



Knowledge Consortium of Gujarat
 Department of Higher Education, Government of Gujarat
JOURNAL OF COMMERCE AND MANAGEMENT
ISSN : 2279-025X

Year-1 | Issue-1 | Continuous issue-1 | June-July 2012

Knowledge Capital

"The basic economic resource is no longer capital, nor natural resources, nor labor. It is and will be knowledge." - Peter Drucker

Knowledge is the human capacity (potential & actual ability) to take effective action in varied and uncertain situations.

Knowledge can take many forms...

- Concepts, methodologies
- Facts, beliefs, truths & laws
- Know what, Know how, Know why
- Judgments & expectations, insights
- Relationships, leverage points
- Intuition & feelings
- Meaning and sense making

Good things about Knowledge

- The foundation of the enterprise
- Grows with use
- Increases when shared
- Primary source of value
- Only solution to understanding complexity

Bad things about Knowledge

- Usually exists in the minds of individuals
- Hidden in some forgotten report
- "Knowledge is Power"-encourages Knowledge Hoarding
- Leaves the organization with the employee
- Knowledge Management

Definition ::

The systematic process of creating, maintaining and nurturing an organization to make the best use of knowledge to create business value and generate competitive advantage.

Knowledge Workers :

1. Dominant group of workers in the 21st century.
2. Specialists with job-specific skills.
3. Have significant formal education or formal training.
4. Are self-directed learners
5. Require multiple, continuous learning opportunities to maintain their specialized knowledge

Emergence of Knowledge Capital :

Emergence of the service society after the last world war brought increased realization of role of employees' knowledge and creativity in adding value to the company. Attempts to capitalize company investments in people on the balance sheet in the 1970s failed because of measurement problems. The subject gathered increased interest more recently in the 1990s, with the rapid emergence of information and communication technologies (ICT)

Knowledge Capital :

Much of the credit for the idea of turning intangible value into a financial asset can be attributed to business pioneer -Paul Strassmann

"Management Value-added"

- Why is a company's market value different (and higher) than its book value (as calculated by generally accepted accounting principles)?
- Strassmann refers to that specific difference with a term he coined and trademarked as "management value-added." A company's management value-added drives corporate success by making its financial capital assets exceed their book value.

What drives "management value-added?"

To a large degree, management value - added depends on the level of "knowledge capital" — a term Strassmann trademarked to denote the value of accumulated knowledge held by employees. Ultimately, this accumulated knowledge, and the increase in working efficiency that comes with it, increases the total value of products or services a company is able to produce

Recognize Employee Skills as a Valuable Knowledge Asset

- The market valuation of a company's employee worth is largely determined by the knowledge accumulated over the course of years of daily activity from attending meetings to getting to know people, to learning a company's processes, products and services
- None of these activities is entirely possible without the basic element of skills
- Product knowledge, customer and supplier information, and operational expertise can give a company a business advantage in its industry. Knowledge capital is the lifeline of an organization.
- Strong knowledge capital flows create value throughout an organization's value ecosystem

Example :

1. To gauge the value of your company's knowledge capital, you can account for it the same way as traditional assets. Take, for example, a comparison between two companies: one from the industrial era, General Motors, and one from the information era, Microsoft.
2. General Motors' \$40 billion market value is comprised primarily of traditional assets, while Microsoft's \$70 billion market value consists of only a few traditional assets other than the buildings that make up its headquarters. IBM's purchase of Lotus is yet another example of the hidden value of knowledge capital. IBM's share price rose immediately after the purchase as investors realized Lotus held software knowledge IBM could convert to profit and business advantage.
3. An organization can begin to define its knowledge management objectives only with a clear idea of what the business as a whole is attempting to achieve.
4. To begin formulating a solid knowledge management strategy, you need to examine corporate culture, knowledge content, information technology infrastructure, and the company's success factors.

Knowledge Capital Views

- People - Brand Advantage
- Process - Strategic Advantage
- Content - Organizational Advantage
- Brand - Mapping of Intangibles
- Alliances - Competitive Advantage
- Customers - Risk Reduction

Operational objectives for knowledge capital are diverse :

- Derive greater value from services.
- Retain employees and customers.
- Increase intellectual property value.
- Grow organizational capacity and capabilities.
- Increase consultative and "soft" skills.
- Differentiate intangible asset value.
- Accelerate organizational and individual learning.

All forms of organizational knowledge must be optimized

- Know-What is technical and product content knowledge.
- Know "What if . . . ?" is hypothesis generation and testing.
- Know-How is procedural knowledge for solving problems.
- Know-When is an essential element of Know-How.
- Know-Where is where key competencies and skills reside.
- Know-Who is an organization's social network.
- Know-Why is how people learn from experience.
- Care-Why is how people derive identity and vest in organizational values.

Valuation Methods :

- Knowledge Capital ® Assessment
- Market Value to Book Value
- Tobin's Q
- Calculated Intangible Value
- Baruch Lev's Knowledge Capital Valuation
- Scoreboard Valuation Technique
- Livson's Valuation of Startups

Baruch Lev's KC Valuation :

Knowledge Capital = (Normalized earnings - earnings from tangible and financial assets)/(Knowledge capital discount rate)

- Strengths: Valuation is forward looking. It has some predictive capability.
- Weaknesses: Requires more effort to apply

Strassmann :

- Intellectual Capital = Market Value (Price/Share x # of shares) - Book Value (Equity - Debt)
- Strassmann's Knowledge Capital = (Profits - Financial Capital "Rental")/(interest rate cost of long term debt)

Tobin

Tobin's Q = Market Value/Replacement Cost

Calculated Intangible Value :

- Calculate average pre-tax earnings for three years
- Calculate average year-end tangible assets for 3 years
- Divide earnings by assets --> company average ROA for 3 years
- Find industry average ROA
- Multiply industry ROA by company's tangible assets. Subtract product from company's pre-tax earnings. --> Excess return.
- Calculate 3 year average tax rate. Multiply by excess return
- Subtract from excess return --> premium
- attributable to intangible assets.
- Calculate Net Present Value of Premium. Divide premium by discount rate. (i.e., cost of capital)

Ben Livson's KC Equation :

- MC=Market Capital, KC=Knowledge Capital, BV=Book Value & CV=Comprehensive Value and

PV=Perception Value in market perception

- $CV=BV+KC$
- $MC=CV+PV=BV+KC+PV$
- Nokia 2000: $MC=\$160b=\$6b+\$94b+\$60b$
- High PV=>Overvalued; Low PV => Undervalued
- Best Stock: Low PV and High KC

Reference:

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