

# IC Rating™ - the missing link to a complete chain of company of IC for performance measurement

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Over the last ten years, there has been an increased awareness of the importance of managing and measuring intangible assets. Here two models that have been developed and successfully applied during the last 10 years, will be reviewed, intellectual capital report and rating and balanced scorecards.

## Strategic Mapping and Measurement

Some say they are complementary others that they are substitutes for each other. Here we present an approach for successfully combining the two models and below we share some of our experiences to date.

## IC Rating™

Intellectual capital can be described as all factors critical to an organization’s future success that are not shown in the traditional balance sheet, i.e. future earnings capabilities. By future sustainability, we mean long-term profitability. In essence the argument is that if you optimize your intellectual capital, you will optimize your long-term profit sustainability.

Intellectual Capital measurements do not replace financial measurements, they are complementary: while financial figures are per default historic in character (the actions behind the figures have already taken place), a measurement of

Intellectual Capital is always future-oriented (capacity for future action).

The management and measurement model of Intellectual Capital is in this approach divided into several components (see model below). A central component is of course the Human Capital. Equally important is however the organization’s structural capital. We separate Structural Capital into Internal and External Structural Capital. In addition to this, we also measure the Business Recipe, i.e. the strategic component.

Each of these components assessed in terms of 3 strategic perspectives; their organizational effectiveness, renewal & development, and risk. The method includes input from both internal employees/management and external stakeholders.

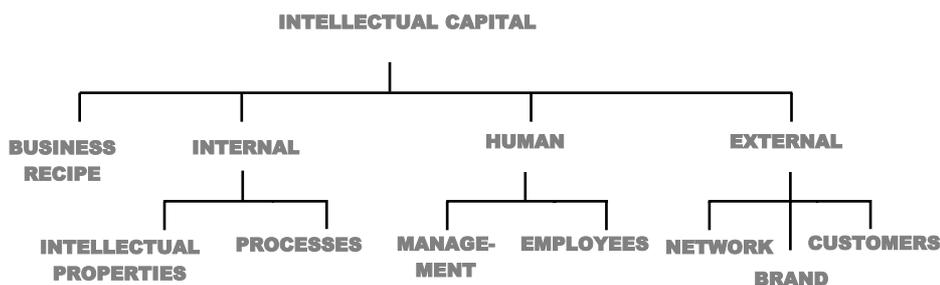


Figure 2  
IC value

The tool IC Rating™ ([www.intellectualcapital.se](http://www.intellectualcapital.se)) is based on the IC model in figure 2. It was first introduced in 1997 as a complement to the S&P rating of financial capital. IC Rating™ is about benchmarking the future earnings potential by rating the IC components between organizations on the three perspectives *effectiveness*, *renewal* and *risk*. It has been used by more than 200 organizations in Europe, Asia and Australia. It has been applied both to business, public institutions as well as regional rating of IC of cities and regions. The outcome is both a pedagogical map for benchmark versus best in class, but also a transparency platform for addressing the future earnings potential, thereby creating an improved trust for the future.

## The Balanced Scorecard

The balanced scorecard (BSC) is an approach to performance measurement that combines traditional financial measures with non-financial measures to provide managers with richer and more relevant information about the activities they are managing. Its creators Kaplan and Norton suggested creating a scorecard looking at financial, customer, processes and growth & learning measures to keep a good balance between present and future and internal and external perspectives. The concept, first introduced in the early 1990s, has become very well known. Various forms of it have been widely adopted around the world. At the same time the Skandia IC navigator was emerging as a tool for addressing the intangibles. The information provided by such scorecards supports decision making about what actions should be taken to ensure that the organization's strategic goals are successfully achieved.

The processes to select the information that appears on the Balanced Scorecard (regardless of design) is one of the challenges. Many people may be involved and the process then just takes too much time, resulting in score cards with more indicators to measure than there is time to follow up. All too often scorecards include measures that are chosen because they are easy to obtain or because the indicator have historically been used to track organizational performance. Another problem is that companies tend to stick to the same indicators year after year for easy benchmarking, risking that indicators and strategy drift apart. Another of the objections to the balanced scorecard approach lies in the control driven dimensions of the four perspectives. This has led to companies having found implementation difficult and insufficient.

