

The balanced scorecard and intangible assets: similar ideas, unaligned concepts

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Summary With their most recent publications on the balanced scorecard, Kaplan and Norton have focused on the learning and growth perspective in an attempt to clarify its constituent parts, as they acknowledge that many organizations struggle with what to include in this perspective. For that reason Kaplan and Norton introduce the concept of intangible assets as the content of the learning and growth perspective. They classify intangible assets into human capital, information capital, and organization capital. However, it is believed that this latest attempt to evolve the balanced scorecard might have an adverse effect. This article outlines how Kaplan and Norton failed to acknowledge the large body of literature on intangible assets and, therefore, produced an inconsistent, incomplete, and potentially very confusing classification of intangible assets.

Keywords Balanced scorecard, Intangible assets, Performance measures, Corporate strategy

Introduction

There has been an astonishing swing in the emphasis that Kaplan and Norton put on the learning and growth component in their most recent iteration of the balanced scorecard framework. This swing, which we believe may have gone unnoticed by practitioners, and certainly goes unacknowledged in Kaplan and Norton's publications, is in the importance that they give to the concept of intangible assets. This article challenges the way in which they have applied this concept in their latest work, and how this impacts the validity and usefulness of their framework.

In their first book – *The Balanced Scorecard* (Kaplan and Norton, 1996) – the term intangible assets is referenced in the index just twice (on pages three and seven of the introduction to the subject). In their second book – *The Strategy-Focused Organization* (Kaplan and Norton, 2000, p. 93) – intangible assets are not indexed at all, but it is in fact mentioned in the following passage: "The learning and growth strategy defines the intangible assets needed to enable organizational activities and customer relationships to be performed at ever-higher levels of performance". In their third and latest book – *Strategy Maps* (Kaplan and Norton, 2004) – intangible assets are suddenly promoted to the book's primary subject matter, indeed its subtitle is *Converting Intangible Assets into Tangible Results*. This is a remarkable change of emphasis.

The balanced scorecard and intangible assets

The principal premise of the balanced scorecard has always been its four essential components or perspectives – the financial perspective, the customer perspective, the internal business process perspective, and the learning and growth perspective, although the latter was originally called innovation and learning (Kaplan and Norton, 1992). In addition, Kaplan and Norton have always maintained that the balanced scorecard was designed for use as a *strategic* performance measurement and management framework (Kaplan and Norton, 1996), and they have urged us to think of the four perspectives as interlinked and layered: so that financial results are driven by customer satisfaction, which are in turn driven by internal processes and, underneath these three layers, is the foundation of the learning and growth perspective (Kaplan and Norton, 2000). This causal relationship between these perspectives can then be visualized in so-called strategy maps (Kaplan and Norton, 2000).

However, the learning and growth perspective of the balanced scorecard has long been considered its weakest link, and Kaplan and Norton admit that this is so (see their response to “Letters to the Editor”, *Harvard Business Review*, May 2004). They concede that several managers have told them this perspective is the “black hole” of their balanced scorecard. The authors’ own observations have been that few organizations have easily figured out how to populate this perspective with meaningful and strategically relevant performance measures. A recent study shows that a third of balanced scorecard users do not even have a learning and growth perspective (Speckbacher *et al.*, 2003). Some companies tend to plug the gap with either human resource related measures (such as staff training metrics, absenteeism levels, etc.) or, particularly in the engineering and technology sectors, innovation measures (such as R&D investment and its results). Indeed, we also know of several practitioners who have abandoned it altogether and simply labeled it the employee (or people) perspective (Marr *et al.*, 2004).

In their most recent publications, Kaplan and Norton have articulated what they consider to be the principal components of the learning and growth perspective; in their *Harvard Business Review* article (Kaplan and Norton, 2004), which is based on their latest book (Kaplan and Norton, 2004), they state that it consists of the following “intangible assets”:

- Human capital (employees’ skills, talent, and knowledge).
- Information capital (databases, information systems, networks, and technology infrastructure).
- Organization capital (culture, leadership, employee alignment, teamwork, and knowledge management).

Are we then happy now that this new explanation resolves the dilemma of what belongs in this perspective of their ubiquitous framework? In our view, while clarification of the scope of the learning and growth perspective itself can only be helpful, Kaplan and Norton have just added to the confusion by applying the intangible assets terminology, and we shall explain why this is so.

