Do Intangibles Matter?

By Jennifer Pellet

l: to r: Al Altomari, Eric Mosley

In the new economy, value isn't where it once was. Solid, quantifiable assets like plants, equipment and inventory are now often far less indicative of a company's value than intangibles like ideas, relationships and expertise. For companies like Microsoft, Google and eBay, those "soft" assets are what will determine future earnings-and, as such, can represent as much as 80 percent of total market value. Yet, because intangibles by nature defy quantification, they're rarely managed by businesses with the same integrated, ROI-centric management philosophy traditionally applied to physical assets.

Bob Donnelly

In fact, only one-third of executives polled in a 2004 survey conducted for Deloitte Touche Tohmatsu by the Economist Intelligence Unit claimed that their companies were proficient at monitoring critical non-financial indicators of corporate performance, let alone managing them effectively. Instead, management and boards have tended to focus their energy on budgets and operational performance, taking the value of intangibles like intellectual property, brands, customer relationships and human knowledge and talent for granted.

But that focus is shifting. Increasingly, companies are recognizing that in the drive for growth amid turbulent economic conditions, intangibles may be hidden gold, pointed out CEOs gathered for a recent roundtable discussion. (See p. 59 for a "mental map" of intangibles that can be leveraged to drive growth.)

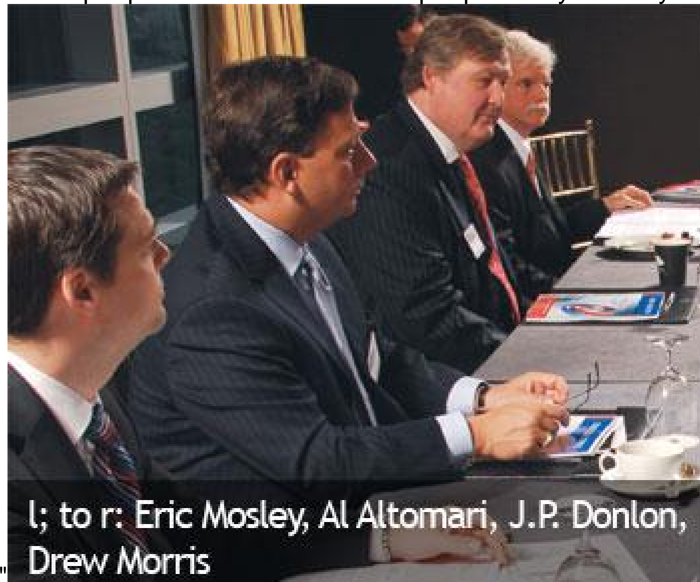
"In 1990, IBM's global licensing revenues were $30 million," points out Drew Morris, CEO of Great Numbers! LLC. "By 2003, that had grown-basically just by deciding to do it-to $1 billion. That's a 3,200 percent increase." In short, IBM turned soft assets-a bunch of patents not being used-into a revenue-producing licensing business.

Profit from Patents

l: to r: Ed Kopko, Lyndon Faulkner

The specialty pharmaceutical company Barrier Therapeutics was founded on similar intangible assets. A spinout of Johnson & Johnson, Barrier "started life as an adolescent" thanks to unused patents it licensed from J&J, recounts CEO Al Altomari, a former J&J executive. "We said, ��If you give us rights to these patents sitting on your shelf that you're never going to monetize, we think we can put enough of a value proposition together to build a company,'" he says. "We have no assets other than our people and our IP. We're running a pharmaceutical company without owning a warehouse, a plant or a lab."

But even Barrier-where it was always clear that intangible assets would be the primary driver of growth-initially overlooked the value of some of its soft assets, adds Altomari. "Initially, our patents represented 90 percent of the value of our company," he says. "Now I would say it's 50 percent patents, 50 percent people. I've learned that the people in my industry are just as critical to the value creation."


l; to r: Eric Mosley, Al Altomari, J.P. Donlon, Drew Morris

Of the 30 core people involved in Barrier's early days, Altomari estimates that 25 hailed from J&J. He pegs their average age as 55. That translates to bringing a boatload of Big Pharma experience-and invaluable industry relationships-to the company's launch. "We have someone on our staff who's been dealing with the FDA for many more years than she will let me say in public," he says, crediting that experience in part for the company's smooth relationship with its industry

regulator. "Our [relatively small] company had 2 of only 32 [New Drug Approvals] granted by the FDA in 2006."

