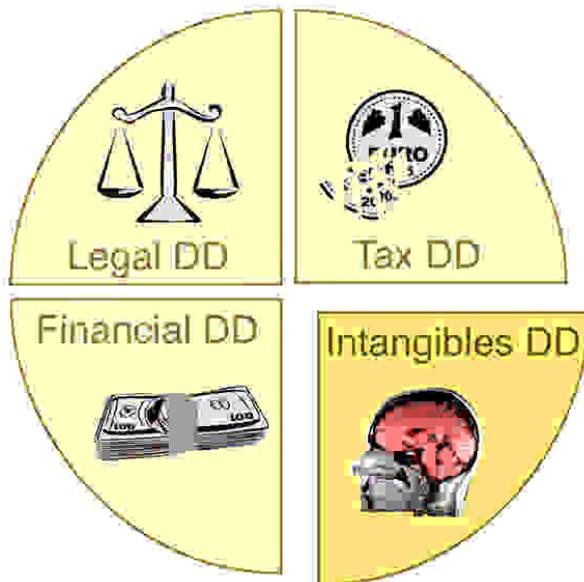


# Intangibles Due Diligence:

## Integration of the Intangibles into the Due Diligence Assessment Framework



Artwork by Béa Boog

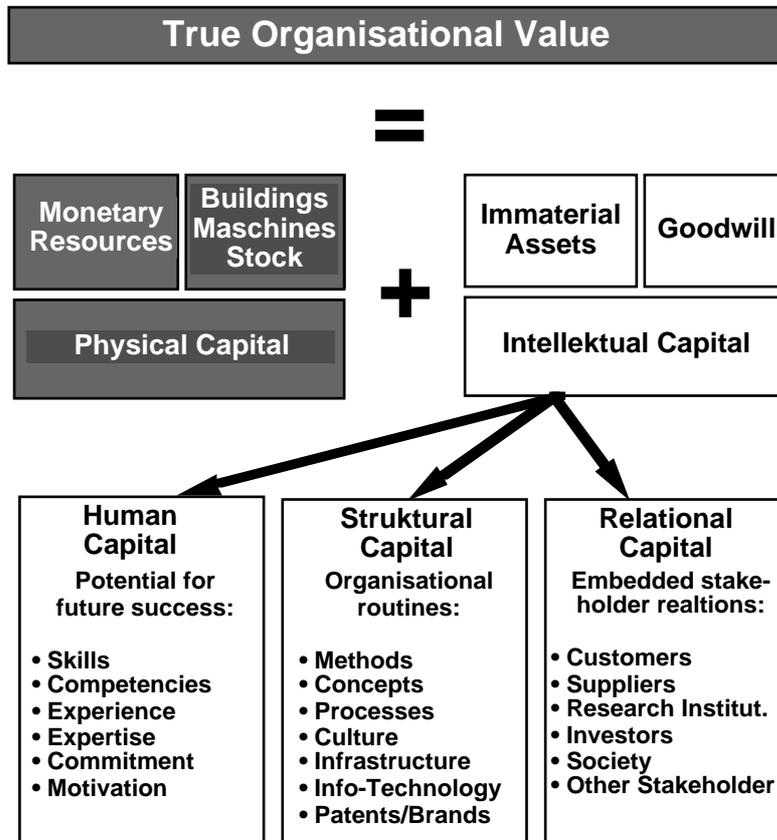
Today's Due Diligence Procedures focus on fixed assets and financial capital. Increasingly, there is criticism, that traditional DD reports do not account for the intangible factors that influence an organisation's true value and its growth prospects. So, DD analysts are asking for standardised tools to measure and benchmark intangibles. While searching for best practices, we were unable to find a convincing approach, but we found some ideas!