## Strategically combining the approaches

Both IC Rating™ and BSC can be seen as performance management systems that

are closely connected to a firm's strategic aspirations. They both look **at the** organization in terms of different perspectives. The IC Rating™ in somewhat more detail of intangibles than the BSC. Figure 3 illustrates the combined approach, inspired by the Japanese applications, called Sei-Cho™ (growth in Japanese).

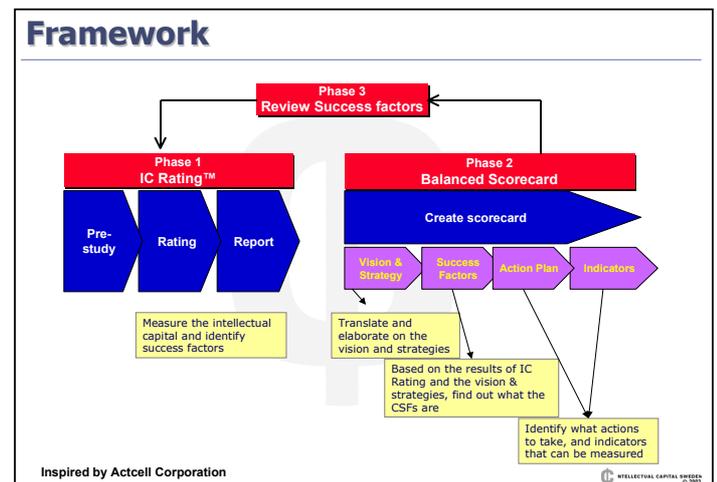


Figure 3- The Sei-Cho™ framework

The Rating™ process starts with a Pre-study. This is an exploratory phase in order to get a deeper understanding of the organization, its issues and its strategic enablers.

The next step is to carry out the IC Rating™. The process takes 4-6 weeks and includes in-depth interviews with internal and external stakeholders, judging more than 200 non-financial company critical factors.

The result of the Rating™ gives a thorough benchmark understanding of the different types of non-financial assets that the company has according to the perspectives shown in the model (Figure 2). It also gives an indication of the organization's key intangible sustainability factors and which areas to prioritize in order to achieve the strategic objectives.

In phase 2, the result of the IC Rating™ is used as input to the balanced scorecard process or IC Navigator. Firstly, since IC Rating™ has already taken the vision and strategy into account (in Business Recipe),

the corresponding steps in BSC are carried out very quickly. Secondly, IC Rating™ will have identified the strengths and risks of a gross list of potential success factors, thus making the process of choosing the company specific success factors very effective. Thirdly, the result is linked to a balanced scorecard system where actions and indicators are continuously accounted for and reported.

Ideally this process should be repeated every 12-18 months as shown in phase 3. By repeating the process the organization can always be sure that they have the right focus and that they are tracking the right indicators in order to achieve their strategic goals.

IC Rating™ and BSC as well as IC Navigator are both methods that have become popular over the last ten years and both have valuable application potential as tools to help managers to focus more effectively on the creation of sustainable (stakeholder) value. By combining the two, the shortcomings of each approach are eliminated giving the management a comprehensive tool for strategic as well as operational performance measurement.

The main benefits derived from combining the two approaches can be summarized as follows:

- process: the process of finding and prioritizing the right critical intangible success factors becomes easier, faster and more accurate. The most important aspect of IC Rating™ in this process is the ability to look at future value creation, including the risk of a decline in the organization's capability to create future value;
- indicators: the combined method makes sure that only the most valuable indicators, from a strategic point of view, are chosen and that they are limited in number. That way the indicators get the attention they deserve from the management;

- design: IC Rating™ with its pedagogical layout, making it easy to implement the BSC with the company preferred design;
- outside in: The IC Rating™ takes an external perspective into account, making the decision process more objective. The management's view is important, but incorporating that with the view of external stakeholders like customers, investors, suppliers etc, will complete the foundation for decision making.