People Power

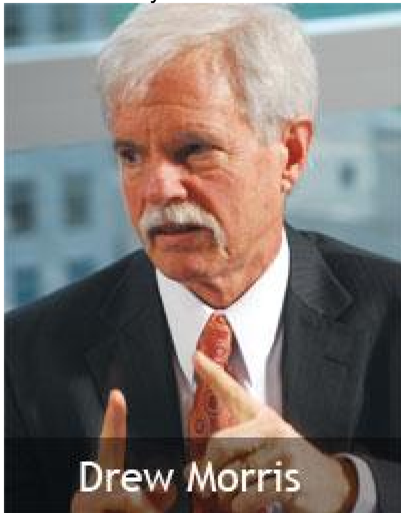
Leigh Abrams

Human capital-and the ability to mine that capital-is widely recognized as one of the more powerful intangible assets. Yet many companies struggle to find ways to maximize the ROI on their investment in talent, agree CEOs. "It's not just about having the people," notes Lyndon Faulkner, CEO of Pelican Products. "It's creating an environment where those people can flourish doing what they're doing."

A work force engaged in a company's mission-one with passion-can impact competitive positioning at virtually every level: from boosting productivity and strengthening customer relationships to controlling costs. "We've all been in meetings where there's a deadline tomorrow, and if someone works a bit later that night, we'll meet the deadline-and if they don't, we won't," notes Eric Mosley, CEO of Globoforce. "It's that discretionary effort that drives a company forward."

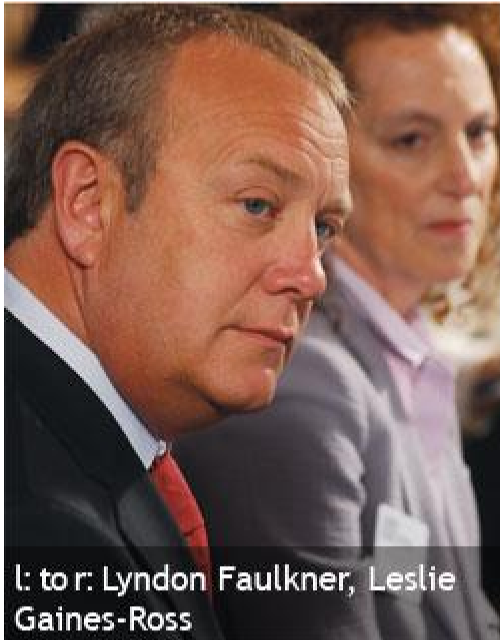
Most companies rely on incentive compensation to drive employee engagement. At Heartland Payment Systems, CEO Robert Carr recounts cutting a deal with employees who were being paid $10.50 an hour. "I said, ��We'll increase the pay here by 50 percent if we can get more out of the organization with an equivalent amount of spend,'" he says. "Today we're three times the size that we were, turnover is down, we have the best service we've ever had, and that's all become part of our culture. Our employees don't tolerate people who aren't doing a good job

because they’ve seen the benefits of their productivity increasing."



Leigh Abrams, CEO of Drew Industries, reports achieving similar success with a bonus program and profit pool that makes his employees the highest paid in their industry. A factory manager at Drew Industries can earn up to 50 percent of his annual salary in quarterly bonuses if he hits certain targets and receive another year-end bonus based on the size of the profit pool. "We never miss a deadline he says. "Because every single manager in our company knows that his year-end bonus and his quarterly bonuses are based on making those goals."

Better still, managers and employees down the line are so invested in the profitability of the company that they take a proactive stance on keeping costs in line with revenues. When the manufactured housing sector they play in went into a decline-volume dropped by 75 percent between 1998 and 2007-Drew Industries’ numbers didn’t track the drop. "Last year, our sales were down about 8 percent but our profits were up 28 percent," says Abrams. "I didn’t have to do anything. People said, ��Business is down, we’ve got to cut overhead,’ and they cut $28 million."


l: to r: Lyndon Faulkner, Leslie Gaines-Ross

While most companies have incentive programs, not all incentive programs are effective, cautions Mosley. "We advise companies to lower the amount of the cash value of their incentive rewards and increase both the percentage of employees receiving them and the frequency at which they're distributed," he says. "Every time people are given an award they're reminded about the value of the company. So if you're touching only 15 percent of the workforce once a year rather than 80 percent quarterly, you've lost a real opportunity."

To be effective, bonuses must also be firmly tied to performance. "Otherwise," notes Carr, "it's called an incentive plan, but everyone considers it their base pay."

