Chapter 8

EFFECTS OF INTANGIBLES ON ORGANIZATION’S PERFORMANCE ESCALATION

Chapter Objectives: It emphasize on the greater need to pay attention to intangible factors as compared to the tangibles. And to determine a factor that may connect increased Return On Investments (ROI) due to Intangible factors.

8.1 Introduction: Intangible investments are inherently uncertain and are consequently systematically excluded in any explicit form from management and financial reporting. Traditionally financial accounting was earlier considered as enough metrics of performance or success of an organization generating huge amount of capital irrespective of inside stories whether good or bad. Several powerful forces viz; globalization, renewed technology, changing demands of the customers, political structure and many others are acting to restructure the economy of the world. Exclusive use of financial performance indicators encourages a focus on short term results, but in today’s complex global competition environment, the incorporation of non-financial performance indicators, such as manufacturing capability, human resource management and supply-chain relationships, provide a cleaner and more relevant picture of performance, Feng-Mei Tseng et.al, (2009). It remains unrealized by and large by most of the organizations that so many problems are generated due to not taking into consideration the invisible / intangible factors which need analysis and attention. Organization’s performance has always been an issue of concern and that it has always drawn focus only on financial matters. All the metrics of performance are oriented toward Returns on Investments (ROI), largely financial. In fact the organizational performance is a host of several “tangible and intangible” factors. Besides several intangible factors, “Human factors” not only help an organization to achieve intangible objectives like better quality, customer satisfaction, goodwill, and responsiveness through continuous
improvement but also have long lasting effects on tangible objectives-profitability through productivity Grover et al. (2006).

For enhancing organizational performance, the principles of Performance management have also to be utilized. Performance management is essentially about measuring, monitoring and enhancing the performance of the staff as the contributor to the overall organizational performance. The staff and organizational performance are closely interlinked in a very complex manner and subject to many external variables often beyond the scope of performance or general management Bach and Sisson (2000). Performance management is “an approach to creating a shared vision of purpose and aim of organization helping each individual employee understand and recognize their part in contributing to them and in doing so manage and enhance the performance of both, individual and of organization. Performance management is “an interlocking set of policies and practices which have as their focus in enhanced achievements of the organizational objectives through concentration on individual performance” Storey and Sission (1998). Performance management is “Organizations to achieve the best possible results”. This is not a system or technology; it is the totality of the day to day activities of all the managers Fowler (1990). Thus it is felt that “achieving or attaining higher standards of performance” is possible through implementation of the principles of performance management that includes metering and monitoring the performance of individual and of organization. Enhanced performance is the outcome of proper performance management of Intangibles. The current school of thoughts lays greater emphasis on team work and established planning review processes. Individual performance is only one aspect of performance management. Individual performance contributes to the attainment of “Enhanced performance” provided the outcomes of appraised performance are utilized for elimination of the drawbacks of the systems. To change the focus to “performance enhancement” from “performance management” a more promising approach would be that the staff gets the necessary help, support and motivation to do their jobs well rather than to verify whether the staff is doing their jobs properly. Whatever be the strategy adopted, the organizations are expected to perform well and yield high returns on investments. For achieving high performance levels, which factors determine the competitiveness of the firm and which factors help in realizing increased competitive
advantage was never thought about. Every thing and thought was oriented around financial, physical or structural things and factors. During and over a period between previous two decades, an intuitive feeling for soft factors likes trust, confidence, cooperation, customer satisfaction, corporate culture values and the like has become the brainchild of thoughtful management. For creating corporate values, the notion of intangible investments must not be oversighted. These concepts are closely connected to the resource based perspectives. Invisible assets are specific technologies, brands, market information, corporate culture etc., which serves as a source for competitive advantage Itami (1987). The intangible factors are too many and each has its own impact or effect in raising performance of the organization.

For acquiring higher performance levels an environment and culture has to be created in the organization which is capable of providing physical and mental comfort and health, safety and security facilities etc. Intangible Returns on investments are the gains made by the companies in the form of good relationship between the employers and the employees. These gains can be intangible gains in the form of winning trust, goodwill or confidence etc. of the employees in the employers and vice versa or tangible gains as higher profits earned by the firm. It is opined that Return on Investments (ROI), have some kind of relationship with organizational performance as discussed in this chapter.