### IC Reporting

The aim of Sei-Cho™ is also to contribute to need for improved transparency and publicly reporting non-financial assets (or intellectual capital). This can then be done according to the guidelines globally emerging (see above), among others the model from the Danish Government developed by professor Jan Mouritsen et al, Copenhagen Business School.

The difficulties in agreeing on a reporting system that complements the traditional balance sheet and profit & loss statement with non-financial information for increased transparency, can be summarized in three interconnected problems:

- there is evidence that the non-financial assets of importance not only varies between industries, but also between companies within an Industry;
- without the possibility to compare non-financial indicators between companies, the readers of annual reports will have to become experts in interpreting very detailed non-financial information;
- if the general readers of annual reports need non-financial expert interpretation skills, the entire argument for non-financial reporting – i.e. increased transparency – will most likely fail.

The idea of the Sei-Cho™ approach for public reporting is to divide the non-financial development work into one internal part and one external part.

The internal part is represented by a BSC process. It does not necessarily have to be the Kaplan & Norton process, but instead a more intangible asset or IC based tool such as the Skandia Navigator ([www.iccommunity.com](http://www.iccommunity.com)) or some of the models reviewed by Dr. Dan Andriessen, Holland in his recent Ph. D. Dissertation These processes are constructed to architect a detailed scheme of non-financial information and indicators for each specific company which works well for non-financial control and development for the management team.

The external part of the Sei-Cho™ approach can be represented by IC Rating™. It illustrates non-financial information on such a generic level that the model works for any type of company. The categories are(see figure 2): business recipe, intellectual properties, internal processes, management, employees, network, brand and customers. Each of these categories are measured by independent auditors using a standardized process.

Since one of the purposes is to clarify interpretation, the result is presented with a letter grading scale, similar to the one used by financial institutes (like Standard&Poor's and Moody's). By adopting the scale, an existing frame of reference is used, making it easy for any stakeholder to read non-financial reports. Some examples of companies including non-financial information based on the IC rating™ and Sei-Cho™ external approach include the Swedish IT company TurnIT (figure 4), the Norwegian state controlled betting company Norsk Tipping (figure 6) and the Australian authority Work Cover (figure 5).

