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Where is the Beef?
Doing a Better Job Assessing Intellectual Capital

By Mary Adams

[http://www.americanventuremagazine.com/articles/364]

Venture capitalists have been key agents in the development of today's knowledge economy. This work has put you in the vanguard of analyzing and valuing the potential of knowledge-based businesses. But are you now being left behind? Is your investment analysis process the same as it was twenty years ago? Or are you taking advantage of advances in management studies to improve your own business process?

The practices of venture investing will always require sound experience and instinct. However, there is room for more discipline and objectivity in the process. Many VC's are learning this discipline from the field of intellectual capital (IC). The formal definition of intellectual capital includes all the intangible assets of a company. The four components of IC include:

- Human Capital – Both employees and managers
- External Relationship Capital – Brands and relationships with customers, and external partners such as suppliers, distributors and development partners.
- Organization Capital – Knowledge, including intellectual property, know-how, processes and software.
- Business recipe – Both the market opportunity and the strategy devised to take advantage of that opportunity.

These four components are already the primary focus of venture investment analysis. VC's get a feeling for the strength of IC through observation and through tapping into the experience and knowledge of respected sources. The next generation of this approach is the intellectual capital assessment.

IC assessments take a structured and consistent approach to analysis of the individual components of intellectual capital. Methodologies differ but the most compelling approaches include feedback from the knowledgeable external and internal stakeholders of the company. The analysis is consolidated so that intellectual capital can be viewed as a portfolio. Some systems, such as IC Rating™, actually assign a specific grade (like a bond rating) to the current strength of IC. This type of methodology also examines the future potential of IC and identifies areas of risk.

Peder Hofman-Bang, one of the leading global authorities on IC assessment, tells the story of a venture fund that had invested in the first round of two similar companies. When it came time for the next round, they decided to use an objective rating of the intellectual capital of the two companies. The ratings showed one company to have a much strong IC portfolio. The fund invested in the second round for the strong company and cashed out at a 60% ROI. The weaker company received funding elsewhere but eventually went bankrupt.

The rigor of an objective assessment is a welcome addition to the investing world. While venture investing will never be a science, it is only prudent to apply more discipline where possible. The latest trends in intellectual capital assessment are a great place to start.

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