What are intangible assets?

While some might welcome Kaplan and Norton’s newfound enthusiasm for intangible assets, there are good reasons to be wary of it. Most readers will be aware of the existence of a field of study into intangible assets – or intellectual capital, as it is sometimes called (Marr and Chatzkel, 2004) – that has been ongoing since the early-1990s. Indeed, Thomas A. Stewart, currently editor of the *Harvard Business Review*, was one of the first to write about the subject in *Fortune* magazine in 1991 and 1994. Since then, the business publishing industry has flourished as a plethora of books on the subject of intellectual capital and intangible assets have been written – see Table I.

Several major studies on intangible assets have been conducted by, for example, the Meritum Project (conducted by a consortium of European universities), the International Federation of Accountants (IFAC), and the Chartered Institute of Management Accountants (CIMA) in the UK.

Table I Sample of intangible assets/intellectual capital publications

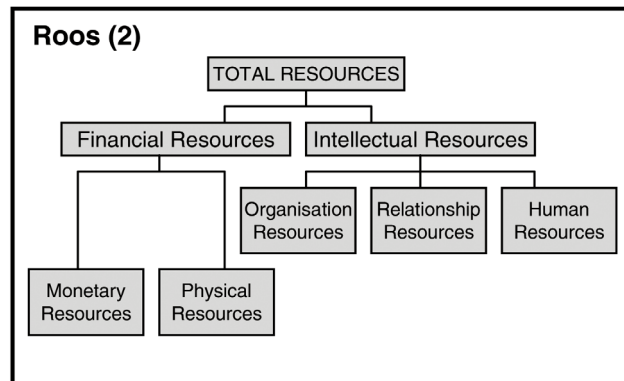
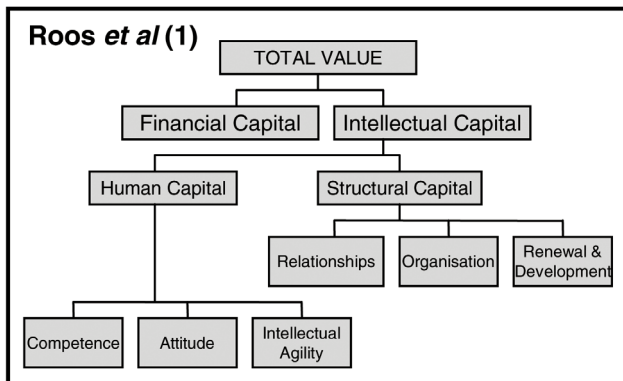
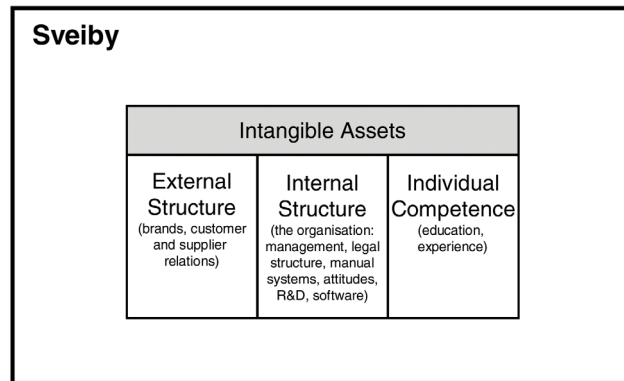
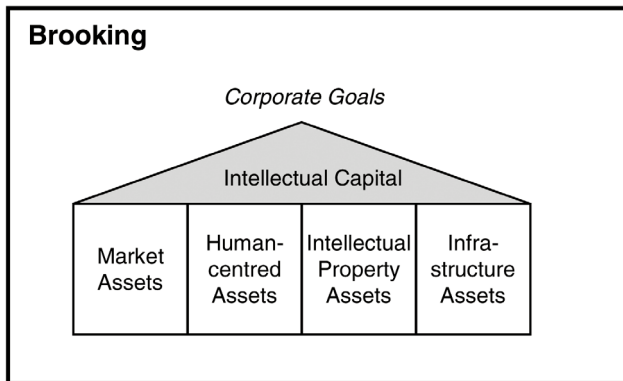
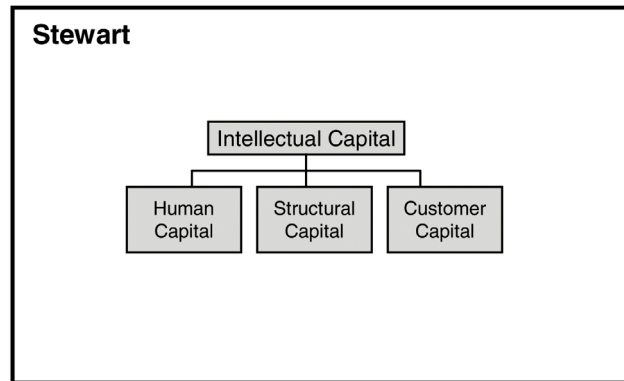
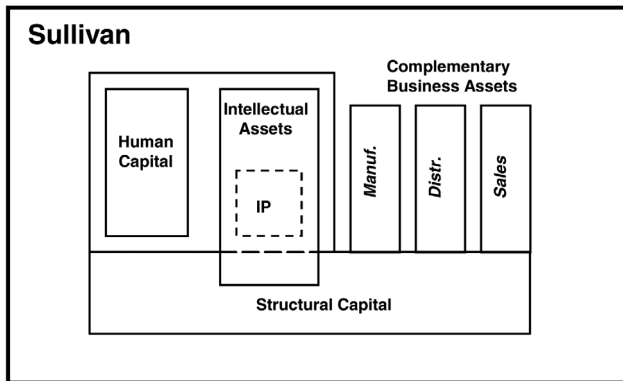
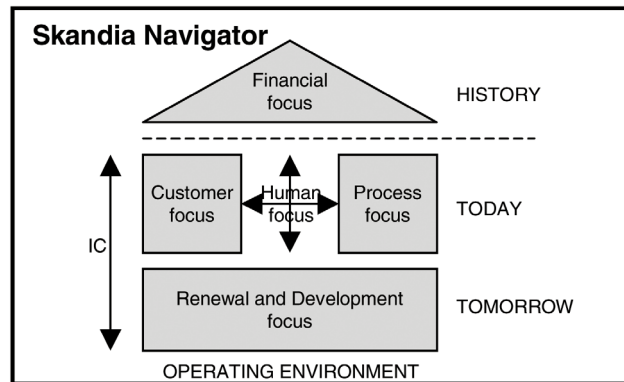
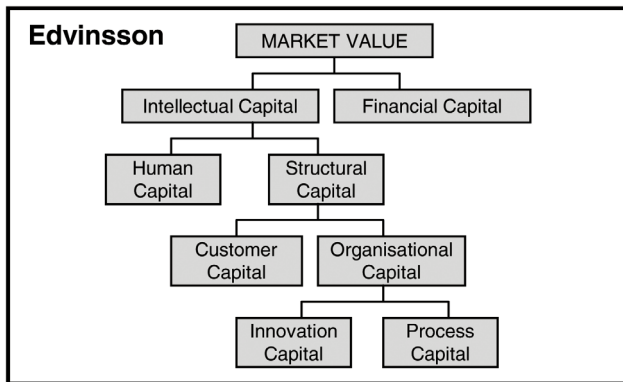
<i>Sample of 20 books on intangible assets/intellectual capital</i>		
<i>Year</i>	<i>Author(s)</i>	<i>Title</i>
1993	William J. Hudson	Intellectual Capital: How to Build It, Enhance It, Use it
