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Core Subject **Intellectual Capital**

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Rating Intellectual Capital

In short:
• The big question is: Needs an IC evaluation system to be as good as possible or is it sufficient, when it works as good as necessary?
• IC reporting systems introduced so far aim towards a monetary evaluation of knowledge in enterprises. But it is undisputed, that a sufficient model to evaluate the intellectual capital does not exist up to now.
• "Listening carefully", what the most important target group expects in reality and the analysis, which tools are accepted by this group for similar challenges, leads to a requirement profile for an alternative evaluation method.

With the introduction of the legendary Skandia navigator twelve years ago, the *intellectual capital (IC) evaluation area* has started. Since then, dozens of new IC evaluation tools appear each year on the market. A lot of them receive initially a high attention, but they disappear usually after some time. Are those IC reporting systems too academic and not practicable? Or, do they not respond to the real expectations of the external target groups? Since both reasons are true in many cases, it might be worth to have a look over the IC's plate border. Moreover, it may deliver new and surprising perceptions.

Expectations from the external target groups

„Intellectual capital reporting is a topic, which is gaining in importance. I know transparency counts in every form, but not exaggerated up to the point of irrelevance", said Fritz H. Rau, chairman of the European Federation of Financial Analysts Societies (EFFAS) in his speech „Intellectual Capital & Investment Professionals: The View of the Users" in Ferrara. [1]. This statement confirms on one hand the increased attention that the intellectual capital receives by the financial world. The actual discussion about the implementation of Basle II offers additional chances to bring this subject into public discussions. On the other hand, the second part of the statement demonstrates that even this financial world (most important target group for IC reports) considers the IC reporting systems introduced so far as being "sub-optimal".

Thus, it seems necessary to get first insight in what financial analysts do really expect from an IC reporting system:

• Reporting form and Time Consumption:
Financial analysts are usually stressed professionals. They are not willing to spend hours to read an IC report. They expect an easy to survey report that doesn't exceed one page, which delivers quantified about all IC categories and allows comparisons with other reports. The competence to analyse such reports shall be possible to learn within a short time frame.

• ***Costs:***
IC evaluation is a new and complementary discipline to judge enterprises. That means, it generates additional costs. Thus, an IC reporting system may have low chances, even when it fulfils the analyst's requirements, when its costs are above the acceptance limit.

• ***Universal usability:***
The knowledge based enterprise management is no longer an exclusivity of research institutions and consulting firms: Almost every product is based on different knowledge based processes and initiatives. However, investment professionals are asking for an evaluation tool that is usable for all organisations, regardless of their sizes and branches.
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• ***Long term consistent benchmark:***
A long-term comparability of IC reports is the top requirement of the investment professionals. They are asking for a consistent benchmark, which is valid for all reporting organisations.

Searching for Columbus's egg

Since the first publication of Skandia's IC Navigator in 1994, hundreds of approaches to report intellectual assets have been introduced. Each of them has specific strengths and weaknesses. However, it is undisputed that a satisfactory model to report intellectual capital does not exist actually. Barriers for acceptance are especially the missing benchmark capability, the non-transparent and costly procedures as well as the often-meaningless information for the target groups. The last point is influenced by the fear of the reporting organisations: They hesitate to disclose their IC data, since they concern them as strategic and secret data, which are reserved for the internal IC management: A full IC data transparency might negate newly realised advantages. Thus, only an interpretable, harmonised and meaningful standard will decide, whether IC reporting will become an ingenious complement to the established corporate communication or whether it remains in its status as being a "nice-to-have" PR tool. [2]

Practice samples: Lessons Learned

While we started our engagement in IC evaluation, we initially believed too, that an overall working indicator metric system might be possible. Finally, a classic lesson learned process led us to an alternative, practicable solution:

