

# Leading Issues Journal

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## In this Issue

The Centre for Leadership for Women focuses on the topic of Intellectual Capital. This relatively new concept comprising the tangible and intangible value of an organisation, appears to be gaining momentum in the field of management and organisational research.

What precisely is Intellectual Capital? How does one develop it? How are organisations acknowledging and implementing this concept to their competitive advantage?

Ms Ann Sherry, Group Executive, Human Resources for Westpac Banking Corporation and CEO of the Bank of Melbourne, a Westpac subsidiary, explores these questions in her address entitled, "Capturing the Wealth of Intellectual Capital in the Public and Private Sectors" which she presented to the Institute of Public Administration Australia on 4 June 1999. With specific reference to the Westpac Banking Corporation, she discusses how an organisation can harness the People, Organisational and Customer capital. She concludes that the value of intellectual capital does "not lie in ownership but in successfully leveraging the benefits of the different forms of capital residing within the organisation."

To view the Centre's interview with Ann Sherry please click here: [Interview with Leaders](#)

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## **Capturing the Wealth of Intellectual Capital in the Public and Private Sectors**

**By Ann Sherry**

### **Introduction**

Two years ago recruitment company Morgan & Banks listed on the Australian Stock Exchange. With a capital asset base of around \$11 million, conventional analysis would have predicted the company could fetch a price of around \$20 million to \$30 million. Instead the company was soon valued at over \$300 million – almost 30 times the book value of its assets.

This indeed was an extraordinary result. But a closer look at the company tells us why, and illuminates the key issue I want to talk about today. Morgan & Banks is a business that revolves around placing the best people in jobs. The bricks-and-mortar assets of Morgan & Banks are worth far less than the inherent value of something more intangible: its intellectual capital. For Morgan & Banks, the talents of its people, the cleverness of its management, and the strength of its customer relationships are the real keys to its future.

In today's competitive environment, when the same products or services can be delivered at equal price by a whole host of providers, factors such as quality, value, service, and innovation are accepted as givens. Our customers and our communities expect no less than that.

Our competitive edge is now shifting away from product and price to people. Knowledge and the ability to capture and bring the knowledge to life with innovation and superior execution are replacing physical materials and assets as the building blocks of a great organisation.

This realisation raises key questions for public and private sector organisations today: what is this concept now being called intellectual capital? How do we in practical terms harness

an organisation's collective intellectual resources? What are the implications for how we recruit and how we organise jobs. How do we use people in a clever way, how do we retain them and develop their potential? These are some of the issues I want to raise today.

### **What is Intellectual Capital?**

Knowledge, of course, is not new. Plato and his fellow philosophers theorised on the meaning of knowledge 2,000 years ago. People in corporations have always sought, used and valued knowledge, even if they didn't realise they were doing so. The most experienced or knowledgeable person would be the person to get the job, or the promotion, or be the source of wisdom and decision-making within the company. In the Public Service, the smartest brain would often be the leading manager and policy driver, someone who could think, manage and implement.

What has changed is our competitive environment. Deregulation, technology leaps and increasing globalisation have had a far-reaching impact on our business. The information revolution means that information streams are becoming the key input along supply chains between companies and their customers rather than touchable, tangible goods. Many companies now spend more on technology that gathers, analyses and distributes knowledge than they do on machines that manufacture goods.

Companies can no longer rely on opening their doors, turning out the same products, and expecting customers to turn up as they have always done. In banking, for instance, customers can go to a mortgage originator or an insurance company for their home loan. They can seek out a foreign investment bank for their investment products. Or they can be get a credit card sponsored by a telecommunications or an automotive company, while knotching up frequent flyer points with an airline at the same time.

The traditional, loyal customers are fast becoming an endangered species, as new information-rich customers take advantage of their access to competitor information and seek out better prices and better service. With the internet now enabling customers to link even more directly to businesses, customer power can only grow.

Change, though, is not just a private sector gig – the public sector is also confronted by pressures for change. Governments around the world are demanding better performance from their public servants and higher value out of a diminishing public dollar. You can't expect an assumed level of funding or even an assumed domain of expertise in areas where the public sector would have ruled supreme. Virtually all your work is open to contest.

You too must find a competitive edge and demonstrate your value in providing services to customers.

