On the Importance of Managing Intangible Assets as Part of Corporate Strategy

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Abstract: Given that a high number of companies return value to investors via acquisition rather than a public offering the development of intangible assets is the bait that sets up the acquisition. This paper discusses how companies can fast track to high valuation by strategic growth of certain intangible assets such as customer tribes, brands, and intellectual property, comparing those strategies to larger companies. It further describes a strategic planning methodology using four asset categories (Market, Infrastructure, Human Centred and Intellectual property) to describe the enterprise as it *would be if it had* achieved its strategic goals. This state is referred to as the "Dream". The Dream is characterised by a set of affirmations describing the "health" of the enterprise's assets. This is called a "Dream Ticket".

Keywords: intellectual capital, SMEs, IC methodology, strategic business planning

1. Introduction

Strategic planning can be described as the process of determining what a business should become and how it should go about achieving its goals whilst capitalising on its opportunities and addressing its challenges. For management teams this can be a real challenge, especially if the strategic goal is couched solely in terms of revenue. For SMEs this is likely to be the case as the number one priority may well be just to stay afloat in very difficult times.

For small companies defining corporate strategy can be a challenge, especially where they have limited access to business mentors or consultants that can assist in facilitating the process, so the CEO typically sets the scene by stating where the company needs to be in one or more years time by way of a mission statement that encapsulates values, vision and purpose. As such it's a "what we will do" type statement that may mean a lot to the management team that brainstormed it but hard for employees who did not participate in the process to grasp or believe in. In the same way as a book title may not convey the story to the reader until after the story has been read, a mission statement may not convey the strategy until the story can been shared.

The Dream Ticket method enables management to share the story with employees.

Entrepreneurs start companies by bootstrapping or raising angel or venture capital. The high technology sector typically takes both angel and venture capital as there is usually a time to market issue when the company will be in research and development mode and will not be generating revenue. Given most VC funds seek to realise a return on investment that requires an exit in less than ten years it doesn't leave the entrepreneur much time to create an enterprise of value. This situation is exacerbated when there are several years of development ahead before product is ready for market. Ironically the more revolutionary or disruptive the technology, the longer the time to mass market share shortening the time to grab it. Further, given exit is a requirement for investors, the challenge facing the management team and Board is how to get the highest valuation at exit in the time available.

As high technology companies tend to manifest value by way of intangible assets it makes sense to develop a corporate strategy that grows and develops them. The challenge is to figure out what assets to develop and how to do it for maximum value.

The Dream Ticket method acts as the mechanism to do this.

2. The Dream Ticket methodology

There are four sets of assets that are used to build a Dream Ticket:

1. Market Assets, these are assets which belong to the company and give it power in the marketplace. They include brands, positioning, customer base, company name, backlog, distribution channels, collaborations, franchise agreements, licensing agreements, favorable contracts and so on.

ISSN 1479-4411 217 ©Academic Conferences Ltd

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- 2. Infrastructure Assets, these are assets which include management philosophy, corporate culture, management and business processes, compliance to standards such as FDA, financial relations, methodologies and IT systems which enable the organization to function and communicate with its customers. Examples include methodologies for assessing risk, methods of managing a sales force, financial structure, databases of information on the market or customers, communication systems such as e-mail and teleconferencing systems. Also included is the financial status of the business, whether it is stable or at risk, wealthy or constantly seeking funding. Basically infrastructure assets are the elements which make up the way the organization works. These assets belong to the company, and make the company operationally strong.
- 3. Intellectual Property Assets are assets resulting from the mind that belong to the company and are protectable in law. These include patents, copyright, design rights, trade secrets, and trademarks.
- 4. Human Centred Assets include the collective expertise, creative, problem solving capability, leadership, entrepreneurial and managerial skills embodied by the employees in the organization. Key is knowledge of aspects of the business to include market knowledge and management expertise. Human Centered Assets also include psychometric indicators on how individuals may perform in given situations, such as in a team or under stress. These assets do not belong to the company but are contracted to the company by way of employee contracts, unless they can be made explicit, thus becoming Infrastructure assets (Brooking, A. 1998)

Thus market, infrastructure and intellectual property assets can be bought and sold, human centred assets can't.

These four categories of assets are used to develop a Dream Ticket that describes the business as it would be if it had already achieved its strategic goal.

