



introduction

What if one day your phone rings, and it's a colleague who wants to talk with you about a company. This company has been around for decades and has grown steadily in recent years. It has good people. Although it has had a rough time in the last recession, it is holding its own and believes that it will be able to benefit from a strengthening economy. Its market holds promise of innovation and growth...Would you take the call? Does this sound interesting enough that you would recommend a deeper look as a potential partner, investor, board member or employee?

What if on closer examination, you discovered that the company has a production facility that it started piecing together in the 1980s with internally-built components. Occasionally, the owners bought third-party parts but, by and large, even these were customized to the point that they are unique to the company. This facility started as a little experiment but has come to be one of the company's most important competitive advantages. Some would say it is the competitive advantage of the company.

When you ask about this facility, you find that since it grew from the inside out, the company never brought it into their accounting. It has no inventory of its raw materials or its production assets. It doesn't keep track of how much it cost to build, maintain, and operate the facility. It doesn't have a map of the production flow of its operations...Would you still have the same opinion? Would you recommend a relationship with this company? Or would you be concerned about the quality of its management, its ability to continue to generate earnings, even the long-term viability of the company?

These are really important questions because the company we are describing is the company where you work, the companies in your retirement plan, the companies on which the United States is banking its future. Our economy has made a fundamental shift from industrial to knowledge production. We still manufacture goods (although less than in the past). But the basis of competition has shifted. Competitive advantage is now based on what you know rather than what you own.

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. This factory is there whether you manufacture physical goods or you provide a service. Knowledge, fueled by information technology, is the raw material, the fuel and the engine of this factory. The success of your company is totally dependent on the success of this knowledge factory.

excerpt from *intangible capital: putting knowledge to work in the 21st century organization*

www.intangiblecapitalbook.com

© mary adams and michael oleksak

page 1



Yet very few companies can provide a description of their own knowledge factory. Nor can they provide an inventory of its critical components. How much it cost to build, maintain, and operate the factory. How well it is performing. The knowledge factory is essentially invisible in most companies.

Experts estimate that easily half, probably much more, of the value of American companies is held in this knowledge factory. This factory has been built through steady investments that were at least equal to the investments made in tangible production capacity in recent decades—and probably much greater. The future of your company and our country will depend on our ability to leverage this investment. But neither the investment nor the value of this knowledge factory is captured in the accounting and management information systems that are used across our economy. And the exclusion of intangibles also means that the operating story that accounting has traditionally told—as raw material moves through the production process and becomes finished goods—is also missing. Today’s accounting shows very little balance sheet movement and a lot of different kinds of expenses, both tangible and intangible, but no coherent story about the value creation process.

All this means that managers, boards of directors, investors, partners and stakeholders of all kinds have to rely on their intuition to evaluate the creation, strength and monetization of intangibles. They ask questions, they get a gut feel for how things work. But they do not get hard data that give them a complete picture of the current and future productive knowledge capacity of our companies.

This is the dangerous secret of our economy. We have all kinds of regulations about corporate disclosure. We have all kinds of management practices vetted by business schools. We profess to value hard data. But no company today can provide a basic set of management information on its knowledge assets and the means by which these assets are put to work to create customer value. And no one will admit that they are managing basically depending on their intuition.

And now we are at a moment of truth. Our economy seemingly made huge progress in the past decades. Computers created efficiencies and fueled profits. They also enabled many white collar jobs to be moved offshore along with manufacturing work. The economic consequences of this outsourcing and the mothballing of so much of our economic infrastructure were hidden by a series of economic booms in the 1990’s and early 2000’s. Then the “Great Recession” of 2008-2009 exposed the fact that our economy was running on consumer spending fueled by financial profits that have long since disappeared. Today, we lack sources of job creation and true economic growth. Add to this economic challenge the even greater ones created by serious concerns about our environment, our energy use, our healthcare system, even our food production. We are in a very difficult position.

What will it take to face these challenges? How can we as a nation convert these enormous challenges into opportunities that can fuel a new century of growth and prosperity? The answers lie in how we leverage the enormous intangible capital of American business. The seeds of the future already exist in the minds of our workers and in the collection of knowledge—the intangible capital—of our organizations. But we are not going

excerpt from *intangible capital: putting knowledge to work in the 21st century organization*

www.intangiblecapitalbook.com

© mary adams and michael oleksak

page 2



to rise to these challenges by ignoring this same intangible capital in our management information and practices. We must use our intangible capital, not to re-create the past but to create a new future.

The times, the challenges and the opportunities demand that we develop intangibles management capabilities to move almost every sector of our economy into the knowledge era to:

- Re-create manufacturing in a new knowledge-intensive and sustainable form
- Change energy production and use across our entire economy
- Create a sustainable, healthy food system
- Re-think education at every level
- Use our greatest resource—our collective knowledge—to fuel a new era of prosperity.

We are both former bankers who began our careers just as the IBM PC hit the marketplace in the early 1980s. That was actually the moment when a discernable “extra” value became visible in the public markets over and above the book value of corporate assets. In hindsight, economists now tell us that this was when the knowledge era began to take off. We, like all businesspeople today, have lived with feet planted in both the industrial and knowledge eras. At Citibank and Bank of Boston, we each received training in state-of-the-art business thinking. But as time went by, it became clear that there was something else going on. The old formulae didn’t work. Assets wouldn’t cover the loan amounts companies needed to fund their operations. It was only later when we had started a consulting firm in the late 1990s, that we came to understand the shift that was underway.

