is an important first step. In order to leverage this portfolio, however, it is also a good idea to get an inventory of the related competencies, processes and networks that support the IP. This is a critical step to communicating, understanding and, most importantly, leveraging the value of IP.
- Add some analysis – some kind of assessment is in order. We recommend tapping into the wisdom of stakeholders to assess intangibles from three perspectives: current performance; efforts to renew/innovate; and risk. This will highlight potential opportunities and/or threats that can be shared with your peers on the management team, with the board and even with external stakeholders.
- Convert knowledge into power – data about what you have and how well it is

Figure 5. Degree of management difficulty of IAM categories



working should drive strategic and tactical thinking about how to grow and improve performance in your company. Once goals are set, the right data set also provides a baseline for measuring progress.

- Break away from the pack – it is clear from our experience, that it is a rare company that understands and profits from the full potential of its intellectual assets in general and intellectual property in particular. Knowledge is power and, in this case, opportunity. As a professional in IAM, you have the potential of being the catalyst for change, growth and innovation in your organisation.

The intangibles fuelling the growth and strength of today's economy present a significant dilemma to most corporations. The management and reporting tools used every day in almost every company around the world were perfected during the industrial era. They do not serve well in a knowledge-based economy. Nowhere is this

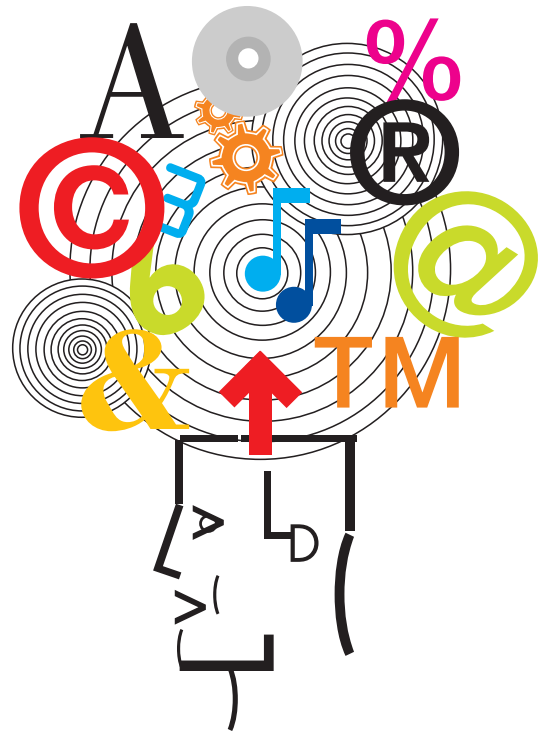
clearer than in the case of structural capital: the processes, knowledge and intellectual property at the centre of value creation in most companies. To succeed in IAM, organisations need to learn to get better at identifying, assessing and leveraging these critical assets. **iam**

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