Technology related developments or product or service modernization is absolutely necessary in response to the user’s requirement or changing needs or demands of the customers. Any change of technology must be incorporated after a careful “utility analysis” and study of “economics of change”. While considering the implementation of the suggested changes an impartial implementation of organization’s competencies i.e., knowledge, skills, aptitude and attitudes must be carried out besides the economic feasibility. Competencies must be studied at individual level as well as at organization level. Measuring routines and following of the procedures is essential for growth of healthy organizational culture. Any dissatisfaction breed out by the employees leads to the negative impact on the organization. Some system must be designed to measure the routines to maintain a control on system’s working and organization culture.
The organization culture is an important factor and refers to the general pattern of behaviour, shared beliefs and values that the members of an organization have in common. Culture can be inferred from what people say, think and do within the organizational setting. Culture involves learning and transmitting knowledge, beliefs and patterns of behaviour over a period of time, which implies that an organization culture is fairly stable and does not change fast. Top managers create climate for enterprise. Their values influence the direction of the firm. Value is defined as permanent belief about what is appropriate and what is not; that guide their actions and behaviors of the employees in fulfilling the aims of the organization. Value can be thought of as a kind of ideology that permeates in every day's decisions. In many successful companies value driven corporate leaders serve as role members, set their performance standards, motivate the employees and make the company very special. It is because of the quality of work force that the human capital that takes the company towards its goal.

8.2 Human Capital: Human capital is what people know about their jobs. Human capital can be regarded as the knowledge residing in the minds of the people. Although it is the soul of the company, yet it cannot be retained by the company Edvinsson and Malone (1997). It is tacit in nature and can be ‘Intrinsic’ or ‘Extrinsic’. Intrinsic human capital is composed of human beings within the organization whereas the extrinsic human capital is composed of people outside the organization, for example material suppliers, vendors or other outside agencies etc. Knowledge, skills, attitude & aptitude and competence etc; are the characteristics of human capital. Tacit knowledge when codified becomes explicit in nature and can be used by every one. In an organization knowledge is the only resource that can create sustainable competitive advantage. Some of the elements of human capital can be for example: Figure 8.1

(1) Work related knowledge,
(2) Education,
(3) Competence / skills,
(4) Innovativeness,

Figure: 8.1 Elements of Human Capital
(5) Proactive or reactive abilities,

(6) Changeability,

(7) Aptitude and attitude, etc.

8.3 Relationship capital: It may be defined as “Different type of relationships between several types of organizations, may be customers, suppliers, competitors or partners etc; .The relationship capital can be external to the organization and it can be inter-organizational also. The relationship determines the image the market gets of the organization Sveiby (1997) and represents potential value an organization can achieve based on intangibles external to the organization itself. Figure 8.2 represents the model of relationship transactions and connectivity among its components.

![Figure 8.2 Relationship Capitals- Model](image)

8.4 Transactions between ‘Human Capital’ and ‘Relationship Capital’:

Human capital is tacit in nature and its protection is essential without prohibiting its flow. Protection here is defined as “the process by which firms sustain the uniqueness and value of their competencies” McEvily, Eisenhardt and Prescott (2004:114). For organizational
development dissemination of knowledge and information is essential but a balance of flow has to be controlled and maintained without compromising on knowledge security. Loss of tacit knowledge happens many times due to employee poaching by the partner or collaborating organizations. Poaching often happen in situations where the people feel that their work is valued more in partner firm, and start to develop loyalty towards the partner firm instead of the parent firm Pitsis, Komberger & Clegg (2004). This issue could be solved by obliging the employees to sign an agreement not to accept competing job offers, before leaving for secondment. For managing the risk of theft of knowledge, organizations must plan some strategies, like:

- Holding on or retaining the staff.
- Developing the culture of loyalty in the staff.
- Keeping an eye on the customer relationship.
- Developing professionalism or professional behaviour of the staff.
- Taking the advantage of the reputation or goodwill of the company.
- Physically protecting explicit or codified knowledge.

8.5 Structural Capital: Structural capital is one of the components of intellectual capital and it can be said that “Whatever is left behind after the employees leave the organization” is the structural capital. By leveraging human capital and making it useful for the whole organization, the employees create structural capital Ordonez de Pablos (2004), Bontis (1998). Structural capital can exist in various forms as shown in figure 8.3

- Innovation capital
- Organizational capital
- Process capital.