Then over five years ago, we were introduced to the emerging field of intangible capital. We started an informational Web site, the IC Knowledge Center (ICKC), and a newsletter that became our way of continuing (and sharing) our learning. The ICKC later morphed into a blog and as of early 2010 became a network with participants from many field of expertise from all over the globe.

We also began to apply the concepts in our client work, helping technology and service companies to grow and adapt to changes in their markets. We began to see a lot of trends that have been emerging in recent years—social networking, innovation, performance and knowledge management—as threads of the same story. Eventually we felt compelled to write a book to pull all these threads together.

This is not the first book we have written together. We met and lived in the Dominican Republic over 20 years ago. At the time we were intrigued by the growing prominence of Latin Americans in baseball. We were upset when we would see sportswriters speculate (often incorrectly) on how and why baseball spread to different countries. When we couldn’t find a book on the rich history of this aspect of our national game, we decided to write it ourselves. We helped set the record straight and start a new thread in the history of baseball.

This book isn’t all that different. We have shared with our clients the urgency of being able to measure, manage, and monetize intangibles. We have seen what works. But we haven’t been able to find a book that

excerpt from intangible capital: putting knowledge to work in the 21st century organization

www.intangiblecapitalbook.com

© mary adams and michael oleksak

page 3



explains this in a clear, practical way. We felt we had no choice but to do it ourselves. Our hope is to get this information out to a broader audience and contribute to the important conversation about how to stimulate innovation and growth in our economy.

The ideas we express here are grounded in the best and most current research. But everything is filtered through the lens of our experience—and that of our clients—as to what really works. Our goal is to arm you with understanding and perhaps more importantly, practical tools and applications to help your organization succeed in the knowledge era. Each idea is linked with its industrial era equivalent so that you can see where it fits in your daily work.

There are three major parts of the book. The New Factory focuses on the performance of your intangible capital. The New Management is about driving innovation in your organization. And the New Accounting explains the link between intangibles and the financial performance and valuation of your business. These images and concepts describe the knowledge-era equivalents of familiar basics in business. We are not advocating the abandonment of the existing basics but, rather, supplementing your existing practices with new ones better suited to the knowledge side of your business.

The New Factory introduces knowledge as a business asset. It's actually a very flexible asset and can take many forms: as a product, as a raw material and as an engine for the growth of your company. This part explains the economics of getting paid for knowledge (and sometimes giving it away) and how knowledge becomes a raw material for your business through three basic classes of assets: human, relationship, and structural knowledge capital. You'll learn that structural capital is the most powerful knowledge asset because it is infinitely scalable and repeatable. But that in order to use and monetize any of these assets, they need to be combined in a system, what we call the knowledge factory. We'll show you how to build a model of your knowledge factory that will help you in thinking how to measure, manage and maximize the performance of your organization's knowledge.

The New Management introduces the layers of networks that make up the knowledge factory and that limit the usefulness of traditional management tools like organization charts, strategic planning and managerial controls. By definition, knowledge is spread throughout your knowledge factory. That means that you need to learn to “manage” information flows from the bottom up and outside in. Nowhere is this more necessary than in the area of innovation where your challenge is to facilitate the development and implementation of new ideas from all levels of your organization as well as your customers and external partners.

The New Accounting explains how today's businessperson is hampered by lack of information about the knowledge factory. Knowledge assets are not captured in accounting systems and are almost invisible in other conventional forms of management information. We will introduce you to strategies to remedy this situation through the creation of simple reports about the cost, strength and performance of your knowledge factory. You can use these reports immediately to support your internal management. We will also prepare you for the day when you use this kind of information to communicate with external stakeholders including investors,

excerpt from intangible capital: putting knowledge to work in the 21st century organization

www.intangiblecapitalbook.com

© mary adams and michael oleksak

page 4



bankers, partners, customers and even employees to increase the valuation that they assign to your business. We end by explaining how your reputation is dependent on the success of the management of your knowledge factory. It holds your factory network together and ensures that your factory will be able to grow and innovate heading into the future.

It is this possibility of performance, innovation and valuation that we hope will lead you to adapt your thinking and your management approaches to the knowledge era. To this end, you will find an exercise at the end of each chapter that will help shape your thinking and apply its lessons in your own company. There is a companion Web site to this book, www.intangiblecapitalbook.com, where you can download worksheets for all these exercises as well as guides for how these ideas can be best exploited by different business functions: the CEO, CFO, CIO, COO, IP, and HR professionals inside a company as well as investment, finance and legal professionals who advise companies from the outside. Through the Web site, we hope to stimulate a conversation to build on the ideas presented here. The really important ideas are yet to come. And they will come from the millions of managers on the ground who live in real time the challenges of living at the intersection between the industrial and knowledge eras. We can all learn from each other and speed the creation of a new management model.

We see the current challenges facing our clients and companies across the globe as once-in-a-lifetime opportunities to create wealth and well-being. The answer is in the knowledge you already have and the knowledge that you can create through collaboration with the participants in your knowledge factory. We thank you for joining us on this journey.

excerpt from *intangible capital: putting knowledge to work in the 21st century organization*

www.intangiblecapitalbook.com

© mary adams and michael oleksak

page 5