

# AN EXPANDED INTELLECTUAL CAPITAL FRAMEWORK

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## 1. Intellectual Capital Framework

On the average, market values of corporations exceed their book values.<sup>a</sup> This fact provides the rationale for managers to pay more systematic attention to managing intellectual capital, which largely accounts for the gap between market values and book values. Concepts and terminologies used to refer to this gap vary across authors and practitioners.

- i. Stewart<sup>b</sup> refers to this gap as “intellectual capital” which he decomposes into three: human capital, structural capital and customer capital<sup>c</sup>. Sullivan<sup>d</sup> and a group of practitioners he belonged to, which consisted in 1999 of thirty companies that called themselves the ICM Gathering, also used the same term, but decomposed it into human capital and intellectual assets. The latter term refers mostly to corporate properties that Stewart calls structural capital.
- ii. Among the earliest knowledge management practitioners to recognize the significance of this gap is Sveiby. He refers to this gap as “intangible assets” or “knowledge-based assets,” a term consistent with accountants’ general usage of the term. He decomposes intangible assets into the same three components as Stewart but gives them different labels: employee competence, internal structure

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<sup>a</sup> On January 22, 2010, for example, the average market-to-book ratio across 5,896 companies in Yahoo Finance’s 215 industrial sectors was 7.14, or book values on the average constitute only 14% of market values. The companies are US-based as well as foreign companies. Only 29.4% of companies have book values that exceed their market values; most of these are financial institutions and real estate companies that were adversely affected by the 2008 financial crisis.

<sup>b</sup> Stewart, T. A. (1997). *Intellectual Capital: the New Wealth of Organizations*. New York: Currency Doubleday.

<sup>c</sup> The term “customer capital” was first proposed in 1993 by Hubert St. Onge. See: Sullivan, P. H. (2000). *Value-Driven Intellectual Capital: How to Convert Intangible Corporate Assets into Market Value*. Singapore: John Wiley & Sons.

<sup>d</sup> Sullivan, P. H. *op. cit.*

and external structure. Internal structure refers to the same elements as Stewart's structural capital, while external structure includes brand and customer relationships.<sup>e</sup>

- iii. Lev<sup>f</sup> calls the gap "intangible assets" and equates the term with "knowledge assets."
- iv. MAKE or Most Admired Knowledge Enterprise is a widely-known global award given by Teleos to best-performing knowledge enterprises. Teleos measures organizational performance along eight criteria in managing corporate "intellectual capital."<sup>gh</sup> This finding implies that intangible assets include non-cognitive or non-knowledge factors and therefore intangible assets cannot be equated to knowledge assets. The term "relationship capital" refers to relationship factors whether internal or external and hence it is preferable over other terms in use such as "customer capital" and "stakeholder capital" which refer only to external relationships. Academic discourse on social capital and corporate discourse on stakeholder capital can be brought together by the introduction of a more generic term "relationship capital"<sup>i</sup>.

The limitations of intellectual capital (IC) arise when this construct is applied to non-profit organizations, as well as to "social enterprises" or enterprise forms that straddle between for-profit and non-profit organizations. For these organizations organizations, an expanded IC framework is necessary.<sup>j</sup> The following sections describe the elements of this expanded IC framework.

## 2. Creation of both Market and Social Values

Because private or for-profit enterprise accounts do not include costs and benefits to external parties, private creation of market value can result to sub-optimization if it entails destruction of social value such as through pollution, health risks to the

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<sup>e</sup> Sveiby, K. A. (1997). *The New Organizational Wealth: Managing and Measuring Knowledge-Based Assets*. San Francisco: Berrett-Koehler Publishers.

<sup>f</sup> Lev, B. (2001). *Intangibles: Management, Measurement, and Reporting*. Washington, D. C.: Brookings Institution Press.

<sup>g</sup> Personal communication with Dr. Rory Chase. See also: Chase, R. (2009). Global Knowledge Management Trends. In: *From Productivity to Innovation: Proceedings of the Second International Conference on Technology and Innovation for Knowledge Management*. Tokyo: Asian Productivity Organization.

