

EC examines reporting rules for intangibles

Edward Truch examines the the European-wide moves towards finding measures for the knowledge economy

With the Euro in the limelight, it is easy to miss other reforms such as those in the area of KM and measurement of intangible assets that are in the pipeline. The European Commission recently funded a major research project that brings together leading business schools from across Europe to examine innovation and measurement practices in the intangible economy, which will include options for statutory reporting on intangible assets. Such regulation would undoubtedly have major implications for knowledge managers, particularly in quoted companies. Suddenly, knowledge practices within organisations would come under new forms of scrutiny. Some aspects will be most welcome, as they will put KM fairly and squarely on the board's agenda, others may be less welcome.

Clark Eustace, director of the EC programme, comments "The overriding problem for all interest groups is how to isolate and measure intangible performance drivers – the portfolio of assets, quasi-assets, commodities and competence that constitute today's real drivers of competitive advantage. In this context, a new generation of analytical models and tools is urgently needed to enable company boards, executives and investors to judge management performance and differentiate good, bad and delinquent stewardship"

Some companies have followed in the footsteps of Skandia in providing intellectual capital measures in their annual



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reports. Evidence is emerging on how such disclosure leads to stabilisation of their share prices as compared with peers who do not. Certainly, City analysts are fast developing their expertise and techniques in looking behind the numbers and assessing companies' intangible assets, which not only include development of new patents and copyrights but also measures of how efficiently organisations build and renew their human capital and knowledge assets. At a conference on business intelligence in the pharmaceutical industry held a year ago a director of Lehman Brothers shocked the audience with the depth of her analysis when she produced hard figures. Her comparison tables assessed the relative values of intangible assets not shown on the balance sheet for companies in the sector, many of which were represented in the hall.

According to Professor Leif Edvinsson at Lund University, measurement of intellectual capital does not have to be in the shape of numbers only; it could be in the form of narratives or storytelling. The former Director of Intellectual Capital at Skandia, likens it to describing the weather. You cannot describe the weather precisely and comparatively without numbers, yet you also need a narrative.

When engaging in this debate it is important to have reasons for the measurement of knowledge assets. These might include:

- operational decision-support for managing knowledge assets;

- resource-based view of overall business strategy;
- organisational and individual competency development;
- reporting to markets and shareholders.

The first three reasons for measurement are purely for internal use and the potential benefits are obvious. Although there is still widespread opposition to such measures, this may evaporate as new standards begin to emerge. There are many parallels with the quality movement whereby, in the 1950's, Edward Deming had to take his ideas to Japan to be heard. Now, these practices are regarded as a prerequisite to good management and ubiquitous in their application. Quality in many ways is as ephemeral a concept as knowledge and yet measures and benchmarks are now seen in daily use.

The more difficult and perhaps controversial issue is that of external reporting. This is truly a double-edged sword – good to report when you are ahead of the game and damaging when you fall behind. Whilst companies vary considerably in the degree of openness in reporting the investment director from Lehman Brother was at pains to point out that what is more important is consistency in the approach to reporting. More eyebrows are raised when a company that is seen as being open suddenly drops a range of measures from its reporting scheme. Before rushing towards open reporting a long-term view needs to be taken of the benefits and risks of setting a precedent in the level of disclosure. One of the dangers of assessing intellectual capital is that measures can rapidly become targets for management. If applied inappropriately this could create a straightjacket that proves to be counterproductive and leads to short-termist decisions.

Many of the issues surrounding voluntary reporting are likely to disappear if new statutory regulations are introduced, as has happened recently in Denmark. In the meantime City analysts are likely to be asking for more information in this area and the sooner managements develop their strategies towards these issues the better.

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