*The tool to complete conventional Due Diligence procedures is the **Intellectual Capital Management System ICMS-15649***

Content:	Title	Page
1	Introduction	2
2	Vision	2
3	The <i>IC-Management System ICMS-15649</i>	3
4.	Performance and Evaluation of Intangibles Due Diligence	4
5	Basic benefit and added value	5
6	Application of the Intangibles Due Diligence	5
7	Differentiation and USP compared to other methods	5
8	Literature	5



## 1. Introduction



*Categories of Intellectual Capital (IC)*

Intangibles or Intellectual Capital (IC) are equivalent terms for the non-accountable assets of an organisation. The change from the agrarian economy to the knowledge society has led to the situation, that the 'unreported' assets in a balance sheet are on average several times those of the tangible assets. Intellectual Capital must be converted into knowledge resources to formulate an Intellectual Capital statement. The most common classifications or types of knowledge resources are technologies, processes, stakeholders and (of course) employees. The three components of IC are interactive: The human Capital raises the Structural Capital; both together generate the Relational Capital. In addition, IC statements can be used to communicate knowledge management's objectives, initiatives and results to a number of target groups. Investors, for example, don't need to rely on financial numbers only; they receive insight in the organisation's ability to survive future competition.

But even the standardised IC evaluation is a big challenge, since benchmarking requires a common measure for all, while knowledge based organisations set different priorities in their knowledge work. In addition, many organisations refuse to disclose their IC data: IC data demonstrate how resource processes contribute to competitive advantage: IC oriented organisations show reservations, since the newly realised advantages might be negated by full IC transparency.

## 2. Vision

The impossibility of comparing IC data in a standardised and benchmarked manner requires an alternative IC evaluation. New thinking is needed and new processes must be adopted to define standardised IC measurements: To get insight in the future IC development an IC assessment evaluates the tools and instruments. This is comparable with the established ISO-9000, where the resulting product quality isn't the subject of interest, but the efforts to reach quality including the documentation and traceability. In other words, an IC assessment doesn't compare quantified IC data (indicators), but researches provable initiatives (instruments & processes) for sustainable an IC management. The Intellectual Capital Management System ICMS-15649 is the tool to achieve a complete *Due Diligence Framework*.



### 3. The IC-Management-System ICMS-15649

To get a prospective benchmark an IC assessment is used, which doesn't focus on WHAT (resulting IC data), it measures the HOW (implemented and documented processes and tools):

<b>IC-Management:</b> Formulation of normative knowledge goals and declaration of a knowledge policy		
<b>Human Capital</b>	<b>Structural Capital</b>	<b>Relational Capital</b>
Description of implemented tools and processes for the sustainable treatment of human resources: • Skills • Competencies • Experience • Expertise • Commitment • Motivation	Description of implemented tools and processes for the sustainable treatment of structural resources: • Patents & Brands • Methods • Concepts • Processes • Culture • Infrastructure • Info-Technology	Description of implemented tools and processes for the sustainable treatment of relational resources: • Customers • Suppliers • Research Institutions • Investors • Society • Other Stakeholder

**Concept of the Intellectual Capital Management System ICMS-15649**

For each of the three IC categories and the IC management, requirements are deviated from the organisational knowledge work. In general, each reporting organisation is asked to respond to all requirements, since every knowledge based organisation does already something for each of the IC components, even when this doesn't run under the knowledge management label. However, it is thinkable, that specific requirements have no relevance in fact. In such a case the reporting organisation is asked to conclusively show and explain the non-relevance. This proceeding has the advantage, that it becomes visible, which knowledge based initiatives are subjects to be optimised and/or can be managed in a more systematic approach.

#### ICMS-Requirements of the IC-Management

Top management shall demonstrate its commitment to meet stakeholder requirements for a sustainable management of the organisation's Intellectual Capital.

- Top management enforces the IC management throughout the organisation in a written public commitment. It states the importance admitted to knowledge and competencies within the organisation's value chain and follows the intention to constantly survey barriers and goal conflicts in IC work.
- Top management shall, at defined intervals, review the IC management system to ensure its continuing suitability, adequacy and effectiveness. The management review shall evaluate the degree of fulfilling previous defined strategic and operative knowledge goals using a derivative indicator system.