For example if the goal of the business was to double its revenue to Euros 10 million this may require a more favourable relationship with its target customers than it had today.

3. Case study: Company X

Take as an example a 30 person company (X) that manufactured facial scanning systems that assessed the photo damage in a woman's skin and estimated her skin age. If she was a sun worshipper or had excessively used sun beds and tanning salons a 30 year old woman's skin age might be calculated as 35 and a woman of the same age who had always used sun block might be assessed as having the skin age of 25. The target market is spas and salons who charge the client £50 for a skin age consultation.

For company X a desirable set of market assets that may enable them to double revenues could be:

- M1. Every customer who buys from us recommends us to three of their peers.
- M2. Every salon or spa who buys from us buys a second system in less than two years.
- M3. Every prospect we have in the UK recognises our brand.
- M4. Every woman over the age of 30 has a skin consultation twice a year.
- M4. All salons and spas retain 100% of their customers.
- M5. Every UK health magazine has an article on skin scanning four times a year.
- M6. There is a stable of celebrity key opinion leaders who are followed by women aged 30.
- M7. Doctors and medical practitioners recommend tracking photo damage as part of a woman's health regimen.
- M8. Company X takes 20 phone queries a day from prospects concerning its facial scanner.
- M9. The salon and spa business is growing by 20% per annum

Each of the affirmations above translates or contributes towards an intangible market asset.

- M1. Refers to a set of evangelists
- M2. Is repeat business
- M3 and M5. Refer to brand recognition

- M4. Refers to product ROI
- M6 and M7 Will contribute to market pull
- M8 Is market pull
- M9 Shows the market is expanding not retracting, reflecting a business opportunity.

For company *X* if the above affirmations were all true it could be said that the business was in a favourable position to double its revenue.

Below are outlined intellectual property assets for Company X.

- IP1. The facial scanner is protected by a thicket of 5 patents.
- IP2. The brand name of the facial scanner is trademarked in all target markets.
- IP3. The patent portfolio is managed and measured for ROI every year.
- IP4.'All software is patented

This set of assets would mean that the scanner would be have a strong competitive position from a technology perspective. With respect to human centred assets the following set would be desirable given the company wanted to double revenues.

- H1. Every employee knows how to take a customer guery and follow through
- H2. Every employee understands the scanner technology and can explain its USPs
- H3. All sales executives have deep product knowledge
- H4. The marketing team are all intimate with the target market sector
- H5. The company has a high staff retention rate
- H6. All customer training staff have previously worked in salons or spas
- H7. All knowledge relating to the manufacturing process is documented.

Human centred assets H1, H2, H3, H4 and H6 all demonstrate that staff is fit for purpose. H5 means the company probably has content employees and H7 means that tacit and explicit knowledge are documented for this task, this is desirable for a potential acquirer..

Finally with respect to infrastructure assets the following would be desirable:

- I1. All products have FDA approval
- I2. All products are CE marked
- I3. All customers are correctly recorded in a database for customer support
- I4. Customer supports sells support contracts to all customers
- I5. Quality manuals are updated and reviewed monthly
- I6. All prospects are tracked in a sales tracking system

The above affirmations relate to the strength of the infrastructure of a company intent on increasing sales by use of internal systems. FDA approval is a major asset for any company wanting to branch out in the USA and having clean databases is an important asset for any company wanting to both increase sales and harvest incremental revenues from the sale of support contracts to customers.

The four sets of affirmations make up the Dream Ticket for company X. It's easy to share this with employees who are then able to visualise where the business needs to go to achieve its goal. They understand the story. The next step is to measure the gap between where the business is now and the Dream Ticket.

An index is assigned to each affirmation reflecting its relative strength, 5 being strong and 0 weak. The business creates methods for measuring each asset's index. Customer surveys, percentage through a process such as CE marketing, staff questionnaires for competence, auditing databases or getting staff such as telesales and customer support to validate and clean databases are a few measures that are typically used.

In using this method for over ten years in numerous high technology businesses estimates by the management team have proven to be just as accurate as in-depth analysis, survey and measurement (which can take a team months to complete) especially in small technology companies where the staff

tends to be both smart and insightful. The benefit of this is that the Dream Ticket can be brainstormed by the management team and indexed in the same session. Once the assets are indexed they can be plotted on a target. If the asset is strong it will have an index of five and be at the centre. If it is weak it will have a zero value and be at the outer edge of the target.