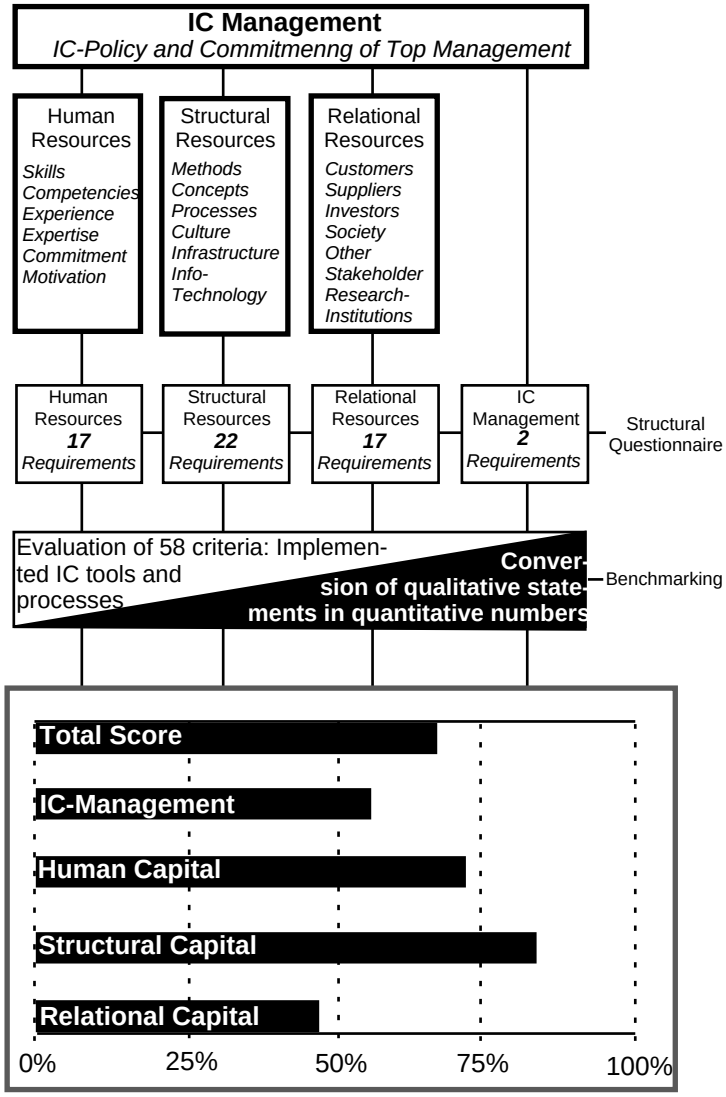
In the early nineties of last century some quality managers of multinational enterprises tried by using an indicator system, how quality can be measured and compared. They realised after short time that this doesn't works; even for homogeneous organisations, much less for comparisons of different sectors. Conclusion: For product quality is no standardised indicator metric definable. On one hand, enterprises might be forced to disclose secret manufacturing information. On the other hand it is simply not possible, that the same standard is valid for e.g. a manufacturer of tool machines and a textile producer. Realising this, the quality experts searched for an alternative approach: Not the resulting product quality (Quality output) shall be investigated, but the way to obtain quality (How to reach qualitative products) is the subject of evaluation. The result of this process was the established QMS ISO-9000.

What is fine for quality management evaluation, shall work for IC reporting too. Compared with an indicator metrics system, the subsequent described approach differs in an additional point. The findings don't result on retrospective data; they report the prospective minded initiatives of the IC management. Based on an IC management system, an assessment allows transparency, which tools and processes are implemented to treat the so-called most important resource in a sustainable manner.

Up to know it seems to be an unwritten law, that IC assessments must be performed at site, attended by a highly qualified auditor. If this is an outcome of commercial thinking or whether it is just fixed in the brains, we leave undecided. Fact is, that the majority of the comparable versatile ***Corporate Governance-, Sustainability- & Corporate Responsibility*** ratings are performed by using a structural questionnaire. This proceeding is widely accepted by the mandators and the target groups. They are persuaded, that the reporting organisations keep the honesty in their own interest, since any misleading information would be discovered sooner or later, leading to decreased reputation up to untrustworthy.

Intangibles Rating: The egg of Columbus?

