

# What is Knowledge Management and Intellectual Capital

White Paper

## What is Knowledge Management and Intellectual Capital?

*In the first of a series reports, Dr. Deborah Swallow outlines the thinking behind Knowledge Management and Intellectual Capital. In her subsequent reports she explores 'Taking Stock of Intellectual Capital' and 'Measuring the Return on Knowledge'*

***“Creating a Knowledge Management system is more than just adopting a new computer programme. Just as television is more than radio with pictures, knowledge management solutions must take a leap beyond documentation, applied learning and new software.”***



### Introduction

Given the hype surrounding it, there can be few of us who have not encountered the term Knowledge Management - even if, like many, we aren't quite sure what it means. The number of conferences, books and articles on the subject has mushroomed over the past five years leaving little doubt that this 'latest management fad' of a few years ago is still a big thing in the world of organisational management. However, what is this "buzz" phrase, and should we take the time to get to grips with it? The answer is a resounding yes.

Since the advent of computers and information technology, the nature of the enterprise has changed. Nowadays, we have developed different methods and skills than those of our predecessors in order to access our customers and provide them with goods and services. These new skills have been developed as a result of information technology, telecommunications technology and the requirement for a more sophisticated work-force which relies on expertise and technology more than manual labour. We have produced employees with new skills. Their know-how is frequently a long time in the making. However, many of today's companies are replacing their workforce every five years, effectively forfeiting their corporate knowledge faster than their ability to retain it.

The more a company grows, the greater its accumulated knowledge. Or so it ought to be. Yet the more complex an organisation becomes, the more difficult it is to keep track of just who knows what and the greater the chance that potential value is being lost. Every time we lose an employee we lose a chunk of corporate memory. Despite the fact that the organisation pays for people – their assets – by way of salary and invests in them by way of training, fast track plans etc., the employee is not

owned by the organisation, which is powerless to prevent its employees pursuing life-threatening hobbies every weekend such as bungee jumping or pot-holing!

### What is Knowledge Management?

To safe guard a company's future business performance and prosperity systems are being developed to acquire and disseminate intellectual assets and to increase the generation of useful, actionable and meaningful information. This is being known as Knowledge Management (of Intellectual Capital) and this is where the importance of new technologies lie. In fact, most of the debate in knowledge management, so far, has centred on technology, yet organisations are finding that this is just the tip of the iceberg.

When business process re-engineering was at its height, and down-sizing was the trend to follow, organisations began to learn that knowledge was not just something that was owned and controlled by the company – it was a factor that walked out of the door when staff was laid off. So, while a company might be good at cutting inefficient, repeatable processes (**“explicit” knowledge**), its ability to respond to change was reduced – something at which the **“tacit”** human brain excels.

**The problem Knowledge Management poses is that knowledge, as distinct from information, cannot be directly managed. It is only possible to manage the environment in which it is created and sustained.**

Knowledge exists in various forms: tacit, explicit, individual, organisational, social, administrative, technical, and scientific. However, an individual's knowledge (within an organisation) can be categorised into three elements:



- **Know-how** – relating to operations, production, logistics, continuous improvement systems
- **Know-what** – relating to customer needs and use of firm's products or services. Understanding what the firm might do with its available competencies or competencies it conceivably could develop. Sales force management, market research, customer service and new business development
- **Know-why** – is fundamental knowledge of the business as a system. Understanding of competitive advantage, industry economics, innovation, competitive intelligence and strategic thinking. May be tacit or explicit.

## Why is Knowledge Management important?

Learning and the leveraging of knowledge are increasingly seen to be the keys to business success. Jack Welch, chairman and CEO of General Electric, attributed his group's success and growth to a financial model which has at its heart cultural values that add up to the 'Learning Organisation'. Organisational learning, knowledge formation, storage and use are dynamic processes. In today's economy, the gap between the book price and the acquisition price of knowledge-intensive companies, on the investment market, is becoming ever larger. Microsoft's market capitalization is more than ten times the company's book value and Nokia's nearly six times.

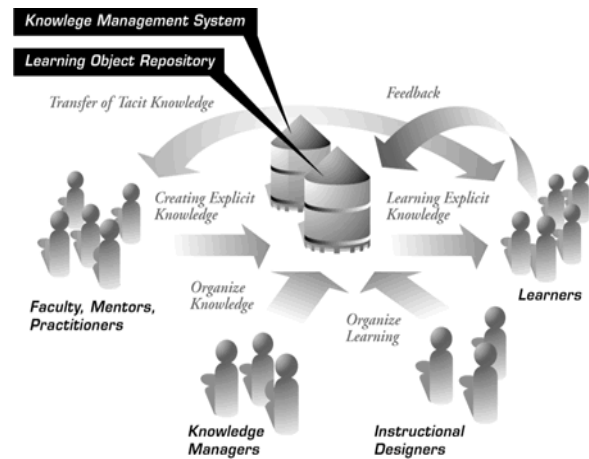


The wealth of high-tech companies like these does not consist only of machinery and equipment. The skills and talents of their personnel are likewise hugely important assets. These intangible assets are being described as Intellectual Capital.

For the modern corporation, understanding the value of its intangible assets is a critical factor to its success. This understanding enables the company to know where its strengths lie and to access them quickly in an ever-changing, fast-moving competitive and networking environment. It also shows the company its underlying weaknesses, and thus gives it an opportunity to fix problems before they emerge as a dangerous operating problem. The increasing importance of knowledge for the sustainability of companies has encouraged the development of many new or at least modified management theories.

## So, how do you manage knowledge?

This has led to attempts to create an Intellectual Capital Index and a Balanced Scorecard as ways to measure or benchmark a company's efficiency in using/capturing their intellectual capital. It is said that the companies of the third millennium will have few tangible assets but have all their 'assets' tied up in the heads of their employees (e.g. Microsoft) and there will be a need to review accounting practices to take this into account. Intellectual Capital (IC) audits can make a company more alert. With an on-going programme of IC reporting, a company can continually monitor its goals and drive itself towards better efficiency, profitability and competitiveness. Moreover, IC reporting can be seen as a more accurate way of valuing a company. The concept of measuring hidden assets, intangible resources or intellectual capital often says more about the future earnings capabilities of a company than any conventional performance measures. Measures of intellectual capital will increasingly be at the forefront in discussing the health and value of companies, simply because they say more about future earnings capabilities.



## Conclusion

Intellectual Capital, both as a language and a set of techniques for addressing future earnings capabilities, implies a different meaning of management and accounting than those we are used to. As well as providing useful insights into the value-creating dynamics of companies, such an IC-index has also been applied on an industry basis in both northern Europe and Australia. Adopting an intellectual capital perspective in a company means more than supplementing the financial reporting with an intellectual capital report. Creating a Knowledge Management system is more than just adopting a new computer programme – it means creating a whole new philosophy about how to do business...



Just as television is more than radio with pictures, knowledge management solutions must take a leap beyond documentation, applied learning and new software. Technology alone cannot guarantee success in the knowledge economy. Clearly, the time has come to rethink the assets of an organisation and develop new tools and techniques – along with a new philosophy about how to approach business - to manage and monitor business and people performance.

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