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trekking

a newsletter on practical strategic thinking and action
issue #20: new growth theory

editor's message

This month's newsletter is inspired by a chapter in the book on our Reading List. The chapter is by Paul Romer, one of the economists behind New Growth Theory, which challenges the traditional economics of scarcity. In *Strategic Thinking*, we explain Romer's ideas and in *Strategic Action*, we explain how to use this information to make your business stronger. Our Industry Spotlight examines these concepts in light of the merger of two local industry organizations and the Reading List reviews *Intangible Assets: Values, Measures and Risks*.

strategic thinking

The "Soft Revolution"

The economics most of us studied in school were focused on finite resources, including land, labor and capital. In a piece called "The Soft Revolution: Achieving Growth by Managing Intangibles" (see our review of *Intangibles* below), Paul Romer injects a new and essentially infinite resource into the mix—something he calls "software." Here's how he breaks down business resources:

- **Hardware** includes all tangible assets used in a business. Hardware is a physical, scarce resource.
- **Software** is a catchall term for all the knowledge, instructions, recipes, and formulas. Software is an intangible, infinitely reusable resource.
- **Wetware** is the human contribution to the process. Humans are also a limited physical resource. However, by learning existing software and creating new software, human capital builds future value.

So what is the lesson for business? Romer says that,

"Once you have got one of these pieces of software [using the broad definition above]...the return you can capture from that investment grows strictly in proportion to the size of the market where you can use it. Think about what kind of potential that means in a world with five billion people and growing; the potential gains for individuals who can capture good pieces of software and use them over and over again are enormous...this process of globalization is just starting." (*Intangibles*, page 71)

You'll recognize this way of looking at growth and value from our past writings on intellectual capital. We see the management of human, structural (Romer's software) and relationship capital as critical to the future success of most businesses. In your own business:

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- What are your key “soft” assets?
- How do you manage them?
- What is the best way to profit from them?

Another interesting interview with Romer—this one by *Reason* magazine—is available on the web at: <http://www.reason.com/0112/fe.rb.post.shtml>.

-Mary Adams (adams@trekconsulting.com)

strategic action

Managing Intangibles and Intellectual Capital

How do you apply Romer’s ideas and achieve growth through managing your intellectual capital (IC)? You probably already manage individual components of intellectual capital through departments or functions. For example, human capital (employees and managers) is the main responsibility of a human resources department and a core function of all managers in a company. Other departments manage other sources of capital such as marketing (brands), sales (customers), operations (processes), and legal (patents and trademarks).

As a critical component of corporate value and success, IC should also be managed on a strategic, company-wide level. Management at this level answers questions like:

- Do we have the right business model and competitive position?
- Are we attracting, cultivating and retaining the people we need (wetware)?
- Do our people share what they learn to create structural capital (software)?
- Are we forging lasting, effective external relationships that build value and knowledge?
- Are we staying close to our customers’ needs?

With effective intellectual capital management, your company becomes smarter and can build on past innovation. This improvement can and should happen anywhere—on a factory floor, in a retail store, at a service business, or within a technology company.

More information on this approach to growth and value is available at www.icknowledgecenter.com.

- Michael Oleksak (oleksak@trekconsulting.com)

industry snapshot

The Merger of Mass Software and Mass Technology

Around the time we read Romer's broader definition of "software", it was announced that the Massachusetts Software Council was planning to merge with the New England Business and Technology Association. The new organization will be called the Massachusetts Technology Leadership Council.

It's interesting to think about this merger in relation to Romer's definition of software. Business is using technology to facilitate continued (and hopefully continuous) value creation. The focus of many businesses has shifted away from thinking about technology as an end in itself (including the traditional definition of software) to thinking about the business processes, the instructions, the enabling knowledge (Romer's broader definition of software) that are the true value drivers.

Going forward, this new organization is free to ignore categorization of technologies and move to a much more productive discussion—how to continue to create economic value at the intersection of business and technology. We look forward to being a part of it.

The combined organization's temporary website can be reached at <http://www.masstechleaders.org/pages/2/index.htm>

reading list

Intangibles: Values, Measures, Risks

Edited by John Hand and Baruch Lev

We have only touched on one chapter from the first section of this book, but the rest of the book is a worthwhile read for a number of other reasons. Other chapters in Section I quantify the scope and effect of intangibles in our economy. An important area of examination is the relationship between stock market values and intangible investments.

The chapters in Section II generally report a positive correlation between values and estimates of intangibles such as brand, trademarks and R&D. But the research, like the stock market's assigning of values, is hampered by the lack of good information about intangibles.

This information deficiency is the subject of the third section. As with many academic works (and this is a pretty dry academic book—one of the editors, Baruch Lev, is a professor of accounting at NYU), the last section frames the future challenges. Lev ends the book by calling for standardized voluntary disclosure of information on intangibles.

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We believe that standardized “accounting” for intellectual capital will be a long time coming. However, there are many ways to apply ideas from this field to better meet the most significant competitive challenge companies face today—how to create value with their own software, hardware, and wetware.

You can read more about this book at the publishers web site:
<http://www.us.oup.com/us/catalog/general/subject/Finance/Investments/?view=usa&ci=0199256942>.

announcements

Trek is kicking off its first IC Rating this week. Stay tuned for more news on the process. In the meantime, feel free to visit our IC Rating website at www.icrating.com.

Please accept our wishes to you and your family for a happy holiday season!

-Mike Oleksak and Mary Adams

Next month in Trekking: “It’s a New Year”.

about trek consulting

Trek Consulting LLC helps companies to face the challenges of growth, building value and dealing with change. Since 1999, we have been a valued partner to business owners and leaders on their arduous journey to business success. We know that we cannot make this journey for our clients, but we can make it easier and more successful. We focus on getting you the best information available, facilitating sound planning and decision-making, making sure you have the right skills and resources to face your challenge, and coaching you through the road-blocks that invariably arise along the way.

Our clients report improved market focus, greater revenues, better margins and increased profits. To learn more about Trek Consulting and how we can help you improve your company’s results, visit us on the web at www.trekconsulting.com or call us at 781-729-1008.



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