But knowledge, information and data - what is it we're looking for? How do we know what's important? I define data as the raw information that exists within the company. For Westpac, for instance, 35 per cent of our customers are aged over 45. Information puts the data in a bigger context; the over-45s are a growing customer segment with a higher potential spend on financial services products as opposed to straight transaction services. The knowledge is where we temper the information with experience and a dash of strategy; we will grow the over-45s segment by 20 per cent if we package the financial services, superannuation and on-line equity trading to meet their diverse needs.

Intellectual capital is actually the combination of data, information and knowledge. As leading business writer Tom Stewart says, intellectual capital is "the sum of everything everybody in a company knows that gives it a competitive edge".

For my bank, it's the knowledge that resides within our workforce; the training, experience and intuition of our staff, and the relationships that we have built between our people and our customers. But the full weight of intellectual capital extends beyond mere existence of knowledge and skills. It's our ability to capture the knowledge, to nurture capabilities, develop a willingness to share the knowledge, be able to distribute and use it, and then translate the knowledge into a product or service.

### **How to Harness Intellectual Capital**

This leads us to the question of how we actually harness the intellectual capital that resides within our organisations and transforming it into a business driver. I believe that we look for intellectual capital in one or more of three places: in our people, in our organisational structure, and in our customers.

#### People capital

When most people think of intellectual capital they think immediately of people. People are of primary importance, of course, because it's their collective brainpower that makes up the organisation. When I say brainpower I don't mean brains measured solely by academic brilliance, but also brainstorming power – the sum of human innovation, ideas, and enthusiasm.

Bill Gates says that, in the information age, "How you gather, manage and use information will determine whether you win or lose" (*Business at the Speed of Thought*, 1999). I would argue that how you inspire, manage and motivate the people who are gathering the information will be the real key to success. Without them, the information has minimal value.

Westpac's driving strategy, for instance, is to get closer to our customers – to make every experience customers have with our bank a professional and personal experience, one they want to repeat time and time again. The way we do that is through enabling staff to understand our customers and empowering them to deliver the services they know the customers want.

Rather than treating people as adjuncts to the main activity of the business, the organisation has to invest in people and bring them into the centre of the organisation.

Traditional hierarchies where the decision-making and knowledge resides at the top, and is parceled into segments as it makes its way down to the bottom, are no longer relevant. The knowledge organisation seeks to break down structures and enable people to operate in a boundary-less way. Information and knowledge in this type of organisation spreads in a far less controlled, but far more productive, way.

As GE chairman Jack Welch says with confidence, you have to get everybody in the organisation involved. "The best ideas will rise to the top."

At Westpac we're still learning how to encourage that to happen; it's an ongoing organisational challenge. But you can see perceptible changes at the retail customer service

level, where banking has changed from mainly branch-level service to a mix of face-to-face contact and electronic solutions such as telephone banking. The shift has actually freed up staff from a lot of paperwork and basic transactions and changed the nature of their jobs, so that, for instance, they might be part of a customer team in a telecentre where their focus is on customer solutions.

Westpac encourages staff to develop individual development plans, which involves them defining their goals and deciding the training, mentoring and other assistance they need. In other words, they decide what they want and go for it.

The training then becomes individually oriented rather than an organisation-wide blanket. This way, the people are motivated to take part, and generally gather far more benefit than if they feel they are part of an enforced training camp.

The measurable benefits of education and training provide some evidence of the importance of intellectual capital. A study of 3,500 workplaces in the US in 1995 by the National Centre on the Educational Quality of the Workforce found that on average, a 10 per cent increase in workforce education level led to an 8.6 per cent increase in total productivity. By comparison, a 10 per cent rise in capital stock increased productivity just 3.4 per cent.

Put another way, the value of investing in human capital is about three times greater than the value of investing in machinery.

The other aspect of harnessing people capital lies in creating the right culture – making people proud of where they work, understanding what their collective goal is, and believing in the vision of the company.

We do this through promoting the core values of our company – explaining who we are and what we are striving for. And we seek to live our values through the human resources policies of encouraging diversity, rewarding through merit, and offering flexible, family-friendly conditions.

We also encourage staff to be part of their communities through programs where we match dollar for dollar any donations made by staff to charities of their choice, or if they prefer, provide paid leave so that they can contribute their time to the charities.

