

Making intangibles count (Published in HRMonthly, March 2005)

The rise of intangibles as wealth-creating assets puts HR in the thick of the action.

By Peter Aughton and John Barton

The change in the way companies value their intangible assets presents big opportunities for HR. Using recently developed concepts and tools, HR managers can manage and measure such assets, and in turn demonstrate how their roles add business value.

Intangible assets have dramatically come to the fore in the past decade as drivers of business value. This is evident from the sustained way the share market has valued publicly listed companies. In the early 1980s tangible assets such as plant and equipment, accounts payable and receivable, inventory, formalised processes and so on accounted for more than 60 per cent of a firm's market value. Today, tangible assets often represent less than 20 per cent of the market value asset base.

Intangible assets have become the key drivers in the new economy, according to American accounting and finance professor Baruch Lev, author of *Intangibles: Management, Measurement and Reporting* (2001). He defines intangibles as "the claim to future benefits that do not have a physical or financial (a stock or bond) embodiment". Such things as leadership and governance, know-how, tacit knowledge, credit ratings, plant flexibility, customer and employee loyalty, informal processes and networks, and brand strength are much more important factors when it comes to the future growth expectations of investors.

The market values of new economy companies like eBay, Intel, Nokia and Skandia are largely determined by intangibles, and managing them is critical because of their impact on shareholder value. The companies treat intangibles as wealth-creating assets that, if managed effectively, produce increasing returns. For example, effectively managing stakeholder relationships produces a relationship capital base from which returns can be generated.

Skandia, Sweden's largest financial services organisation, considers intangible assets so important, it separately accounts for them in its financial reports. It is also pioneering the development of in-house tools to better manage its intangible asset base. (see the Investor Relations page at www.skandia.com.)

The only way intangibles gain value is through people, so there is a compelling argument that their custodian must be HR. The responsibility

also entails implementing the conditions that enable employees to maximise returns from this asset class.

One example of using intangible asset tools to clarify the connection between people and results involves a senior HR manager from the sales and service division of a large multinational Australian company. When his division's strategy group announced its strategic plan in July last year, he noticed there was no detailed planning for one of its key goals – relationship management.

The division's strategic plan centred on three messages: profitable growth, customer experience and relationship management.

The first two were supported by detailed action plans backed up by extensive research. The action plans were cascaded to various regions and then through to individual role accountabilities.

On the other hand, relationship management was primarily left to the regions and individuals to manage at local level. All that was mentioned was that “we'll work in partnership with our stakeholders to deliver significant relationship improvement”.

Although the strategy group knew that relationship management was critical for business success, they seemed not to be aware of tools and concepts to manage it efficiently and effectively. They saw relationship management as a ‘black art’ that was best left to intuition and feedback surveys.

However, the HR manager could demonstrate the strategic imperative of effectively managing both tangible and intangible drivers of business value. He was able to influence his general manager and others to implement a relationship management strategy to show, through time, how it improved business performance.

The HR manager highlighted to the management team the growing importance of having an effective relationship management strategy, particularly as products in their industry were generally becoming commodities. The business environment required the organisation to focus increasingly on leveraging its intangible assets, such as relationship management, to continually improve its competitive advantage.

The HR manager, with support from the marketing and strategy managers, developed detailed plans to leverage relationship capital within the context of profitable growth and customer experience goals. The relationship management strategy had these objectives:

1. Identify priority market segments and the nature of relationships that need to be managed there.
2. Develop a customer experience business model to spell out the

points of leverage for relationship management.

3. Develop stakeholder relationship indexes to measure the relationship drivers of business performance.

Customer experience business models highlight the roles different internal and external stakeholders play in transforming potential customers unaware of the organisation's products to fully fledged customer advocates. In this case, as a result, a program is being put in place to strengthen the relationship with various stakeholders in the customer experience cycle (see diagram 1).

The models also highlight the strategic importance of having key customer-facing management roles focused on managing a network of relationships. This involves identifying critical customer segment relationships followed by the use of a stakeholder value proposition template (modified from the Kaplan and Norton customer value proposition template – see Kaplan and Norton, *Strategy Maps: Converting Intangible Assets into Tangible Outcomes*) to redefine roles around stakeholder management strategies, including crisis management programs.

Combining these models and producing relationship indexes for each of the key stakeholders produces a whole-of-organisation relationship management business driver model that can be used to track, through time, the different relationship drivers of business performance. The driver model maps quantifiable relationship connections to business outcomes that are used to pinpoint potential for improvement.

Finally, the customer experience models provide management with a diagrammatic framework for communicating strategy and business initiatives. Getting a consistent strategic message across to staff is lot more reliable using diagrams rather than wordy documents.

As the importance of managing intangible assets becomes more widespread, the traditional HR role needs to broaden.

Evidence of this trend can be readily found in recent HR job advertisements. Statements such as these, from the *The Age* on January 15, are not uncommon: “Step outside traditional HR and advance business improvement”; “Use your higher-level HR skills to refine people strategies and facilitate business improvement and change”; “Embrace the opportunity for a broader business focus”; and “Demonstrate an interest in innovative people strategies”.