1996	Annie Brooking	Intellectual Capital: Core Asset for the Third Millennium Enterprise
1997	Thomas A. Stewart	Intellectual Capital: The New Wealth of Organizations
	Leif Edvinsson and Michael S. Malone	Intellectual Capital: Realizing Your Company's True Value By Finding Its Hidden Brainpower
	Karl-Erik Sveiby	The New Organizational Wealth: Managing and Measuring Knowledge-based Assets
	Johan Roos, Goran Roos, Nicola Dragonetti and Leif Edvinsson	Intellectual Capital: Navigating the New Business Landscape
1998	Patrick H. Sullivan	Profiting from Intellectual Capital: Extracting Value from Innovation
2000	Daniel Andriessen and Rene Tissen	Weightless Wealth: Find Your Real Value in a Future of Intangible Assets
	Patrick H. Sullivan	Value-Driven Intellectual Capital: How to Convert Intangible Corporate Assets into Market Value
2001	Thomas A. Stewart	The Wealth of Knowledge: Intellectual Capital and the Twenty-first Century Organization
	David J. Teece	Managing Intellectual Capital: Extracting Value from Innovation
	Baruch Lev	Intangible Assets: Management, Measurement and Reporting
2002	Jay Chatzkel	Intellectual Capital
	Leif Edvinsson	Corporate Longitude
	Jonathan Low and Pam Cohen Kalafut	Invisible Advantage: How Intangibles Are Driving Business Performance
	Ed. Chun Wei Chow and Nick Bontis	The Strategic Management of Intellectual Capital and Organizational Knowledge
2003	Ed. John Hand and Baruch Lev	Intangible Assets: Values, Measures and Risks
	Jay Chatzkel	Knowledge Capital: How Knowledge-based Enterprises Really Work
2004	Daniel Andriessen	Making Sense of Intellectual Capital: Designing a Method for the Valuation of Intangibles

