

Intangible Assets: The Art of Creating Value



Juergen H. Daum

The success of companies no longer depends upon production facilities, financial capital, and ownership, but more and more upon immaterial values, known as intangible assets. Such assets include not only relationships with business partners, brand awareness and new business ideas, but also know-how, corporate culture, and the ability to innovate. Today, identifying, valuing and managing immaterial assets is becoming increasingly important for companies. How can companies recognize and use the potential offered by intangible assets? In a conversation with sapinfo.net, Juergen H. Daum¹ explains the function of intangible assets in enterprise management.

- *Despite the increasing importance of intangible assets for companies, too little attention is given to these values in practice and in economic theory. Why?*

Daum: You're right. The importance of intangible assets, the immaterial value of companies, has greatly increased – especially in the last decade. One clear indication of the trend is that the portion of a company's total market value that exceeds its book value has increased from 40 percent of in the early 1980s to over 80 percent at the end of the 1990s. That means today only 20 percent of a company's market value is reflected in its accounting system. For knowledge-based companies, such as SAP, it is often under 10 percent. And that's exactly the problem: accounting, controlling, and management instruments have not kept pace with the economic realities of the last few decades. The largest portion of companies' economic activities, with which they create value for stockholders and stakeholders, is no longer captured systematically. Accordingly, it is not transparent internally or externally, so its importance can easily be overlooked.

- *What preconditions must be in place for immaterial values to attract the attention they deserve and be used more advantageously for the success of a company?*

Daum: Intangible assets have to find a place in accounting, controlling, management reporting and external corporate communication. These disciplines must expand their systems so that they truly represent economic reality. We're at the beginning of a new economic age, in which the industrial activities of a company create value, but no longer create added value. Our service-oriented and knowledge-based economy creates added value, that is returns beyond the costs of capital, primarily through innovative work in strategic management, product and market development, and by creating unique relationships with customers, business partners, and other stakeholders, such as employees. At the beginning of the 20th century, industrial mass production served as the motor to generate value; this required more complex cost accounting, beyond the abilities of previous accounting practices, to enable management to control and optimize these new value creation processes. In the same way, we must now expand accounting and controlling systems to a new level, to enable companies to optimize, manage and report on today's new value creating activities and processes.

- *How can accounting be improved to provide the information required for the use and optimization of intangible assets?*

Daum: The value of intangible assets comes into existence and develops only in a concrete context. Investments in human resources, such as training, generate financial value through

lower costs or higher revenues only when they are combined with other factors, such as improved business processes and the availability of the right information systems. You really have to look at the entire system that generates added value, because it's the context that creates intangible value and more important, allows the effective exploitation of available intangible assets. Only a consideration of the entire system enables you to decide if, for example, you can post investments in product development as assets in accounting. Baruch Lev, an expert in accounting for intangible assets and a professor at the Stern School of Business of New York University, recommends that you capitalize such expenditures as soon as you have information confirming that they lead to positive and secured economic results. But you can do so only when in the framework of the product development process information on marketing and customer relationship processes can be accessed, analyzed, and verified with tests as early as possible. Accordingly, accounting must become more closely geared to these new value creation processes, just like classic industrial cost accounting is closely linked to production processes.

- *How do you have to set up controlling and management systems to enable managers to optimize value creation based upon intangible assets?*

Daum: As a controlling instrument, an information system is needed which provides a holistic, but nonetheless concentrated view on all the areas critical to the success of a company today: the successful implementation of a new strategy, the status of the product development pipeline and time to market of new products, and performance in operations and in management of basic resources, such as human resources, financial capital, or, more important, intellectual property, such as patents. I call such a system of key performance indicators a *tableau de bord* in my book. This system allows systematic monitoring of performance and risk in the company's overall value creation system and is an important building block for the management system. In addition, companies need management processes that permit quick and efficient exchange of knowledge between individual managers to ensure optimal usage of this information. Such processes include a strategic management process that establishes continuous, strategic dialog throughout the company and thus ensures that the company remains a nose ahead of external developments that could harm its intangible assets based competitive position. Companies must also have a process for performance management that optimizes the exploitation of existing assets in order to achieve short term income goals. Both processes need to be linked with each other to enable management to manage for growth and for short term results at the same time.

(information about the book "Intangible Assets and Value Creation" can be found at: <http://www.juergendaum.com/mybook.htm>)

- *What challenges do you see for companies and their management in the new decade?*

Daum: Companies will experience ever-harder competition for best practices in all areas. Innovation cycles will accelerate massively. These challenges demand optimization and improvement of all value-adding processes in the company: continuously and simultaneously. Companies must make the appropriate adjustments as quickly as possible, but nonetheless successfully. Managers must therefore have a broad and deep understanding of all the important value-adding areas in the company. They must learn to apply systems thinking so that they can estimate the dynamic interactions in the system and their overall affect on long-term success of the company. General management will therefore become an even more demanding task.

- *What's your motto?*

Daum: Where there's a goal and a will, there's a way.

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As *Chief Solution Architect* of the Business Solutions Architects Group EMEA at SAP in Walldorf, Germany, he is the conceptual father and co-founder of the SAP Finance Best Practice Network), a network for the CFOs and senior finance architects of European companies. For CFOs, finance managers and controllers of numerous European companies he acts as a generator of ideas and stimuli for the redesign and transformation of the finance organization and for developing the CFO and controller function in organisations.

As *president and founder* of the *International Institute of Enterprise - Heidelberg (IIOE-Heidelberg, www.iioe.eu)*, a think tank and training organisation, he develops and promotes innovative concepts for enterprise management and entrepreneurship for organisations in Europe and provides impulses and practical concepts for "management innovation" and for strengthening the entrepreneurial and innovation power in organizations.

He regularly publishes articles in journals, speaks at conferences, and is author of the books "Intangible Assets and Value Creation" (English edition: John Wiley & Sons 2003, German: Galileo-Press 2002) and of "Beyond Budgeting (German edition: Meidenbauer 2005). Before his time at SAP he was CFO of a German midsize company.

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