Relationship Revenue

Robert Donnelly, CEO of Compact, sees customer relationships as his company's biggest intangible asset. "This is a battle for the customer's mind," he asserts. "Our goal is to own the plant engineer, and the way we do that is by convincing that engineer that we're able to help them engineer a solution to whatever problems they have."

For many companies, the value of customer relationships and brand go hand-in-hand. For example, Pelican Products, which makes protective cases primarily for the military, enjoys a reputation in its industry for unparalleled quality.

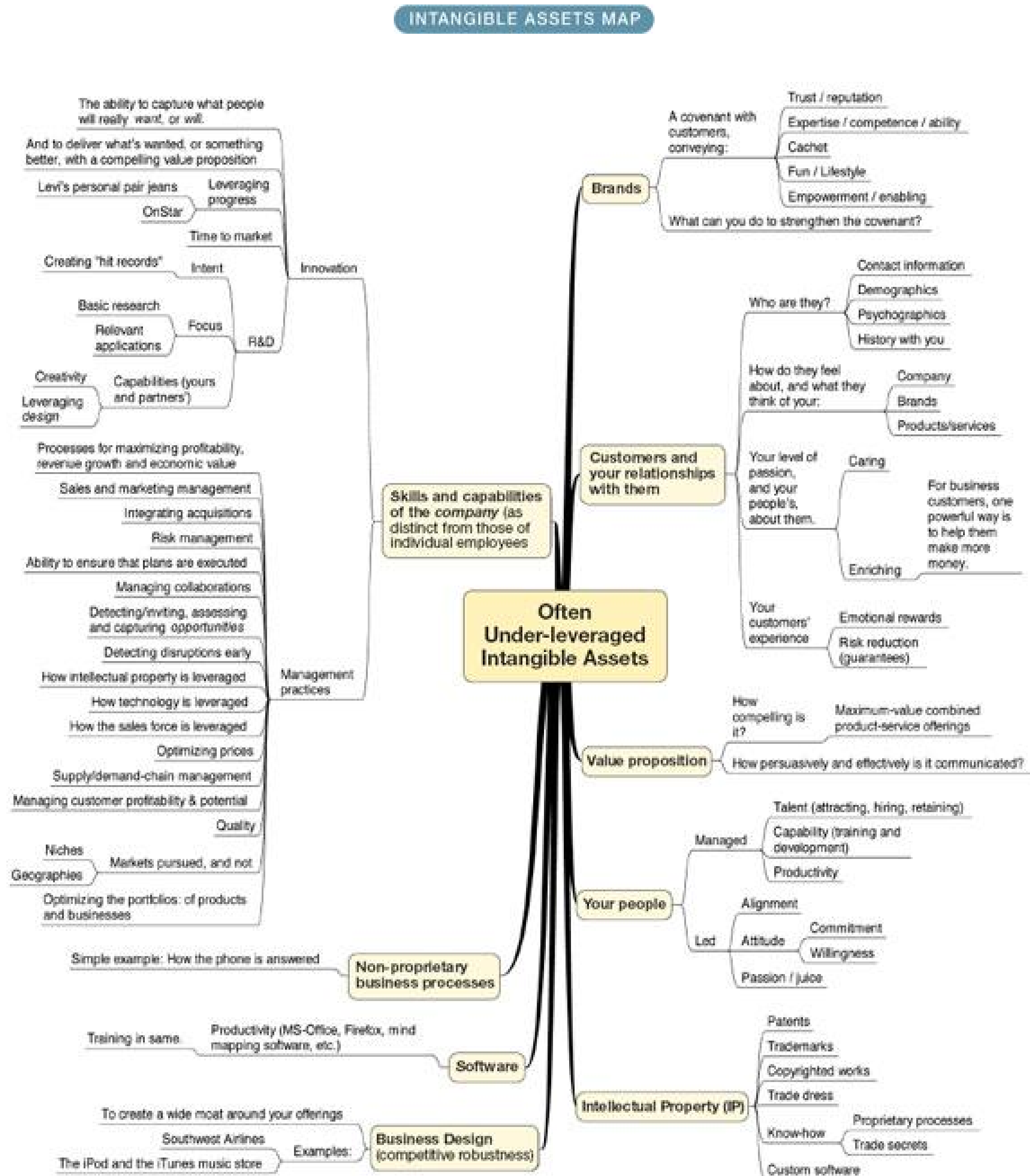
A company's reputation hinges on many factors, from product and service quality to the credibility

of m   anagement and leadership, agrees Leslie Gaines-Ross, chief reputation strategist at Weber Shandwick (See sidebar, p.60). "You really understand the power of reputation as an intangible when you lose it," she points out. "What happened to Bear Sterns stock price is a good example. Unfortunately, the downside is a way to measure the importance of intangibles."