<sup>h</sup> Talisayon, S. (2009). Organisational energy and other meta-learning from case studies of knowledge management implementation in nine Asian countries. *Knowledge Management for Development Journal*, 5(1), 21-38. U.K.: Routledge

<sup>i</sup> Talisayon, S. (2008). *Relationship Capital versus Stakeholder Capital versus Customer Capital*. Blog post in: Apin Talisayon's Weblog, 16 December 2008. Web site: <http://apintalisayon.wordpress.com/2008/12/16/relationship-capital-stakeholder-capital-customer-capital/>

<sup>j</sup> Talisayon, S. and V. Leung. *An Expanded Intellectual Capital Framework for Evaluating Social Enterprise Innovations*. 6<sup>th</sup> International Conference in Knowledge Management. Hong Kong, 3-4 December 2009.

community, depletion of non-renewable natural resources, etc. To avoid this, the creation of market value must be ***complemented by another enterprise objective: creation of social value***. Already, private corporations are moving in this direction through the adoption of the corporate policy of corporate social responsibility (CSR), albeit from the perspective of enhancing their market competitiveness.<sup>k</sup>

When best practices in community-based anti-poverty projects are analyzed, it was found that: (a) communities own or have access to many other forms of intangible assets than those of private enterprises, and (b) success of anti-poverty projects is attributable more to communities' intangible assets than to their tangible assets.<sup>l</sup>

Towards creation of social value and chances of success, private enterprises can acknowledge the same forms of community intangible assets in their CSR projects such as:

- Indigenous knowledge
- Social capital: established relationships and roles within the community and between the community and external entities.<sup>m</sup>
- Traditional access to natural resources from the public domain
- Access to natural resources donated by a private party
- Franchise from the national government.

### **3. From Corporate Level Stakeholder Capital to Community or Social Level Relationship Capital**

To be consistent with social value creation, the concept of stakeholder (or relational) capital from a private enterprise perspective must be ***broadened to relationship capital***<sup>n</sup> from a larger community or social perspective (see next Section 3). *“There is actually not much difference between the East and the West when we talk about relationship capital,”* said Greg Layton, director of Interviva, a personal coach who dedicates 10% of all his company's income to charity. The Japanese build up business relations with golf sessions. The British gather for glasses of beer after work. The Chinese treat dinner

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<sup>k</sup> Talisayon, S. *Corporate Social Responsibility and Emerging Models of Management of Stakeholder Capital in Philippine Conglomerates*. Paper read at the Fifth International Research Workshop on Asian Business. Singapore Management University, Singapore, 13 April 2009.

<sup>l</sup> Talisayon, S. and Suministrado-Rimando, S. (2008). *Community Wealth Rediscovered: Knowledge for Poverty Alleviation*. Quezon City, Philippines: Center for Conscious Living Foundation and Peace and Equity Foundation.

<sup>m</sup> After reviewing many definitions of social capital from the literature, Claridge observed that the meaning common to most definitions is “social relations that have productive benefits.” See: Claridge, T. *Social Capital*, Web site: <http://www.gnudung.com/>

<sup>n</sup> Talisayon, S. (2008). *Relationship Capital versus Stakeholder Capital versus Customer Capital*. Blog post in: Apin Talisayon's Weblog, 16 December 2008. He proposed that (a) relationships within the corporation be included in the otherwise solely externally-oriented concept of “stakeholder capital” or sometimes referred to as “relational capital” and (b) the three forms of social capital be further included to form a larger construct called “relationship capital.” Web site: <http://apintalisayon.wordpress.com/2008/12/16/relationship-capital-stakeholder-capital-customer-capital/>

part of business negotiation process. Today with Web 2.0, people can build up relationships by joining social sites such as LinkedIn, Twitters and Face Book disregarding national and other boundaries. Cultivation of relationship capital in Asia may be facilitated by the value that many Asian societies place on social and group harmony (versus individualism).