A number of international symposiums and conferences have been held on the subject too, such as the annual World Congress of Intellectual Capital at McMaster University at Hamilton, Canada, held since 1998. Since 2000 the movement has had its own respected journal, the *Journal of Intellectual Capital*, and many academic and practitioner papers have been published both there and in other prestigious publications. Furthermore, in parallel, even more publications have appeared on the subjects of human capital, one of the key sub-components of intangible assets.

Richard Hall (1989, 1992) introduces the concept of intangible assets to the strategic management field. Intangible assets are defined as those key value drivers whose essence is an idea or knowledge, and whose nature can be defined and recorded in some way (Hall, 1992). The author splits them into intellectual property (those assets for which the organization has property rights) and knowledge assets (those assets for which the organization does not have property rights). Intangible assets drive capability differentials, which in turn drive sustainable competitive advantage, which is why organizations need to bring intangible resources and core competencies into their strategic thinking (Hall, 1993). Itami (1991) calls them invisible assets and includes technology, consumer trust, brand image, corporate culture, as well as management skills. Many other classifications have followed over the past decade (Hudson, 1993; Brooking, 1996; Roos *et al.*, 1997; Sveiby, 1997; Edvinsson, 1997; Andriessen and Tissen (2000); Marr and Schiuma, 2001).