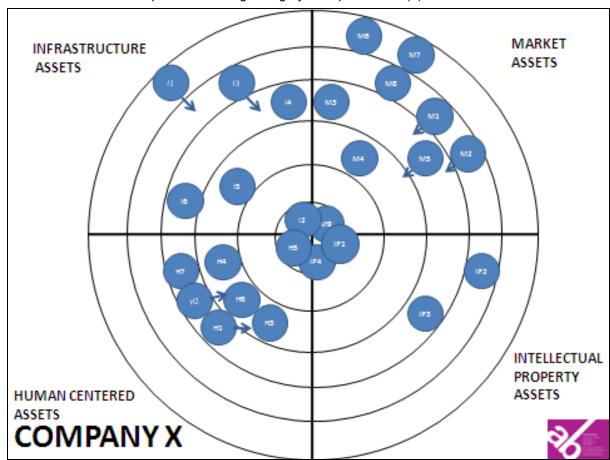
Dream Ticket for Company X with Index (5 is strong)	
index/5	
M1. Every customer who buys from us recommends to us three of their peers. 1+	
M2. Every customer who buys from us buys a second system in under two years. 1+	
M3. Every prospect we have in the UK recognises our brand.	2
M4. Every woman over the age of 30 has a skin consultation twice a year.	2
M4. All spas retain 100% of their customers.	3
M5. Every health magazine has an article on skin scanning four times a year. 2+	
M6. There is a stable of celebrity key opinion leaders who are followed by women aged 30	0
M7. Doctors and medical practitioners recommend tracking photo damage as part of a	0
woman's health regimen.	
M8. Company X takes 20 phone queries a day from prospects concerning its facial scanner.	1
M9. The salon and spa business is growing by 20% per annum	5
IP1. The facial scanner is protected by a thicket of 5 patents.	5
IP2. The brand name of the facial scanner is trademarked in all target markets.	1
IP3. The patent portfolio is managed and measured for ROI every year.	2
IP4. All software is patented	5
H1. Every employee knows how to take a customer query and follow through 2+	
H2. Every employee understands the scanner technology and can explain its USPs 3+	
H3. All sales executives have deep product knowledge	4
H4. The marketing team are all intimate with the target market sector	4
H5. The company has a high staff retention rate	5
H6. All customer training staff have worked in salons or spas	4
H7. All knowledge relating to the manufacturing process is documented.	2
I1. All products have FDA approval 0+	
I2. All products are CE marked	5
I3. All customers are correctly recorded in a database for customer support 2+	
I4. Customer supports sells support contracts to all customers	2
I5. Quality manuals are updated and reviewed monthly	3
I6. All prospects are tracked in a sales tracking system	2

At this stage it may be useful to note the assets direction of travel. If the asset is getting stronger, that is measures are underway to strengthen it, its arrow points toward the centre of the target, if it's getting weaker the arrow points to the outside of the target as shown in Figure 1.

Assets moving away from the target are not always a bad thing. In young companies they typically show something wrong with the business. In more mature companies they may show a change in strategy where perhaps a particular asset is no longer considered to be of value, or a patent has been in place for 18 years and has only two years of its life left. However the position of all assets on the target will be relative to the goal and also to the context of the business at the time.

This pictorial representation tells us a lot about the Company X. We can see that it has a number of assets in the middle of the target:

- I2. All products are CE marked (5)
- H5. The company has a high staff retention rate (5)
- IP1. The facial scanner is protected by a thicket of 5 patents (5)
- IP4. All software is patented (5)



M9. The salon and spa business is growing by 20% per annum (5)

Figure 1: Direction of travel of assets

From a strategic planning perspective this is good, and especially good as this company is small and early stage. Its target market is growing, it has taken care to file intellectual property and high staff retention tells us the company is stable from a critical knowledge function perspective. This is what we would expect to find in a high technology start-up. The issue for Company X is to build its strength in the market and fix its infrastructure so that it was able to both target and support its customers generating both loyalty and revenue.

The asset M1 tells us that the company seeks to grow through referral, creating a tribe from its customer base and this is a good strategic move for a company that is resource constrained. M6 and M7 tell us that the business thinks that it understands who the key influencers in its target market are; the issue now is how to make these assets strong so the Dream Ticket becomes a reality.