IC evaluation can be performed "offside" too: Comparable to Corporate Governance- & Sustainability-Ratings the reporting form is a self-declaration, which is based on a structural questionnaire. The reporting organisation receives the questionnaire including an interpretation guideline. It is invited to respond to each of the 58 requirements, whereas the statements shall consist of three to four precise sentences. If an organisation can conclusively explain, that a specific requirement has no relevance for them, so will that requirement be excluded from the assessment. A qualified auditor evaluates the returned questionnaire. He uses a taxonomy, which allows benchmarking. The best score (100%) is reached, when all requirements are fulfilled. For each of the IC categories and for the IC management, mean values are calculated and shown in bar diagrams. Those results a verbally commented including some recommendations how to optimise the detected deficits in IC work.



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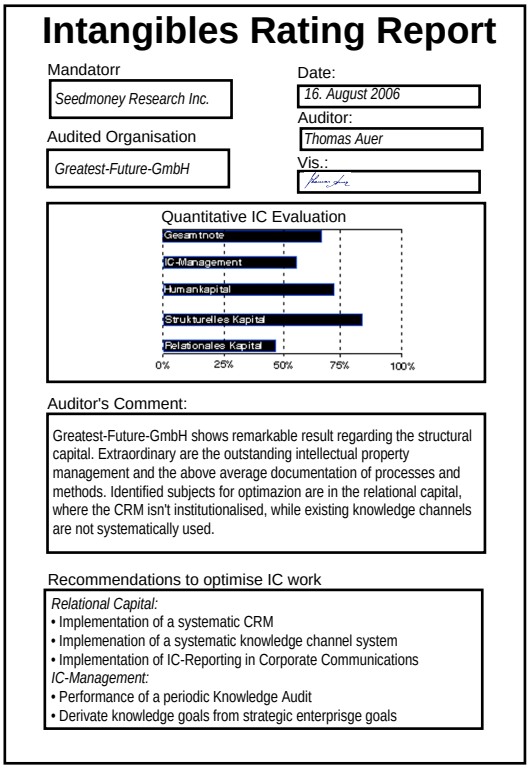
Application fields for IC-Ratings

The interest in disclosure of intellectual assets raises outside of financial markets too.

Intangibles Reports following the rules of the BMWA guidelines [3] are a first step in the right direction. But this approach didn't receive a big attention, since it doesn't deliver harmonised reports. The other extreme is the Intangibles Due Diligence [4]. It delivers harmonised reports, but is very time consuming and costly.

The IC rating model introduced in this paper goes a middle way, which offers a sufficient harmonised report at moderate costs.



Application fields	**Addressees**	**Benefits**
Evaluation Creditability	Investors	Insight in Innovation Capability
Enterprise Evaluation	Financial Analysts	Prospective Indices in Value adding Axis
Sustainability-Ratings	Sustainability Funds	Inclusion of Intangibles in Assessment
Sustainability Reports	Reporting Organisations	Addendum for socio-economic criteria
Corporate Governance Ratings	Funds manager, Supervising Boards	Transparency about Operative Implementation
Successor Processes	Enterprise-Owner & -Buyer	Prove of investments in future survival
Internal Fitness-Check	Strategic Enterprise Planning	- Detection of sub-optimal Resource Processes - Internal Benchmarking
Accounting Standards	CFO's	Fulfilment of Requirements Basle II, IFRS etc.
Recruiting	Potential Employees	Complete Information

Discussion:

The question is essential: Needs an IC evaluation to be as good as possible or is it sufficient, when it is as good as necessary? The described "Reduce-to-the-Max"-approach allows a quick procedure at low costs, delivers benchmark-capable reports and can be performed for all knowledge based organisations, regardless of their scopes and sizes. Interpretation skills – asking the right questions in context with the results – can be learned in adequate time. The limit of this approach is its exclusive positioning as a stakeholder communication tool: In contrary to the Intangibles Reports introduced so far [5], it doesn't generate indicators, which can be used as steering parameters for strategic decisions.

Literature:

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