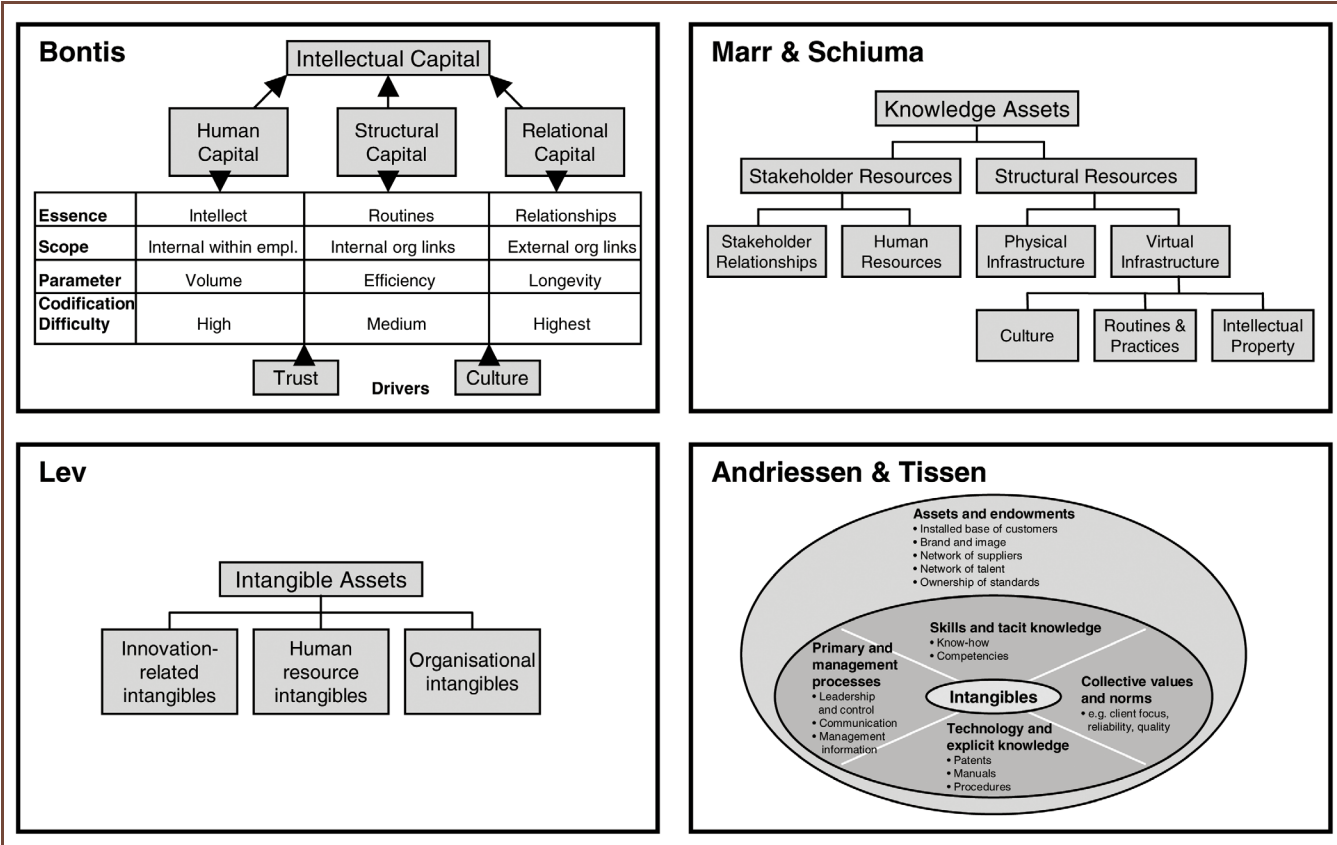
One of the problems with intangible assets is that there are almost as many classifications as there are authors on the subject – see Figure 1. One of the earliest frameworks used in practice is the Skandia navigator (Edvinsson, 1997). This is a five-faceted framework, developed by the Swedish insurance and financial services company Skandia. It consists of a financial focus (“history”), a customer focus and a process focus (“today”), a renewal and development focus (“tomorrow”), plus an integrating human focus – rather like a balanced scorecard with a fifth (human) perspective, in fact. Even though it possesses obvious similarities to the balanced scorecard, it has not been widely adopted by practitioners.

Figure 1 Sample of intangible assets/intellectual capital frameworks



(Continued)

Figure 1



The different classifications are rather confusing for practitioners who want to apply the concept in practice. However, it is important to realize that the concept of intangible assets is discussed from various perspectives, including accounting, strategy, human resource management, information systems, knowledge management, among others (Marr, 2004), and these different perspectives can lead to different emphasis in the definitions (Marr *et al.*, 2003).

Nevertheless, while the terminology used to describe and categorize intangible assets is far from being cohesive at the detailed level, there has recently been a general convergence towards a three-pronged overall framework consisting of human capital, organizational (or structural) capital, and relational capital (MERITUM Guidelines, 2002). This convergence applies in particular to the concept of strategic resources, which is also the perspective of the balanced scorecard (Marr *et al.*, 2004). Human capital relates to the skill-sets, aptitudes and attitudes of the organization's employees or human resources. Relational capital refers to the nature of the organization's relationships with all its key stakeholders (it started as customer capital, but quickly expanded to encompass a broader set of stakeholders). However, structural/organizational capital is the most complex – its original idea was to segregate the knowledge that went home every night (human capital) from the knowledge that was retained and owned by the organization (Edvinsson, 1997); but, while it makes a point, this notion is oversimplified and not particularly helpful towards classification of diverse elements. More recently, several commentators have suggested alternative ways in which to dissect it into sub-components, such as culture, innovation and process, while others choose to add further dimensions, such as intellectual property, and the organization's routines and practices (Marr *et al.*, 2002).