#### 4. Consumption Capital and Socially Responsible Consumption

In his book “Consumers Also Can Be Capitalists”, Professor Chen Yu proposed the view that development can be propelled not only by financial capital and by intellectual capital, but also by “consumption capital”.<sup>o</sup> According to his consumption capital theory, a common consumer can earn continuous profits from the enterprise he patronizes thus his consumption becomes also a kind of private investment. A McKinsey study shows that, in the aftermath of the global financial crisis, China can achieve dramatically faster growth in the medium-term by shifting to consumer-centric policies instead of continuing with export-led and stimulus package growth policies.<sup>p</sup>

Consumption is also becoming a kind of social investment. Since the emergence of awareness of fair trade, the concepts of ethical consumption and “socially responsible consumption” as a consumer responsibility and as a social movement have started to take shape. The humanitarian message behind the term is the care for the needy people as a criterion in consumption decisions. Based on an Oxfam Hong Kong survey, middle class consumers in Hong Kong are willing to pay a premium for products which have a social value and comparable quality.<sup>q</sup> Enterprises should target at winning the “votes” from consumers who are willing to endorse the enterprises’ social vision through their purchasing power and preference choice.

When consumers become co-owners of enterprises – through various forms of new social arrangements now under experimentation in China<sup>r</sup> – the perspective shifts: from consumers as actors external to enterprises to *consumers as socially-responsible co-owners of enterprises*.

#### 5. Employee Capital and Consumption Capital

The 2008 global financial crisis exposes the vulnerability of a system where stockholders can at any time quickly withdraw ownership by selling their stocks. When business

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<sup>o</sup> Chen, Y. (2006). *Consumers Also Can Be “Capitalists” – Consumption Capitalization, Theory and Its Applications*. Guangxi: Science & Technology Publishing House

<sup>p</sup> Devan, J., Rowland, M. and Woetzel, J. (2009). *A Consumer Paradigm for China*. McKinsey Quarterly, August 2009.

<sup>q</sup> Chee, C.H. *op. cit.*

<sup>r</sup> Several new forms of social enterprises are under experimentation in China where consumers are more actively engaged in co-managing and co-owning enterprises. These were reported in the First Global Consumption Capital Summit held last December 19-20, 2009 in Beijing, China.

confidence and trust (read “stakeholder capital”) drops, stockholders stampede to sell their stock holdings as fast as possible before prices go down further – actions that further cause a spiraling down of stock prices.

As we saw above, financial capital constitutes only 14% of market value of corporations. The remaining 86% of market value are created mainly by employees and by consumers. However, under the present Western system, governance of corporations is wielded largely by owners of financial capital – who are the first to flee ownership during financial crises. To address this governance gap, co-ownership by employees and consumers was proposed.<sup>s</sup> When *enterprises are also co-owned by employees and consumers* who have an inherent stake in the enterprise, the results are more organic forms of enterprises which should be more stable or less vulnerable to factors that led to the 2008 global financial crisis.

## 6. From Intellectual Capital to Metacapital

Besides the various community intangible assets found above, other concepts of capital are gaining currencies in other disciplines. In sustainable development, ecology and environmental management, the concepts of “natural capital,” “biological capital,” and “biodiversity capital” are appearing in academic literature and in practitioners’ discourses.<sup>t</sup> Less common but notable are new concepts in the behavioral sciences such as “positive psychological capital”<sup>u</sup> and “emotional capital.”<sup>v</sup> The *generic term “metacapital”* has been proposed to embrace all factors recognized – whether in corporate or in developmental applications – as contributors to value creation, including IC, natural capital and social capital.<sup>w</sup>

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<sup>s</sup> Talisayon, S. *Exploration of Variants of Consumer and Employee Ownership Schemes*. First Global Consumption Summit, Beijing, China, 19-20 December 2009.

<sup>t</sup> Usage of the terms had become widespread. “Natural capital” is now appearing in World Bank documents ([http://info.worldbank.org/etools/snc/tools\\_economics.htm](http://info.worldbank.org/etools/snc/tools_economics.htm)). Both “natural capital” and “biological capital” were used by UNCTAD ([http://www.unctad.org/sections/wemu/docs/cimem1p01\\_en.PDF](http://www.unctad.org/sections/wemu/docs/cimem1p01_en.PDF)). A fruit tree is a common example of biological capital or natural capital; it is a form of capital because it yields annual income, namely, fruits. “Biodiversity capital” is used in an FAO document (<http://www.fao.org/docrep/W4347E/w4347e11.htm>).

