THE INTELLECTUAL CAPITAL STATEMENT AND THE BALANCED SCORECARD AS COMPLEMENTARY MODELS IN MEASURING FIRM’S INTANGIBLES. AN EXPLORATORY STUDY

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The purpose of this paper is to examine the role of two different new management tools, the Balanced Scorecard (BSC) and the Intellectual Capital Report (ICR) in managing and reporting intangibles. Unlike the majority of IC scholars the author, and consistently with Bukh et al. (2005), the author starts from the idea that BSC and ICR are not alternative, but complementary tools in measuring intangibles, addressing different needs for firms that measure, manage and report intangibles. The research hypothesis of the paper will be demonstrated through the analysis of a case study of an Italian group which use both intangibles’ reporting systems. A case study methodology has been chosen, given that it is widely used by researchers and provide the basis for the application of ideas and extension of methods (Yin, 1994). Intercos group has been chosen to test the research hypothesis, since it makes use of both models in measuring and reporting intangibles. The study of the case Intercos group found evidence that the two types of extended reporting are different and yet complementary and that both tools are necessary for firm in measuring IC, since they address different aims. This includes therefore a marked difference in use of indicators, given that IC indicators in the ICR have to support the overall aims derived by company’s strategy, while BSC indicators provides a breakdown of strategic goals with respect to profitability, growth etc. The contribution of the paper to the IC literature is to extend the findings of the Bukh et al.’s (2003) study, investigating the hypothesis (and finding evidence) that BSC and ICR are complementary in reporting intangibles in an Italian group. Implications of the paper are for company’s manager, who increase the awareness that they have at their disposal two management tools, with address different aims, to manage intangibles.

Key words: Intellectual capital report, balanced scorecard, complementary models

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1.Introduction

In the present economy, known as the knowledge-based economy owing to the critical role played by this factor, relevant changes, external (related to the competition’s modalities) and internal ones (related to the resources’ composition) has caused a modification in value creation modalities, whose main source is no longer based on the production of material goods, but on the creation, acquisition and evaluation of intangibles (Prism Report, 2003). Since intangibles have become the main value drivers for the 21st century firm, the problem measuring intellectual capital (IC) performance became a central issue in measuring firm’s performance. The definition and classification of intangibles (or IC) is still an open question (Zambon, 2003). The definition accepted in this paper considers IC as a dynamic system of intangible resources and activities, at the basis of the organization’s sustainable competitive advantage. All of the major players in the IC field share the idea that intellectual capital, from a qualitative point of view, can be divided into three categories: structural (organizational) capital, human capital and relational capital; even if the labels utilized are different, the content of categories is more or less quite similar. Briefly, human capital consists in knowledge, capabilities, competencies and skills possessed by firm workers. Organizational capital is constituted by structured knowledge.
possessed by firm and shareable (database, procedures etc.). Relational capital is constituted by
the totality of relations between firms and its main stakeholders (Bontis et al., 1999).

Basically, methods for measuring IC can be classified in methods focused on the financial side of
measurement and the monetary value of intangible assets and “scorecard” methods that look for
indicators able to measure intangible resources and activities (Sveiby, 2009). To the category of
scorecard methods belong methods measuring multiple aspects of firm’s performance, including
intangibles, such as the Balanced Scorecard (BSC) and methods develop ad hoc to measure
intangibles through a system of IC indicators disclosed in an IC report (Chiucchi, 2004).

The main’s paper aim is to demonstrate, by using case study methodology (Yin, 1994), that
Balanced Scorecard (BSC) and IC Report (ICR) models are not alternative but complementary
model in measuring intangibles.

2. Literature review on the IC scorecard measurement systems

The Balanced Scorecard (BSC) belong to the multidimensional firm’s performance models
(Bitcici et al., 1997), developed to overcome the limits of the traditional, mono-dimensional
performance measurement models, focused only on the accounting/financial side of firm’s
performance. Briefly, in the BSC four perspectives are considered: financial, customer,
processes and learning and growth perspective. The financial perspective identifies long term
financial results; the customer perspective allows managers to ask themselves on what factors
client consider really important and which actions the firm have to implement to reach customer
satisfaction; the processes perspective is an internal one, which allows managers to evaluate
which factors have a deep impact on client’s valuation, such as production and delivery times,
productivity, flexibility, etc.; the learning and growth perspective concurs to the distinctive
competencies which maintain and increase the firm’s competitiveness. BSC tool had great
evolution with time, from a performance measurement system (Kaplan and Norton, 1992), to a
strategic performance management system (Kaplan and Norton, 1996, 2001), to a system focused
on transformation on intangible assets intangible results (Kaplan and Norton, 2004).