It seems the concept of intangible assets has huge potential to displace complacent balanced scorecard thinking – especially when allied and linked to financial measures (Neely *et al.*, 2003).

Critique of Kaplan and Norton's use of "intangible assets"

The collective wisdom that has been developed and published on the subject of intangible assets and intellectual capital over the last decade is clearly considerable, albeit sometimes contrary and confusing. But how much of it is acknowledged in Kaplan and Norton's latest work that gives this subject prime importance? The answer is: none. There are almost no references at all in Kaplan and Norton's recent work to the practitioner or academic research already carried out on this topic. What is more, there are no references either to the independent research done on some of the intangible assets' principal components: on human capital, on knowledge management (apart from a single reference in their previous book) and information technology, or on organizational cultures, let alone some of the other aspects of the concept that are often included as part of intangible assets (such as stakeholder relationships, intellectual property rights, brands and reputation management).

In their latest book – *Strategy Maps* – Kaplan and Norton state (on page 13) that: "The fourth perspective of the balanced scorecard strategy map, *learning and growth*, describes the organization's intangible assets and their role in the strategy. Intangible assets can be classified in three categories:" [they then list the definitions of human capital, information capital and organizational capital noted above]. Most students of intangible assets/intellectual capital will ask themselves the question "Why we needed another definition of intangible assets that differs from the existing classifications?" Furthermore, most will regard this new classification as an incomplete and confusing definition of their field of study.

First, it is not clear why information capital is separated from organizational capital as most scholars group information technology under organizational or structural capital (MERITUM Guidelines, 2002). In Kaplan and Norton's definition, information capital includes a company's strategic IT portfolio of infrastructure and applications, where infrastructure comprises hardware such as central servers and communication networks (2004, p. 56). The latter are in fact tangible infrastructure assets and, from a semantic point of view, should not be categorized as intangible assets as it will only add to the confusion of taxonomies. Marr *et al.* (2001) for that reason call them knowledge-based assets, which include physical infrastructure assets such as servers and networks.

Second, and more importantly, the concept of relationship capital is completely missing from Kaplan and Norton's definition of intangible assets. This category includes an organization's relationships with its stakeholders, such as customers, suppliers, network partners, or investors (Roos and Roos, 1997). The balanced scorecard includes a customer perspective and one might argue that customer relationships could be included into this perspective. In fact, Kaplan and Norton (2000, p. 172) argue that this perspective should include the customer value proposition, which describes the unique mix of products and service attributes, customer relations, and corporate image that a company offers. In the Mobil case study that they describe, they include "friendly, helpful workers" and "recognize customer loyalty" under relationships. Even if relationships might be included the issue remains that according to Kaplan and Norton's definition of intangible assets, relationship capital is not included, which defies the views of most researchers working in this field as outlined above.

So, let us be clear, when Kaplan and Norton use the term intangible assets, we need to be aware that they are not using it to mean quite the same thing as other authors who specialize in this subject.

Furthermore, Kaplan and Norton (2004) state that: "In developing the balanced scorecard more than a decade ago, we identified, in its learning and growth perspective, three categories of intangible assets essential for implementing any strategy:" [they then list the same definitions as above]. But that is tantamount to rewriting history – remember that until 1996 this perspective was known as *innovation and learning* and had a significantly different emphasis – and what

they actually identified in 1996 was something only approximately similar to what they are now claiming. They defined it then as (Kaplan and Norton, 1996, p. 127):

- employee capabilities (also referred to as staff competencies);
- information system capabilities (also referred to as technology infrastructure); and
- motivation, empowerment, and alignment (also referred to as climate for action).

While these may constitute similar ideas to those that they are now calling human capital, information capital, and organizational capital, these terms were not proposed as such in their earlier publications. And so it is fatuous to suggest that the same ideas and terminology that they are now using were proposed more than ten years ago. It simply was not and the term intangible assets, as we have shown, was hardly even mentioned then.

One might argue that the emphasis on intangible assets is an attempt by Kaplan and Norton to capitalize on the emerging popularity of intangible assets in contemporary management theory, and adapt their established framework to its sentiments. However, the constraints of their four perspectives do not allow the accommodation of the three overall classifications of intangible assets into their learning and growth perspective, and changing their balanced scorecard framework to accommodate all intangible assets might put the entire causal logic of the framework into question (Norreklit, 2000; Norreklit, 2000).