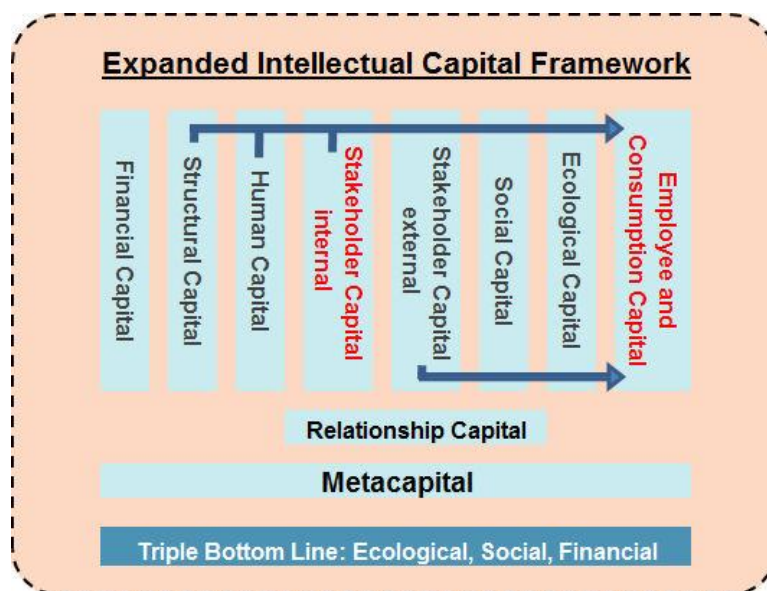
<sup>u</sup> For example, see: Luthans, F. et al. *Positive Psychological Capital: Measurement and Relationship with Performance and Satisfaction*. *Personnel Psychology* 60(3): 541-572. September 2007. See also: Page, L. F. and R. Donohue. *Positive Psychological Capital: a Preliminary Exploration of the Construct*. Working Paper 51/04. Monash University. October 2004.

<sup>v</sup> The Business Dictionary defines “emotional capital” as the “brand value or goodwill of a product or firm that motivates people to keep on buying the brand or the firm's products” (<http://www.businessdictionary.com/definition/emotional-capital.html>) while the BNET Business Dictionary defines it as “the intangible organizational asset created by employees’ cumulative emotional experiences, which give them the ability to successfully communicate and form interpersonal relationships” (<http://dictionary.bnet.com/definition/emotional+capital.html>).

<sup>w</sup> Talisayon, S. and Suministrado-Rimando, J. (2008). *Knowledge for Poverty Alleviation: A framework for design and evaluation of development projects for low-income communities*. Paper read at the Conference on Knowledge Architectures for Development. Singapore: Singapore Management University.

## 7. Conclusion

In summary, the proposed Expanded IC Framework consists of adoption of: (a) social value creation to complement corporate value creation from a market perspective, (b) the more generic term “relationship capital” that is applicable both to corporate and to community or social perspectives, (c) expanded governance to include employee and consumer co-ownership, and (d) adoption of the concept of “metacapital” to consolidate both the corporate IC framework and the developmental “Triple Bottom Line”<sup>x</sup> framework.



From the lessons of the global financial crisis, enterprises should start to identify, manage, value, utilize and report all forms of intangible assets for success and sustainable growth, from the wider standpoint of new enterprise forms that engage not only owners of financial capital but also new owners of employee capital and consumption capital.

<sup>x</sup> John Elkington originally introduced the term in 1994. He also uses the acronym 3P or “People, Planet and Profit.” The framework has since been adopted widely among NGOs and non-profit corporations. See: Elkington, J. (1997). *Cannibals with Forks: Triple Bottom Line of 21st Century Business*. Oxford: Capstone Publishing Ltd. Also see website: <http://www.johnelkington.com/activities/ideas.asp>.