These policies are not altogether altruistic. They're based on the belief that if our staff are satisfied in their work, then they'll carry over that satisfaction in the way they deal with customers. Westpac's experience of the last few years has driven home to us that there's a clear link between happy, motivated staff, and happy, satisfied customers. Nurturing this link has seen our staff satisfaction levels increase from around 5 on a scale of 1 to 10, to reach 7.5 and our customer satisfaction increase by 25 per cent. That's quite a leap, and I think highlights the fact that investment in our people capital has a very clear dividend for the future.

### Organisational capital

If we do invest carefully in our people, then we're well on the road to harnessing our intellectual resources. But the second part of the journey involves the organisation itself.

We need to build an organisational structure that connects people to the vast data we collect, and make it meaningful and useful to our business.

Today workers can be so overloaded with information that the number of emails on their screens is starting to look like a 100-year flood mark - only the level keeps on rising and rising.

We're receiving, storing and shifting so much information through our intranets, web browsers, search engines, databases and knowledge exchanges we're in danger of over-investing in information as a result. No wonder the information alarm bells are sounding.

The challenge for the organisation is to discover the meaning of the information. It has to marshal resources so that the data can be mined in an intelligent way, so that it can contain and retain the knowledge it needs, and so that the information can augment and support ideas being put to work. We have to remember that technology is only a tool in this quest.

When our managers or financial advisers sit down and speak to a customer, or operators answer telephone queries, we need to have the collective resources of the bank at work, so that the right information can be available to support the customer contact.

While some may hanker for the old days of knowing their local bank manager, customers in most cities use at least five different branches in carrying out their everyday banking.

No one staff member can handle all a customer's transactions, and no one staff member can answer all a customer's enquiries. The immense diversity of services offered by banks today makes that task far too complex.

However, technology does make it possible to store and access the customer information, and essentially to enable us to know our customers. In this sense, the intellectual capital lies in our data warehouses and our thinking ability to use the data in a smart way that delivers customers a benefit.

The issue for every organisation then becomes connecting the people and the technology: what information do we collect and who do we provide it to? We have to build our knowledge stocks – to know what knowledge to store, know where to find it, what priority to give it, and then devise how to access or distribute the knowledge. We have to avoid falling into the trap of collecting too much information for the sake of it, then failing to use the data. That's disconnected information, not capital.

Westpac has giant customer databases, as you'd expect, but we also have a knowledge management database that tells us who knows what in the company so that we can access their expertise, regardless of where they sit in the organisation.

We can pinpoint, for instance, who knows government, who knows company X or industry Y, who knows how to speak Mandarin, who has done a particular type of merger or acquisition. We're not defining people according to what their job title is, but their broader base of skills and experience. Ideally, instead of undertaking jobs and following a vertical career path up through the organisation, people work on projects that can take them from side to side, gathering knowledge and skills as they go.

We've done three mergers with regional banks in the last four years, and as an organisation we've developed and now retained the intellectual capacity to go out and undertake new mergers if we decide that's the best strategy. (Today you would argue it has also given us capacity to really judge whether we have the pre-conditions for success right as well.)

Our team for the integration with the Bank of Melbourne last year comprised people who had the knowledge and capabilities needed for a merger exercise. People were there because of what value they could add to the process, not because of their place in a particular business unit's hierarchy.

Westpac has built what I call "pods" of intellectual capital throughout the organisation. These living pods show how people combine with technology and a flat organisational structure to deliver knowledge that is active and accessible. Information will never be intellectual capital unless it moves.

### Customer Capital

The third and final aspect of intellectual capital is customer capital. This is possibly the most valuable form of intellectual capital because it's the customers who pay the bills, and it's their ongoing loyalty that will build a business. Every company that has customers will have customer capital.

The information revolution means we can track their every contact point with us, like a technology footprint, through data bases showing what transactions they conduct, what products they buy, what queries they have and payments they make. Figures such as customer retention rates, or the flip side, defection rates, profitability per customer, and market share in different segments are all really measures of customer capital.

The value of knowing your customer is enormous.

One US automotive company estimates that every percentage point increase in customer loyalty – that is, how many cars they return to buy – is worth \$100 million a year in profits. A US credit card provider estimates that if it cuts the rate at which customers defect by just 5 percentage points, it will increase the lifetime profitability of the average customer by 125 per cent.

We take customer capital very seriously at Westpac because it lies at the heart of our business strategy. We have spent the last decade rebuilding our customer base through regional acquisitions and through getting closer to our existing customers.