While overall reputation can be difficult to measure, there are ways to quantify the value of a brand. "One is called excess earnings, where you base the value on how much more of a return you're getting than you would with an unbranded product," says Morris. "Another is relief from royalty, where you model what you would have to pay as a royalty to use the brand if someone else were to own it." Neither is an exact science, which is the case with most intangible asset

valuations-and at the root of why companies often fail to recognize that value, much less maximize it.

"Our job as CEO, is basically to go find the higher results inherent in the business that are latent," notes Morris. "Pick a few you think are promising and measure as you go. It's one of the more exciting and rewarding adventures you can have as a leader."



"Getting more out of these intangible assets can be the most powerful way to boost results. For examples of that power and how executives have tapped it, visit http://www.greatnumbers.com/IntangibleAssetsRoundtable.cfm

The Hidden Wealth of a Good Reputation

Reputation is increasingly recognized as a vital intangible asset and proven wealth generator. Total shareholder returns for the top 50 world's most admired company all-stars greatly exceed those of the S&P 500 over one-, three-, five- and 10-year periods (Hay- Group). The value of a good reputation continues to grow largely because of the competitive advantage and market differentiation it delivers-higher sales generated by satisfied customers and their referrals; relationships with the right strategic and business partners; ability to attract, develop and retain the best talent; benefit of the doubt by stakeholders if crisis strikes; spread of positive word of mouth; potential to raise capital and share price; and in some cases, the option to charge premium prices. Also, in an age of regulatory watchdogs, a positive reputation can improve relationships with government officials and regulators.

According to Weber Shandwick's Safeguarding Reputation™ with KRC Research, global business influencers estimate that a significant 63 percent of a company's market value is attributable to reputation. Because reputation is so widely recognized as a distinctive intangible asset and critical factor in how companies are valued today, the consequences of a damaged reputation run far and deep. Without a doubt, the convergence of globalization, instantaneous news and online citizen journalism magnifies any corporate wrongdoing or other misstep. Barely a day goes by without some company facing new assaults to its reputation. Weber Shandwick's "stumble rate" reveals that over the past five years three-quarters (79 percent) of the world's number-one most admired companies lost their crowns in their respective industries.

Reputation recovery is a hard-won battle. Not only are reputation failures perceived to be escalating-a majority of global business executives believe that it is harder to recover from reputation failure than it is to build and maintain reputation. The process is neither easy nor short-term. Reputation recovery takes approximately three and one-half years. This figure squares with former Chairman and CEO Lou Gerstner's assessment of IBM's reputation recovery that began in 1993: "By 1997, we'd declare the IBM turnaround complete." When compared to a race, reputation recovery is often more like a marathon than a sprint. Unfortunately there is no completion date.

The sheer number and severity of corporate falls from grace in the last few years have magnified the need for a viable framework for the repair and recovery of damaged company reputations. Every organization deserves the opportunity to redeem itself and in many cases,

second-act performances can surpass the first. Knowing how to build a reputation may no longer be enough. The greatest intangible asset of them all may be knowing how to protect and restore a good name.

WHO'S WHO

Leigh J. Abrams is president, CEO and director of Drew Industries, a manufacturer and marketer of recreational vehicles based in White Plains, N.Y.

Al Altomari is CEO and director of Barrier Therapeutics, a specialty pharmaceutical company based in Princeton, N.J.

Robert O. Carr is chairman and CEO of Heartland Payment Systems, a payment processing company based in Princeton, N.J.

Robert M. Donnelly is CEO of Compact, a process controls solution provider based in Paramus, N.J.

J. P. Donlon is editor-in-chief of *Chief Executive* Magazine, based in New York City.

Lyndon Faulkner is president and CEO of Pelican Products, a marketing and manufacturing firm based in Torrance, Calif.

Leslie Gaines-Ross is chief reputation strategist of Weber Shandwick, a public relations firm based in New York City.

Edward M. Kopko is chairman, president and CEO of Butler International based in Ft. Lauderdale, Fla., and chairman, CEO and publisher of *Chief Executive* Magazine.

Drew Morris is CEO of Great Numbers! LLC, a management consulting company based in Red Bank, N.J.

Eric Mosley is CEO of Globoforce, a provider of strategic recognition platforms based in Southborough, Mass.