### TurnT company AU-gruppen

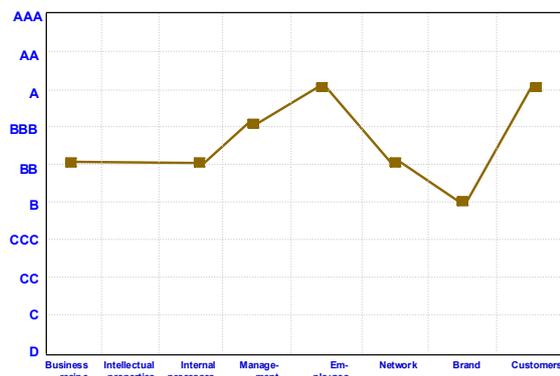


Figure 4 – IC Rating™ result on efficiency for AU-gruppen

### Norsk Tipping

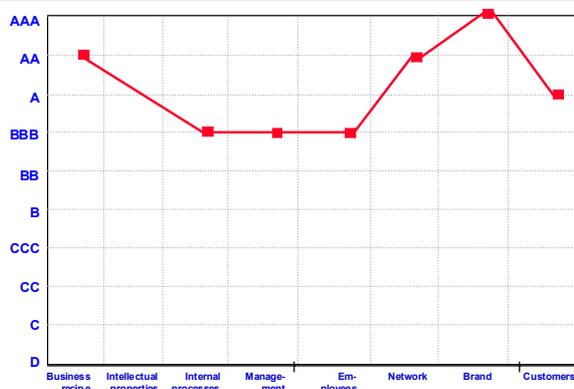


Figure 5 – IC Rating™ result on efficiency for Norsk Tipping

### Work Cover

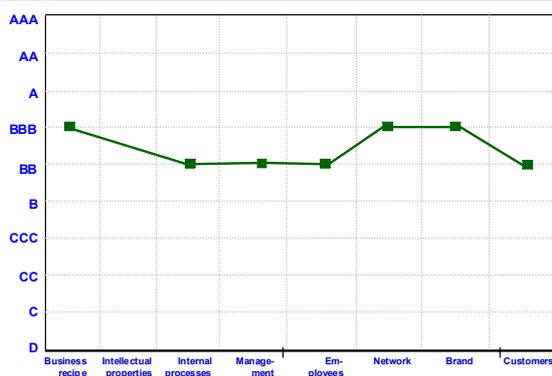


Figure 6 – IC Rating™ result on efficiency for Work Cover

Some interest parties that watch the development of IC Rating™ with great interest are institutions and companies working with corporate risk assessment on a daily basis, i.e. banks, venture capitalists, stock exchanges etc. They realized long ago that financial risk often is separated from operational risk. Their problem has been to find assessment tools that will give them a fair view of a company's operational risk, such as strategic path, internal structures, corporate culture, people and relations. Their hope is that tools like IC Rating™ can provide the platform they lack in order to make operational risk assessments for investment and lending decisions, as well as listing companies on stock exchanges.

The usage of the Sei-Cho™ process is growing fast. Coming out of Japan with practitioners such as Hitachi, and Yukiwa, there is also a very strong interest in other Asian countries (Hong Kong, Singapore, Taiwan, South Korea etc). The reason behind this is the perceived ability to use this type of approach to set a foundation for succeeding with growth strategies in the knowledge economies aiming to increase their competitiveness with the western continents.

It has also been concluded that the approach is applicable to other organizations – not only corporations:

- prototypes of the external part of Sei-Cho™ (IC Rating™) has been applied to schools and hospitals. The purpose is to realize their true potentials and effectively navigate these institutions into future challenges;
- municipalities use Sei-Cho™ in order to become more competitive, i.e. providing better value to citizens, businesses, investors and visitors;
- a special version of Sei-Cho™ has been used by the Norwegian oil cluster (consisting of all major

players both horizontally and vertically). The analysis revealed important risks to the Norwegian oil industry resulting in a launch of major projects to increase innovation for the future as well as to strengthen relations between the companies, with local politicians and other oil clusters globally.

### Norway: Entire Oil Cluster - Value creation

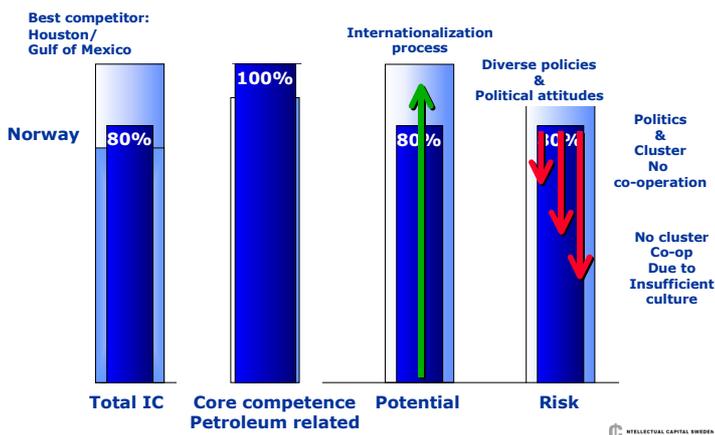


Figure 7 – IC Rating™ . The Norwegian oil cluster had a total IC value which was about 80% of the total IC value of the best competitive oil cluster, Houston. However in one important aspect of the total IC, Norway was considered to be best in class – petroleum related competence. Their largest potential to increase their competitiveness was discovered in their ability to improve internationalization. Three major risks were found: the lack of knowledge on a political level, poor relations with politicians, and poor cooperation among the players in the industry, due to insufficient culture.



*Peder Hofman-Bang ist Mitarbeiter von Intellectual Capital Sweden AB. Das Unternehmen wurde 1997 von Leif Edvinsson gegründet.*