A. C. Macris Consultants

UPDATE

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Highlights

INTELLECTUAL ASSETS

Throughout the history of UPDATE, we have presented articles and perspectives dealing with the softer side of business and organizational issues. This focus has been our forte and where we have a proven track record. Of increasing concern to leaders and managers is the return on investment (ROI) of training and professional development initiatives. Our feature article addresses this issue from a different viewpoint. Chris provides interesting insights into the value of intellectual assets and why it is important from both business and financial performance perspectives.

INSTITUTE UPDATE

New studies show leadership skills are top global HR priorities. This article summarizes a recent DDI study reported in the May 2000 issue of Training & Development magazine. The Institute is positioned to assist in meeting the challenge.

UPDATE is published quarterly by A.C. Macris Consultants. UPDATE's charter is to provide interesting articles, on timely topics, authored by people in industry, academia, or business.

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INTELLECTUAL ASSETS

by Chris Totolis

Currently the Federal Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC) are holding hearings on the proposed new rules for business combinations and intangible assets, a topic that is fast becoming a hot potato. These hearings involve the seven FASB members who questioned some forty accounting firms, universities, consultancies, and associations. Many agreed with the FASB that pooling of interests should be eliminated. A former General Electric executive stated that, "The very idea that amortization of intangibles and goodwill somehow communicates anything useful is absurd."

Others claim that if pooling of interests is eliminated, it will injure the small entrepreneurial companies fueling the knowledge based high growth economy without the countervailing benefit of enhanced financial disclosure.

"When two different accounting methods are used for what is essentially and economically the same transaction, it is confusing to investors," said FASB Chairman Edmund L. Jenkins. "We believe that the purchase method of accounting gives investors better information about the initial cost of the transaction and the acquisition's performance over time than does the pooling of interests method."

The definition of "pooling of interests" states that under the **pooling of interests method** of accounting, combined companies just add together the book values of their assets. In a pooling, an investor can't tell what price was actually paid for the companies to merge nor can they track the acquisition's subsequent performance. In contrast, under the **purchase method** of accounting, one company is identified as the buyer and records the company being acquired at the cost it actually paid. The excess of the purchase price over the fair value of the acquired company's net assets is known as goodwill. Goodwill is then charged to the company's earnings over time, but not under the Board's proposal, for more than 20 years.

Mr. Jenkins noted that the Board also considered many other issues in proposing to eliminate pooling. (For more information on this, please contact UPDATE)

A former SEC commissioner testified on behalf of a technology consortium.
The Senate Committee on Banking, Housing, and Urban Affairs announced that the full Committee would hold hearings. These hearings are currently in process.
The FASB chairman noted, "Accounting rules are based on fairness in the capital markets."

Until the FASB and the SEC, working together devise a metric to measure Intellectual Assets, convince Congress to allow and sanction such assets within the tax code, we will be buried with self-developed metrics that may or may not be valid. With Intellectual Assets accepted within the tax code, they can then be shown on the balance sheet and understood by everyone. We should strive to eliminate un-standardized metrics that require constant explanation because they are established to suit each individual organization needs. Our financial rules, regulations and accounting methodology must progress to meet the twenty-first century.

Let us take another perspective on the issue of Intellectual Assets. Recently, the subject of intangible assets has been appearing in a myriad of articles, written in financial, industrial, training, human resource, insurance, computer and internet publications just to name a few, on a consistent basis.

When it comes to measurements or metrics of intangible assets, these metrics are applied to customers, markets, processes, human factors, and knowledge or competency development. Examples of Intangible Assets, both good and bad, are listed with the associated company or incident in parenthesis:

- Knowledge management systems (General Electric)
- Brand (Coca-cola)
- Corporate culture (Microsoft)
- Customer loyalty (AOL)
- Environmental sustainability (Love canal)
- Innovation (Post it notes – 3M)
- Product management aptitude (Supply chain logistics - Dell)
- Technological sustainability (Patents - DuPont)

Clearly each authors/editors of the variety of articles written on this topic has their own definition of knowledge, brainpower, intellectual assets, technological sustainability, competitiveness, consistent improvement, informational systems, and process system assets.

Along with the variety of definitions, companies develop unlimited metrics. One company's human resource department proudly announces that they use more than one hundred metrics in measuring employees at various positions and levels. Everyone is trying to figure out a way of assigning value to either the company books or to the stock value through some metric that is explainable to security analysts. These metrics usually show a form of company value over the competition.

In the March 2000, Computerworld magazine's "Business Case Study" featured Skandia Assurance and Financial Service's system for measurement Intellectual Capital (IC). Skandia is headquartered in Stockholm Sweden, and owns 26 companies in 20 countries. They define IC as the sum of human capital (such as employee competence, relationship ability and values) and structural capital (such as software, databases, customer lists, manuals and trademarks). Skandia began reporting on IC in a supplement to its 1993 annual report.

What to Measure?
Here are some examples of IC measures from Skandia's current high-level view of its operating companies worldwide.