As outlined above, Kaplan and Norton have ignored the opportunity to acknowledge (even selectively) the substantial body of knowledge that has already been accumulated and so help to validate the inclusion of intangible assets within their framework. Furthermore, they have overlooked some important aspects of intangible assets theory and so leave unresolved gaps in their explanation of the framework.

Cynics might argue that Kaplan and Norton have some history of adapting their framework to contemporary needs. This has been done on both a macro and micro level. On the macro level, the balanced scorecard has evolved from a measurement (Kaplan and Norton, 1992) to a management framework (Kaplan and Norton, 1996), then to a strategic change framework (Kaplan and Norton, 2000) and then to a framework to manage the readiness of intangibles (Kaplan and Norton, 2004). An example of a micro level adaptation is the inclusion of other stakeholders inside their framework. The balanced scorecard has been criticized for its lack of attention to the demands of multiple stakeholders that are a significant feature of the modern business environment or complex ecosystem (Neely *et al.*, 2002). Its four perspectives address only the wants and needs of investors and customers, leaving those of employees, suppliers, alliance partners, regulators, local communities and pressure groups unrequited. With the emergence of other frameworks, like the performance prism (Neely *et al.*, 2002), that challenged the premise of certain aspects of the balanced scorecard, Kaplan and Norton have reacted with additional descriptions of their internal business processes perspective that address some of the highlighted shortcomings. For example, the internal process perspective (Kaplan and Norton, 2004, pp. 66-7) now includes processes such as manage regulatory and social processes (that includes sub-processes for environment, safety and health, employment, and community) and the operations management processes now include a sub-process called develop supplier relations. The manage regulatory and social processes example is interesting because, since Kaplan and Norton's framework does not acknowledge regulators or communities as stakeholder perspectives, they then find it difficult to logically link this process to the customer perspective in a strategy map and, therefore, have to make it leap a layer direct to the financial perspective (Kaplan and Norton, 2000, p. 96). Now it seems that it is the turn of the learning and growth perspective for a makeover. Staff competencies, technology infrastructure, and climate for action (*The Balanced Scorecard*, p. 129) are out, and in comes human capital, information capital and organization capital with their respective sub-sets, together with the remarkable new emphasis on intangible assets.

The evolution of established management approaches to meet contemporary needs should generally be applauded; however, re-defining fundamental concepts – such as intangible assets – to inadequately fit an existing framework causes confusion. The outlined sequential evolution of the balanced scorecard also makes it difficult to implement the system since there



is no common understanding of what is meant by a balanced scorecard. Speckbacher *et al.* (2003) even classify the users of the balanced scorecard into three types to reflect the different stages in its evolution and understanding. In fact, many organizations use the term “balanced scorecard” (note lower case) as a generic term for their performance management system rather than for the tenets of Kaplan and Norton’s framework (Marr and Schiuma, 2003).

Conclusion

The above analysis has identified and illustrated Kaplan and Norton’s tenaciousness in adapting the application of the balanced scorecard framework to contemporary needs. They have done this through a series of subtle changes to its supporting material. Whereas this has generally been a welcomed approach, it seems that the latest attempt to integrate the concept of intangible assets has failed because, in doing so, Kaplan and Norton had to re-define the concept of intangible assets to fit their model. This meant that they failed to acknowledge any of the extensive body of research on the topic of intangible assets and classified intangibles into human capital, information capital (including tangible assets), and organization capital. By doing so they completely ignored relationship assets as a major category of intangible assets and defy much of the earlier work in intangible assets.

We would like to stress that the balanced scorecard has been of immense help in breaking the mould of financial measures being “the only game in town” over the dozen years since it was introduced. However, Kaplan and Norton’s latest adaptation – to give significantly greater emphasis to the emerging interest area of intangible assets – seems to be inadequately explored and poorly grounded. We do not believe that it was necessary to provide a new definition for intangible assets for any other reason than to fit the balanced scorecard. We believe that this latest attempt to shed more light on the components of the learning and growth perspective might backfire and, instead of providing clarity, add to the already existing confusion of what the intangible value drivers are in today’s organizations.

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