![Fig: 8.3 Structural Capital](image-url)
If an organization wishes to create shareholder’s value or competitive advantage and the first mover advantage, then its efficient utilization is essential. In an organization the structural capital can exist as: model, patents of the firm, templates, computer systems, culture and atmosphere and administrative procedures etc; besides in several other forms. Tacit knowledge residing in the minds of the people, when codified becomes explicit and can be utilized by others in the organization, and becomes a part of the structural capital.

8.5.1 Innovation capital: It refers to the abilities of the organization to create or develop newer products or services with added values and utilities for the end users or customers. It is due to the rich innovation capabilities, that organization can develop and manage patents or licenses to run monopolies in a limited manner, where others are not allowed to make an entry to the market for a specified period of time during which inventor develops and tries to capture the market. Figure 8.4 represents the model of Innovation capital of an organization. All these components contribute to the development of an organization.

On account of the good innovation capabilities of an organization, it

- Acquire patent rights.
- Manage strong portfolios.
- Develop certain amount of monopolies for a certain period of time.
- Generate licensing income.
- Develop autonomy in activities.
- Help in developing loyal customer bases etc;
The great advantage of patenting is for example, almost no cost is involved and customers remain immune to the offerings of other competitors for quite some time even after the expiry of the patent. Thus automatically all these result in increased organizational profits. Patent’s income provides stability and can be used to sustain operations during economic down time. Japan Patent office (2000): Internet and Delphion industry insight (2002: internet). The various forms of innovation capital can be for example,

- Models
- Computer systems
- Trade marks.
- Copy rights.
- Administrative processes.
- Culture and atmosphere.
- Templates etc; and can be many others.

8.5.2 Organizational capital: There is no consensus definition of organizational capital. Information Technology (IT) can boost productivity, but the real gain for business comes from combining IT investments with organizational capital. IT investments have shown an increase in productivity of the organization in late eighties and early nineties. Organizational capital includes,

![Organizational Capital Model](image)

Fig: 8.5 Organizational Capital-Model
• Various pointers of organizational capital can be like; All existing computer systems.
• Distribution and supply channels.
• Corporate philosophy and culture
• Data bases
• Laboratories
• Organization charts.
• Trade secrets etc.

The net effect of all these constitute organizational capital as shown in figure 8.5

Some of the factors of the organizational capital must be legally protected.

• Number of new patents registered.
• How many of new products have been launched or introduced.
• Expenses incurred in research and development work.
• Modifications made in the products due to customer’s demand or requirements.
• Percentage of money spent on IT with respect to total expenses incurred by the organization.
• Extent of data base used.
• Rise in earning due to introduction of new product etc;
• Number of computers and computer systems being used.

8.5.3 **Process capital:** “Process capital” and “Innovation capital” stand at higher hierarchial position in structural capital and may provide competitive advantage and first mover advantage to an organization. It is quite difficult to identify, codify, analyze and manage the process capital. A carefully and well designed or planned process developed after interaction with a large number of people and then fixing the tasks, like process or plant or system automation will definitely provide business benefits or advantages. The figure 8.6 below represents the process capital model.
Fig: 8.6 Process Capital-Model

It must be difficult to imitate so that it becomes the case of long term success. Process capital management forms the basis for ‘document management’ work flow management, task management and process automation’ etc.

An innovative look at process capital helps in several ways for example by utilizing

- Setting the best practices,
- Deciding strategies,
- Preparing the process manual,
- Patenting the processes,
- Preparing guidelines for the processes and
- Standardizing the procedures, a process capital model has been developed.

Process improvement by discarding the traditional methods of working and using process capital model for:

- Process optimization.
- Cost control or cost reduction thereby increase in profits.
- Performance improvement or performance retention by fixing right type of people in the right slots at the right time.
- Customer retention is one of the prime objectives,

This will provide advantage to an organization.
All such efforts as are directed towards process capital management may be taken as customer centric operations / activities. All newly developed and valuable processes must be patented or registered to protect the Intellectual capital of the organization against imitation by the competitors.

