Triangulating Intangibles

A strategy for accounting in the knowledge era....

Mary Adams
I-Capital Advisors
Corporate value is increasingly intangible

Research: Ned Davis
Mergers are 70% intangible

- Tangible, 30%
- Intangible, 23%
- Goodwill, 47%

E&Y: Acquisition Accounting – What’s Next for You?
Global sample of 700+ mergers in 2007
The gap is not “goodwill”

• It’s not the result of some abstract market “feeling”
• It’s the result of 30+ years of investment in the knowledge infrastructure of American corporations (people, processes, info tech, networks)
• Annual investment in knowledge intangibles now exceeds tangible investment….
It’s about investment in knowledge

U.S. corporate investments - 2007

Intangible $1.6 trillion, 57%  
(Tangible $1.2 trillion, 43%)

(includes software, R&D, advertising, and training)

Business Week, October 29, 2009 (using unpublished data from Corrado, Hulten and Sichel)
Intangible Capital

Knowledge Assets

Human Capital
- Competencies
- Experience
- Management skills

Structural Capital
- All captured info and knowledge
- Processes
- Intellectual Property

Relationship Capital
- Customers
- Vendors
- Partners
- Brands
- Reputation
Filling in the intangible info gap

The New Factory

The New Management

The New Accounting
Narrative is not enough

PwC provided two different versions of an annual report to groups of analysts:

1. Financial statements, narrative, a few key metrics and extensive quantified nonfinancial data [full Coloplast annual report]
2. Stripped out quantified nonfinancial data [resulting report still similar to/better than market norm]

Very different results:

1. 60% of analysts recommended “buy”
   ➜ earnings estimate lower but more consistent
2. 80% recommended “sell”
   ➜ earnings estimate higher

Source: http://corporatereporting.com/benefits-reporting.html
How to fill the gap?

A. Inventory

B. Measurement - triangulation

1. Financials
   ➡️ investment is easiest but ignored

2. Quantitative
   ➡️ KPI’s popular but dangerous

3. Qualitative
   ➡️ assessments create quantitative data about hard-to-measure but critical data

C. Narrative/XBRL
   ➡️ give them something to talk about
Triangulating intangibles

- Capacity
- Earnings
- Valuation
- Innovation
- Reputation

Corporate Intangibles

Investment (financial)

Performance Management (quantitative)

Assessment (qualitative)
I-Capex* ($1.6 trillion/year)

- Most intangible capital expenditures are expensed under today’s acctg standards
- Cost is actually the most concrete piece of data available about intangibles
- Should be tracked in a management report
- Internally, will help with better decisions
- Externally, will help tell corporate story

* the new capital expenditure
IC assessment*

• Systematic analysis of qualitative issues
• Turns qualitative into quantitative data
• Range from self-assessment to broad review by stakeholders (both internal and external)
• Focus on adequacy, performance, risk, outlook
• Can be built for strategy, innovation, valuation, reputation perspectives
• Ideal is a 360-degree review of the entire IC/knowledge factory portfolio

*the new balance sheet
Sample assessment output

IC Rating™ consolidated report
Performance measurement*

• Uses non-financial quantitative indicators
• Examples: headcount, customer demographics, IP mapping, process metrics
• Bottom up for learning
• Top down for management and reporting—key performance indicators (KPI’s)

* the new income statement
Simple triangulation example

Pre- and post- implementation of a new knowledge sharing platform

1. Investment in new knowledge sharing platform (human, structural, relationship)
2. Qualitative measures (employee communication and collaboration)
3. Quantitative measures (number of steps to solve a problem, time to resolution)
Triangulation at corp level

FIRST - inventory primary value-creation processes (SC), competencies (HC) and relationships (RC)

- Track annual investments
- Assess performance, risk, outlook
- Track key quantitative measures
For now…

• We need to work within existing systems
• The place to start is management accounting for bottom-up learning
• Changes to statutory reporting cannot be institutionalized until there is a clear emerging practice
• For now, the best top-down influence is education…and the best place to start is to teach accountants triangulation
Triangulation

...to help stakeholders to understand the performance and capacity of the knowledge-era business
Resources

I-Capex Is the New Capital Expenditure
IMA: Statement on Accounting for Intangibles
Book: www.intangiblecapitalbook.com
Community: www.icknowledgecenter.com
Blog: www.smartercompaniesblog.com

Mary Adams, 781-729-9650
adams@i-capitaladvisors.com
Twitter: maryadamsica