#### ICMS-Requirements of the Human Capital

*The organisation shall make efforts to get full transparency about the employees skills and knowledge capacities, their commitment; and shall determine, which individual knowledge goals have to be reached to cover the organisational knowledge goals.*

#### ICMS-Requirements for the Structural Capital

*Everything remaining in the organisation, when the staff has left home, can be described as part of the structural capital; for example:*

- *Specific infrastructure*
- *Data base containing customer- & supplier information*
- *Document maintenance (Content Management)*
- *Descriptions of procedures and work flow*
- *Customised IT solutions*

*Patents and brands (Intellectual Property) belong to the structural capital too. Those are the only IC components that can be included into conventional accounting.*



## ICMS-Requirements for the Relational Capital

*Relational Capital is the third category of intellectual capital and includes all embedded relations of the organisation to the outside world: Besides customers and suppliers this includes investors, potential employees, authorities and the society.*

### Concrete example of a Human Capital Requirement

The below example covers the ICMS requirement Collective Knowledge Development

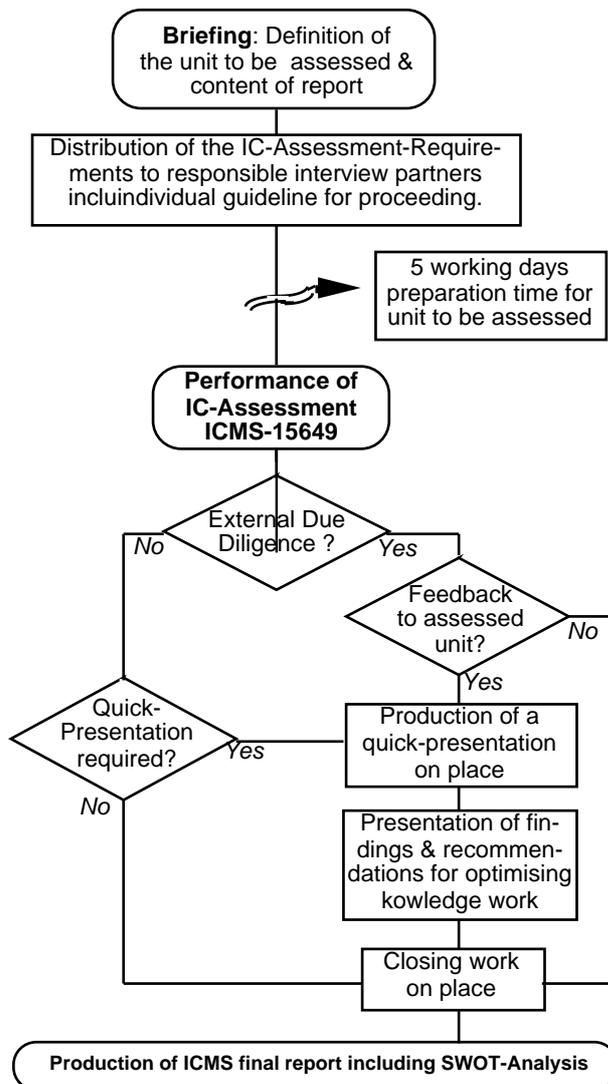
• **ICMS-Requirement Collective Knowledge Development:**

The organisational learning and innovation capacity becomes a deciding core competence. The quantitative and qualitative networking of varying competencies is an important impact in the future's working environment. The increasing innovation speed requires not only a drastic growth of data and knowledge access tools, but also prospective and proactive learning processes.

Requirements:

- The organisation performs Best-Practices-Analyses regularly
- The organisation uses learning arenas like *Think Tanks* and/or *Lesson Learned*
- The organisation uses established creativity methods

## 4. Procedure and Evaluation of the Intangibles Due Diligence



**Process of Intangibles Due Diligence**

The briefing results in a commitment, which organisational unit shall be assessed and about the content of the final report.

The unit to be assessed receives 5 days prior to the assessment date a questionnaire including help remarks. This time can be invested to prepare traceable proofs.