Our analysis focuses only on BSC in relation with the measurement of intangibles and on its role
in measuring. Until 2004, in fact, authors had never explicated their concept of IC, so the IC
scholars made a connection between the three non-financial areas, especially the one of learning
and growth, and the IC. In 2004 Kaplan and Norton “making official” the shift of the BSC from
strategic management tool to an intangibles management tool by providing their own version of
IC, identifiable within the learning and growth perspective. According Kaplan and Norton
(2004), IC can be divided into human (employees’ skills, talent and knowledge), information
(databases, information systems, networks and technology infrastructure) and organizational
capital (culture, leadership, employee alignment, team work and knowledge management). Such
division perplexed some IC scholars, since it does not consider the traditional IC division in
human, structural and relational capital on which, in recent times, there is an almost general
convergence (Marr and Adams, 2004). For this reason, BSC is a model included, by some IC
scholars, in the measurement of intangibles models (Sveiby, 2009; Zambon, 2003).

There are different positions in doctrine about the usefulness of BSC in measuring intangibles.
Some scholars (Bontis et al., 1999; Petty and Guthrie, 2000) consider BSC a fundamental tool to
measure intangibles, some others question the use of the BSC model to value intangibles since it
is not a model created ad hoc to measure IC, and intangibles, for their own peculiarities had to be
measured by ad hoc measurement systems (Mouritsen et al., 2005; Lev, 2001).

The IC scorecard measurement models had an evolution passing from the first, pioneering studies
to the advanced ones (Chiucchi, 2004; Veltri 2007). To the pioneering models, belong, among
others, the Intangible Asset Monitor – IAM (Sveiby, 1997) and the Skandia Navigator
Briefly speaking, in the pioneering models, attention is focused on the content of the IC subcategories. The vision behind is a typical accounting vision, according to which IC is an aggregate of intangible resources. The mainstay of these models is the IC value measurement and their main aim is to explain causes of the differential between accounting and market value, mainly attributed to IC. The advanced models adopt the evolved notion of IC as a dynamic system on intangibles resources and activities based on knowledge. The attention is focused on the interactions between the IC items, at the basis of the organization’s value creation, and on intangible activities essential to produce, maintain and develop intangible resources. The assumption behind these IC models is the knowledge management, the main aim of the advanced models is to identify the paths of the organization’s value creation based on knowledge.

Our position is that both instruments, BSC and ICR, are needed to measure intangibles, and we try to prove it by analysing a real life case of a company that use both tools in measuring intangibles, with different aim, in the next paragraph.

3. Research methodology: the Intercos case study
The research method used to investigate if BSC and ICR are complementary tools in measuring intangibles is the analysis of a qualitative case study. Case study methodology is widely used by researchers across a variety of disciplines to examine contemporary real-life situations and provide the basis for the application of ideas and extension of methods (Yin, 1994). We took the idea of the paper from the Buhk et al. (2003)’s study, which investigated the same research question for a Danish software company, Systematic Software Engineering, finding that BSC and ICR were different and yet complementary when applied to Systematic Software Engineering.

In details, the ICR and the BSC of and Italian group, Intercos, have been investigated in order to highlight the different role of the two tools in measuring intangibles and to analyze their relationships. Intercos group's history is excellent, since it focuses on innovation and capability to manage the complexity of business. Intercos group experienced a big growth: founded in 1972, it has become an international firm, global leader in creation, development and production of make-up products. In the last years Intercos group has confirmed its leadership in the cosmetic sector. Intercos is one of the few Italian group to issue an IC report and the only one in the cosmetic sector. Our analysis focused on 2004 Intercos group’s ICR and BSC, since after 2004 Intercos group stopped to disclose its IC report to stakeholders (Gasperini and Novellini, 2004).