CUSTOMER FOCUS

- Market share (number of accounts)
- Customers lost
- Fund assets per customer
- Satisfied-customer index
- Number of contracts
- Number of fund managers
- Number of funds

RENEWAL AND DEVELOPMENT

- Competency development expense per employee
- Marketing expense as a percentage of managed assets
- Marketing expense per customer
- IT spending
- Training expense per employee
- Premium from new launches
- Increase in net premium

HUMAN FOCUS

- Employee turnover
- Average years of service
- Gender
- Age
- Education
- Number of women in management

PROCESS

- Outpayment processing time
- Percentage of applications filed without error
- PC's per employee
- Laptops per employee
- Administrative expense per employee
- IT expense per employee
- Contracts per employee
- Processing time on contracts
- Empowerment index
- Change in company's IT literacy

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INSTITUTE FOR LEADERSHIP & MANAGEMENT UPDATE

A recent study conducted by Development Dimensions International (DDI), and reported in the May 2000 issue of Training and Development magazine, indicates that Leadership development is the number one global Human Resources priority. "Many organizations and their leaders believe they do not have the necessary leadership capabilities." Further the article states that "The gap between current leadership skills and those that will be needed in the future is becoming increasingly apparent." In the global context the article continues, explaining that global companies face an added burden in dealing with this leadership crisis. "Not only do they require leaders with solid leadership abilities, but they also need leaders who can manage within a variety of geographical locations while trying to build a common corporate culture."

The top Global HR Priorities are reported as follows:

Leadership development	**47%**
Performance management	**45%**
Recruiting high quality employees	**42%**
Employee retention	**33%**
Building strong organizational values and corporate culture	**33%**

For these very reasons we forge forward with the Institute for Leadership and Management. Since our Millennium issue of UPDATE, when we introduced the Institute for Leadership and Management, we have made steady progress. We have completed our first public engagement, demonstrating various team-building activities that can be used for executive conferences.

In addition, we are focusing on establishing the charter membership of our Advisory Council. The mission of the Institute is to create a forum for exploring and engaging, through dialogue, real world leadership and management issues, challenges and solutions. We will include the finalized advisory membership list in our next issue.
The Institute is grounded in dialogue. It is based on the expression of ideas based on experience, and the learning community that is developed from the sharing and listening around these ideas.

Our team of professionals brings a different kind of expertise to the experience of working with individuals and groups from corporate and non-profit organizations. We welcome the chance to speak with you about your challenges and discuss how we can support you in meeting these challenges.

Are you confronted with issues such as:
Technical teams that have never had the opportunity to really talk with each other, to discuss their current communication patterns?

Managers and staff who feel isolated from the decision making processes that occur at the upper levels of your organization?

Groups or teams that are so busy with day-to-day details and demands that they never have time to deal with the people issues of their organization?

Corporate goals and mission statements that are known by many, but, in reality, are not reflected in the daily operations of your company?

The Institute for Leadership and Management exists to assist you in sorting through these challenges both developing and implementing proactive initiatives to yield positive outcomes. We bring together people from multiple and diverse companies, who have a desire to work together for a common focus of learning.

We welcome the opportunity to discuss any of these questions and more with you.
Please contact us!

Recommended Reading

The following book is worth including in your professional library: *The Five Tempations of a CEO*, by Patrick Lencioni, published by Jossey-Bass,
ISBN # 0-7879-4433-5.

Realistically, if one were to study the consistently leading corporations that excel in both book value increases and stock value performance, one would find that these leaders allocate a higher percentage of dollars to training in their budgets than their competitors. In addition, they also have their own training centers and a formalized program for executive development. The programs include rotation through various departments and/or facilities performing a variety of assignments. Constant evaluation of these employees on the "fast track" coupled with associative outside schooling is mandatory.

One cannot become valuable to the organization working in a vacuum. The trainee must be able to see the "big picture," meaning all the inter- and intra-relationships of the business. The intention of these programs is to not develop employees with ten years of seniority within the organization with only one years experience repeated ten times.

With the above training, intellectual assets can be developed by designing a metric for adding value (through training) along with superior performance of difficult responsibilities. Conversely, the newly developed metric should be depreciated at times of poor performance.

If we continue as present, self-developed metrics will continue to increase, adding more confusion to corporate asset analysis and eliminating the ability to compare apples with apples in similar industries.

Perhaps two-way employment contracts should be developed so that executive talent, on the books, can be traded for dollars, similar to professional athletes.
In this manner, the book value can be tested and adjusted, when necessary, to a realistic figure. This is not anathema to the current day mobile executive who is used to transfers.

Since the above scenario may never be resolved, at least not to everyone's satisfaction, corporate strategy should include a formalized internal and external training program for employee development. These programs add "knowledge value" and prevent the obsolescence of its employees, and the corporation itself, regardless of what the corporate books show.

Chris Totolis is the Northeast Operations Manager for Unidyne Corporation, a subsidiary of the Titan Corporation. These companies are large defense services organizations. Prior to Unidyne, Chris worked for a prestigious management-consulting firm headquartered in New York City. For close to 20 years he was President and CEO of Photronics, Inc., manufacturing solid-state circuit boards.