We looked at every customer relationship we had, assessed its current profitability and its potential for future source of business. Today we constantly look for ways to add value to every relationship, and we do that by knowing customer needs then delivering on the products and service.

In our merger with the Bank of Melbourne we adopted a three-pronged approach that combined the business objectives with our staff and customer objectives. That means we didn't jettison high-cost customers for the sake of getting the figures to match the projections. We worked very hard to protect the strong relationship that the Bank of Melbourne had with its customers so that we could carry that over to the new integrated bank.

We did that in many ways – through close and regular consultations, customer surveys, building a customer focus with staff, and introducing policies that delivered on the type of bank that the customers said they wanted to emerge from the integration.

At the end of the day we finished with 30,000 more customers than the combined Westpac and Bank of Melbourne had started with – a first, I think, for any bank merger. We increased our number of priority customers by 25 per cent, and lifted customer cross sales from an average of 1.7 to 2.9 products per customer. The true test of course, will be in the longer term. Indications are that customers have made the transition, and now the challenge is to retain their loyalty.

### **What About the Public Sector?**

I've been talking mainly about the private sector today, using my experience at Westpac as an example of how we're building intellectual capital.

But the principles can still apply to the public sector.

1. The value of agencies and departments does not lie in the property, cars, equipment or systems they own. It's in the unique and distinguishing intellectual capabilities of the people who make up the Public Service.
2. Capturing the wealth of intellectual capital covers the broad spectrum – your people; your organisational structure; and your customers, or clients.
3. For people, you have to foster teamwork, build a workplace culture that encourages and rewards skill and performance, and empower people to use all their knowledge resources.
4. For the organisation (and I know that today it's a very devolved organisation), it's a matter of having the capacity to define and capture the right kind of information that floods through your systems every day, and translate that into living, workable policies.
5. And for your customers .. well, you have to define who they are – is it the people of Australia, or the government of the day, or is the issue how do you best serve both, as an independent adviser to government and as an implementer of policy? I know I could start getting into hot water here ... but the point is that it's the public-interest aspect of a public servant's work that makes it unique, and that creates special, if not complex, demands.

Notwithstanding the complexities, I think it is possible to use your skills to hone in on particular constituencies or stakeholders, assess their needs and aim to provide innovative solutions. We all have varying constraints, both financial and community, but we can seek to capitalise on our customers by investing in them too.

### **Conclusion**

I'd like to conclude with one last observation on intellectual capital. Harnessing intellectual capital is not the same as other forms of capital. We don't buy and own staff, customers or their information. Value doesn't lie in ownership, but in successfully leveraging the benefits of the different forms of capital residing within the organisation.

Knowledge management thinkers Klein and Prusak emphasise that intellectual material does not actually become intellectual capital until it has been "formalized, captured, and leveraged to produce a higher-valued asset".

*"Intelligence becomes an asset when some useful order is created out of free-floating brainpower .... when it is captured in a way that allows it to be described, shared, and exploited; and when it can be deployed to do something that could not be done if it remained scattered around like so many coins in a gutter. Intellectual capital is packaged useful knowledge."*  
(my emphasis)

In the private sector the packaged, useful outcome is more easily discernible – it's what people buy.

For the public service I think the packaging and usefulness is still a key – but possibly it's "buy-in" rather than dollars and cents of purchasing that you look for. The "buy-in" to your ideas. To the incredible level of information you hold about Australians in your databases. To how you use the information to advise government and then to build better services for the community.

Today organisations – public and private - have to differentiate themselves on the basis of what they know, so that they can use their knowledge to do things better, smarter, and quicker. Intellectual capital gives them the power to do that.

Morgan and Banks doesn't own the people it recruits and places in employment. It captures the insight, contacts and cleverness of its people so that they make recruitment a success. You don't buy Microsoft shares because of its software factories, because it doesn't own any. You buy its ideas, its competitive edge, and its nous in a fast-moving market. You don't shop at amazon.com because of its chain of bookstores. They don't exist. You buy its extraordinary access to any book in the world and its cleverness at delivering what you want – quickly and cheaply.

When organisations start to value the intellect power of their people as greater than their tangible assets, and as worthy of serious investment, then they will be equipped for competition in the information economy of the 21<sup>st</sup> century. We're working towards that goal at Westpac.

I believe the public sector has a head start on using intellectual capital. I'm not so sure that either the value or the opportunity is articulated well enough to either the community or the Government. That is your challenge.