8.6 **Return on Investments (ROI):** These are the gains made by the companies on account of the investments made by the companies. ROI are calculated on the basis of the previous historical figures or data and they could not provide any insight for business improvements. Returns on investments can be either “tangible returns” in the form of financial or material returns or “intangible returns” abstract in nature or in both forms. Returns on Investment Factor ROIF can be calculated using the formula,

\[
\text{ROIF} = \left( \frac{\text{Total revenue collected} - \text{Total business expenses}}{\text{Total business expenses}} \right) \times 100
\]

\[
= \left( \frac{\text{Net Gain}}{\text{Total business expenses}} \right) \times 100
\]

This is also called “Net ROIF”

\[
\text{Net ROIF} = \text{Tangible ROIF} + \text{Intangible ROIF}
\]

It is expressed as, a percentage of “Net gain” on Total expenses incurred in business”. Intangible ROI factor is the ratio of “Gain due to adoption of intangible factors” and “Total business expenses”. Similarly, Tangible ROI factor can be found as the ratio of “Gain due to tangible factors / investments” and “Total business expenses”.

‘Gain due to adoption of intangibles’ can be found by subtracting from “net gains”, the “gains due to tangible investments”. The Intangible ROI factor gives the numeric concept of
the percentage of gains on total expenses incurred in business, as a result of the attainment of the higher value of “Intangible Return on Investment Factor”. The factor so found has been named as “Sahai-Grover Return on Investment Factor” and abbreviated this as, (SGROIF).

**Intangible ROI:** An organization can also earn ROI in Intangible forms, for example,

- Improved relationship between employer and employees.
- Positive attitude of the employees.
- Trust and confidence of employers and employees in each other.
- Employee’s retention and stability.
- Corporate culture development.
- Customer satisfaction.
- Goodwill and reputation of the organization.

**8.7 Concluding Remarks:** The current work suggests that in order to sustain an organization in a stiff market place, it has to strive hard for the attainment of competitive advantage and the first mover advantage. This can be possible by integration of multiple factors consideration approach. In this work a relationship and connectivity has been established between components of Intellectual capital (IC), and Tangible and Intangible Returns on Investments (ROI), in relation to Performance escalation of an organization. It is felt that intellectual capital and organizational performance have some kind of relationship. Through the Intellectual Capital constituted of, Human Capital, Structural Capital and Relational Capital; it is possible that by its efficient utilization along with the factors stated above, to achieve higher performance levels. The knowledge capital must be protected by suitable methods whether legal or otherwise and a perfect balance of flow of IC must be maintained. Some procedural constraints in knowledge transactions with the partners in the joint ventures must be imposed. Employee poaching by the partner or collaborating organizations must be checked by making use of ‘Relational Capital’ and imposition of certain procedural constraints. By doing so, the organizations earn Intangible ‘Returns On Investments in the form of:

- Positive attitude of the employer and employees towards each other.
• Mutual trust and confidence of each other.
• Employee retention and stability.
• Goodwill and reputation of organization.
• Customer satisfaction due to relationship of contented employees of the organization, etc. and so on. This will mean great intangible gains to the organization.

To extend the performance further and to receive higher ‘Returns on Investments’ adaptation of Human-Machine Interaction and Ergonomically Enabled Environment and use of the principles of Information Technology and Knowledge Management is not only desirable but essential. This integrated approach helps to:

(a) Promote productivity.
(b) Attain higher economic gains.
(c) Provide better quality of product at lower cost.
(d) Achieve higher tangible and intangible Returns on Investments.
(e) Reduce ‘Work Related Injuries’ (WRIs) and health disorders hence lesser, medical expenses and money spent on compensations.
(f) Develop improved employer-employees relationship.
(g) Achieve better quality of life, etc

Further, it is strongly felt that:

• If the organizations really wish to attain higher performance levels then they must not ignore invisible factors and resort to the utilization and protection of knowledge capital, and adopt Ergonomic culture. Proper Human-Machine Interfacing is not only desirable but essential.

• The Intangible Return on Investment Factor (SGIROIF) gives the numeric concept of the percentage of gains as a result of the attainment of the higher value of “Intangible Return on Investment Factor”. The factor so found has been named as “Sahai-Grover Intangible Return on Investment Factor” and abbreviated this as, (SGIROIF). Similarly, if this factor is calculated on the
basis of tangible returns on investments then it will be called, "Sahai-Grover Tangible Return on Investment Factor" (SGTROIF).