Once the target has been populated the next step is to design measures that will close the gap and move the assets toward the centre of the target as quickly as possible. In this particular Dream Ticket there are twenty six assets. This is quite a low number, as this business scenario is only looking at one product and one distribution channel in one country. When this business went global and included a full product range it had close to sixty assets it was managing. Designing sixty measures to grow sixty assets is too complex so assets need to be grouped and prioritised so that "super" measures can be designed to strengthen the Dream Ticket as a whole. In this particular scenario measures might include a KOL generation and management programme, or partnering with a medical organisation that would verify that increased photo aging is linked with other diseases like skin cancer. An example of grouping assets is shown in Figure 2.

4. Asset grouping

This company is a biotechnology company that was seeking to generate revenue by licensing intellectual property. The patent portfolio is quite strong with the exception of one weak patent that can be viewed (IP7). However the key weakness here is the lack of staff with appropriate expertise

and this can be seen from the number of human centred assets that remain on the outside of the target. Early stage high technology companies cannot afford to have either weak intellectual property or weak human centred assets. The cross target linking of human centred assets and infrastructure assets tells us the wrong people are in place to set up the infrastructures that are required. So people will need to be trained or replaced. The mix of market assets here: four strong the other seven weak is in fact because whilst there is a market for the service this company wishes to offer it has neither the market presence, infrastructure nor people to grab it.

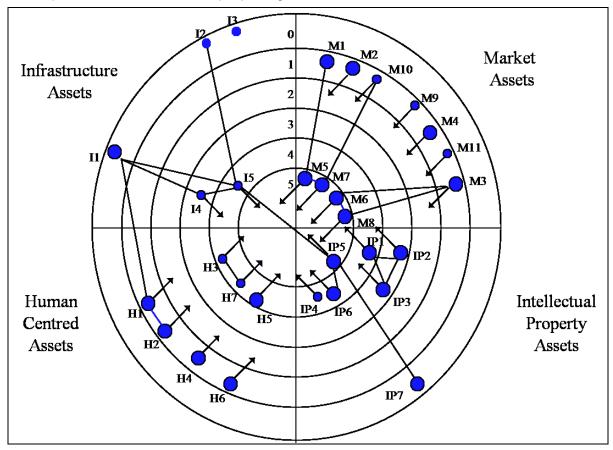


Figure 2: Asset coupling

Once the measures have been designed to strengthen the assets their cost can be estimated and a budget drawn up. The measures become part of the tactical and timelines planned. If the business does not have the finance to fund the plan then either less expensive measures can be designed or a less ambitious goal agreed. Should that be the case the Dream Ticket may need to be redesigned completely or in part, and re-indexed. It is likely that some assets will change their relative strength if a less ambitious goal is chosen, for example the business may be in a stronger position to increase revenues by 50% rather than doubling them.

Intangible assets have been shown to be the major driver for acquisition of high technology businesses. Sometimes this manifests as an intellectual property portfolio of patents, trademarks and design rights. Sometimes it's access to market via a distribution channel or a network of KOLs that an acquiring organisation can leverage for their own product range.

One thing is certainly clear to this author, if exit is to be by acquisition the value of assets changes depending upon the goals of the acquirer. Different context, different value, and for that reason research to put a monetary value on individual assets has ceased as it is impossible to predict who will acquire the business. The alternative strategy is to build a strong business composed of strong intangible assets in the hope that there is an acquirer who will consider the entire package valuable rather than just the intellectual property portfolio or the customer base.

That said, building a Dream Ticket that describes the business as it will be in two or three years time gives the business the opportunity to build a profile of potential acquirers for the business as a whole

or in part. This also opens up the opportunity to sell the business "many times over" by transferring ownership of intangibles to a holding company and licensing them all or in part to various subsidiaries then selling them off one at a time, in parallel building a valuable holding company that has a royalty stream from licensing, and consulting revenues using critical knowledge skills only found in the holding company, all of which are also intangible assets.

This is a much more pro-active strategy with intangible assets that sets out from day one to plan for value and exit.

5. Conclusion

In a knowledge based economy, where the growth of high technology companies is the business trend that delivers highest returns to investors, building valuable intangible assets is the corporate strategy.

The Dream Ticket method allows the management team to describe and build a Dream scenario that is easy to understand and communicate to all employees and stakeholders in the business to both achieve its corporate goals and in parallel build and position a company of high value for potential acquisition.

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