Other occupational groups have already recognised the phenomenon of creating wealth from intangible assets. The IT/knowledge management industry has long recognised the importance of tacit knowledge as a wealth-creating asset and has produced sophisticated applications, such as

expert systems, to better manage it within organisations.

The marketing sector, too, understands the importance of intangible assets. In a paper titled *What Value Marketing?* on the Australian Marketing Institute website (www.ami.org.au), the institute says: “Marketing is arguably entering the most exciting period in its history as businesses come to recognise that critical generators of value are to be found in the intangible assets that are the central concern of marketers.”

And the finance and accounting professions are well advanced with their thinking on these issues too, as demonstrated by Baruch Lev in the previous reference and the current discussions about changing accounting standards.

Opportunities abound for the HR community to drive shareholder value from intangible assets. A good place to start is to adopt the Ulrich and Smallwood (David Ulrich and Norman Small, *Why the Bottom Line ISN'T!: How to Build Value Through People and Organization*) Architecture for Intangibles framework (see diagram 2) and complete these steps.

1. Identify the assets essential for driving shareholder value.
2. Develop intangible asset business driver models for each asset base and use them to demonstrate how HR adds organisational value.
3. Implement the enabling conditions that will give employees the means to continually improve returns from intangible assets.
4. Learn how suitable indexes can be constructed to measure intangibles

While completing these steps, it is important for HR to initiate collaborative efforts with other business units, such as IT, marketing and finance, so there is an integrated approach to generating performance improvement from intangible assets. For example, relationship management needs to be effective across all business units for sustainable competitive advantage; it is not just the preserve of any one “silo” group. Wealth creation is impeded if managers in different parts of the organisation only have silo-focused goals.

A number of recently developed systemic business tools and concepts, such as the different approaches to organisational mapping, and both qualitative and quantitative model building, are available for HR managers to clarify the connection between people and results. Also available are state-of-the-art tools and concepts that establish the enabling conditions to generate increasing returns from intangible assets.

As creating wealth from intangible assets intensifies, there will be career-enhancing opportunities for forward-looking HR managers who broaden

their credentials and put their hands up for intangible-asset manager roles that demonstrate their contribution to organisational performance.

The customer experience business driver model

What are the relationship drivers that move customers from one state to the next?

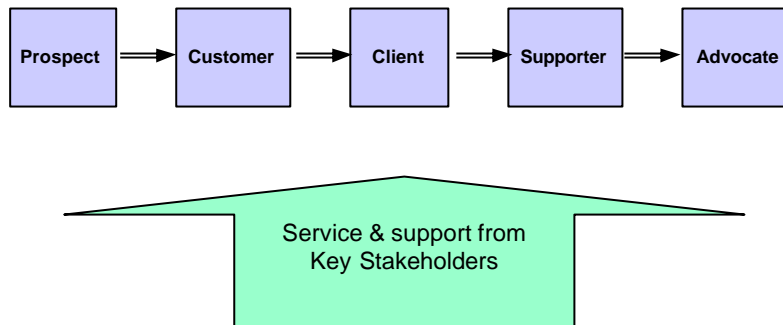


Diagram 1

Architecture of Intangibles

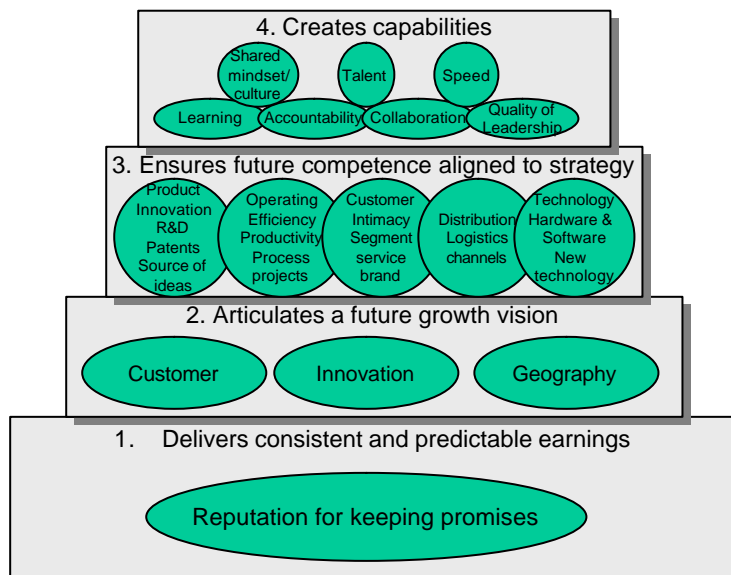


Diagram 2

Information

'People Power – Developing the Talent to Perform', by Kim Warren, Adjunct Professor of Strategic Management at the London Business School, and UK writer and consultant, Jeremy Kourdi, Vola Press, 2003

Intangibles: Management, Measurement and Reporting by Baruch Lev, Brookings Institution Press, 2001

'Strategy Maps: Converting Intangible Assets into Tangible Outcomes', by Kaplan and Norton, Harvard Business School Press, 2004

'Why the Bottom Line ISN'T!: How to Build Value Through People and Organization' by David Ulrich and Norman Small, John Wiley & Sons, 2003.

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