The attention of Intercos towards intangibles was a reaction to a stakeholder satisfaction survey, in which customers and employees did not consider fully satisfying the relationship with company (only 50% were fully satisfied). The results of the survey pushes Intercos to consider the opportunity to issue an IC report (Gasperini and Novellini, 2004). The identification of intangibles indicators was a shared process, on the basis of interviews and workshops which had the aim, at first to identify the type of company business and of its vision, then to identify the strategic areas of value creation (30 value drivers creators were identified) and to define a set of key indicators (350 intangible indicators were identified, which have also the finality to evaluate the employees’ behaviour (fig.1). In 2004, the main aim of the IC Report (Intercos Group Global Report) was to enlighten the culture and philosophy which animates Intercos group. In preparing the ICR, Intercos Group declared to follow DMSTI guidelines. The strategy (a global one) defines the framework within which initiatives related to knowledge resources taking place. The Intercos Group approach put the customer at the centre, and each section (customer, innovation, marketing, supply chain, people) illustrates a series of intangibles indicators focused on customer and related to the global strategy; the section dedicated to customers summarizes important information with regard to customer satisfaction, measured in relation to company’
The declared aims of the Intercos group’s BSC are to monitor the key factors for Intercos group within the BSC framework and to communicate corporate strategy within Intercos group (fig 2).
The BSC of Intercos Group comprehends a wide number of IC indicators in all areas, with a main focus on internal area, because of its main role is to translate the broader IC objectives included in the IC report into more detailed objectives. Therefore, the two instruments are related, meaning that BSC provides the necessary degree of detail, breaking up the objectives defined into the ICR in more achievable objectives contained in the BSC and derived by ICR (whose number is reported in fig. 2). BSC has also the aim to control that employees carry out the adequate activities to achieve the objectives, given that a detailed internal management control system is based on BSC.

4.Research results
Both intellectual capital reports and balanced scorecards relate corporate strategy and integrated performance management systems, and they both expand reporting beyond the financial view with categories of customers, processes, and employees. This paper discusses their differences and complementarities based on an analysis of their use in one Italian cosmetic group. Intercos group has published ICRs for three years and implemented a balanced scorecard after the first year of reporting IC. From the analysis of its 2004 IC report, it can be said that Intercos stresses the double scope of the statement as a management tool (intangible indicators are included in the incentive plan) and a communication tool about the firm's knowledge management activities (at Cosmoprof 2003, the major of the cosmetics market, Intercos presented its IC report instead of its products). As regards the BSC, Intercos introduced this tool after the publication of the first IC report in 2002 and use it with an instrumental role, to anchor corporate strategy to single projects and to people’s objectives and in order to promote the employees’ commitment. BSC comprehends sensitive data, so it is only an internal tool, while ICR has both an internal and external aim. The use of BSC in Intercos was obliged by the consideration that ICR cannot address the operating needs to coordinate the different activities, to detail them and to link the commitment of employees to the corporate aims. On the contrary BSC, due to its features, such as the possibility to include sensitive data, to make explicit cause-effect relationship and the
possibility to be developed at a single project level, can address the organizational needs above mentioned and qualifies itself as a tool linked to the ICR by an instrumental relationship. A comparison of the indicators in the BSC and the ICR reveals that they do not report the same indicators, given that BSC has been developed after the ICR to break down IC indicators. Another important difference is that BSC relates its indicators in a cause-effect relationship, while ICR presents the indicators related to the dimensions of Intercos presentation framework. The study of the case Intercos group found evidence that the two types of extended reporting are different and yet complementary (BSC in included in the Intercos group’s ICR) when applied in this firm and that both tools are necessary for firm in measuring IC, given that they address different aims. This includes therefore a marked difference in use of indicators, given that IC indicators in the ICR have to support the overall aims derived by company’s strategy, while BSC indicators provides a breakdown of strategic goals with respect to profitability, growth etc.

5. Conclusions
The intellectual capital statement and the balanced scorecard in Intercos group both report issues beyond the financial on customers, processes, and employees, but they do this differently. Using two integrated performance management systems does not seem to be difficult for Intercos group. The ICR is used primarily as a means to develop and communicate the firm's intangible activities, and the balanced scorecard is used primarily as a mechanism to make employees accountable for achieving the company’s objectives. In Intercos these models are complementary. The difference in indicators is a consequence of the different purposes of the models. The intellectual capital statement is produced with the purpose of external communication and therefore it cannot contain sensitive data and measures according to strategy and competition. On the contrary, the balanced scorecard is developed with the purpose of internal management of projects and is never intended to be published externally, which makes it possible to include sensitive issues and measures in the model. The main limit of the paper lies in the circumstance that it is based on just a qualitative case studies. In order to investigate on the complementary relationships of these two management tools, many qualitative cases should be studied. The contribution of the paper to the IC literature is to extend the findings of the Bukh et al.’s (2003) study, investigating the hypothesis that BSC and ICR are complementary in reporting intangibles in an Italian group. As for the company analyzed by Bukh’s et al.’s (2003), we found evidence that the two types of report are different and yet complementary when applied to Intercos group. Implications of the paper are for company’s manager, who increase the awareness to have at their disposal two management tools, addressing different aims, to manage IC.

References