The IC assessment lasts for one integrated unit (independent of its size and purpose) one working day. Not included in this time frame are the travel time and the preparation & carry out of a quick presentation.

In case of an external Due Diligence procedure it is the mandator's decision, whether assessed unit receives an instant feedback. In case of an internal Due Diligence an instant feedback can be arranged too.

The production of the final report including a SWOT analysis lasts up to three working days. It contains a taxonomy from 0 (= non-existent) to 5 (= above average) is used. Those items, that are non-relevant for the assessed unit, are not subjects of the evaluation.

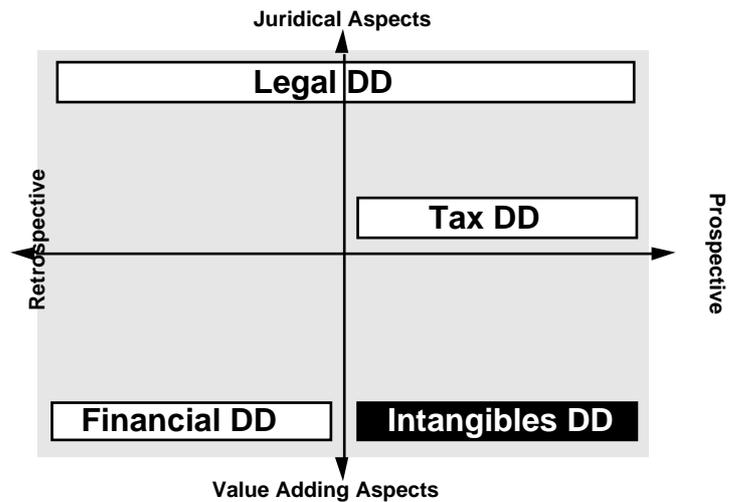
The final report shows on the one hand individual results for each of the three IC categories and of the IC management; on the other hand the individual results are weighted according to the organisational structure and used to allow benchmark comparisons.



## 5. Basic Benefits / Added Value

If established DD categories (Financial, Tax & Legal DD) were brought in context with their temporality and scope, it is visible, that prospective statements in the value-adding axis depend on individual's good intentions. This gap is filled by the *Intangibles Due Diligence*.

Using ICMS for internal Due Diligence procedures, steering parameters are raised supporting strategic decisions. A systematic IC treatment depends on its periodic evaluation. Otherwise, the future development of the so-called most important resources will be a product of hazards and/or of the good intentions of individuals.



## 6. Application of the Intangibles Due Diligence

The ICMS-15649 has been developed for external and internal Due Diligence procedures of knowledge based organisations, independent of their goals and sizes.

<b>External Due Diligence</b>	• Mergers & Acquisitions	>	Potential buyers
	• Substantial interest	>	Institutional shareholders
	• Creditability	>	Investors
	• Sustainability Funds	>	Sustainability-Researcher
<b>Internal Due Diligence</b>	• Mergers & Acquisitions	>	Potential vendors
	• Diversified Organisations	>	Internal best practices
	• High-Tec Organisations	>	Strategic planning
	• Organisations in Crisis	>	Reorganisers

## 7. Differentiation and USP compared to other methods

ICMS is a tool offering **harmonised reporting** and goal-oriented development of an organisation's intellectual capital. Compared to other methods (Intangibles Reports) ICMS doesn't aspire to reach a standardised benchmarking of IC assets, since there is no standard for individual knowledge based organisations. To achieve a highest possible comparison, ICMS evaluates the HOW (implemented instruments & processes) and doesn't look to the WHAT (individual IC indicators).

## 8. Literature (Active-Links)

• [Benchmarking Intellectual Capital](http://www.hrm-auer/english_docs.php) T. Auer; In Wissensmanagement (D) 2004/04

• [Intangibles Reports are a HIT but nobody looks after it!](http://www.hrm-auer.ch/english_docs.php) T. Auer, In Wissenschaftsmanagement (D) 06/2005

• Detailed ICMS-Descriptions are available for personal use from [www.hrm-auer.ch](http://www.hrm-auer.ch)