



# Winnovation

BY ROWAN GIBSON

## Building a company's “Innovation Capital”

As usual it was Peter Drucker, the godfather of modern management, who said it first. Right back there in 1966 (!), in his landmark book “The Effective Executive”, Drucker argued that companies would need to build a new kind of organizational capital as the industrial economy gave way to the knowledge economy. His famous proclamation was that, in future, brainpower would be a more valuable asset for wealth creation than factories and financial clout. All of which came true, of course. But that was not the end of it. Now, over four decades later, we are once again challenged to rethink organizational capital as we make the transition from a knowledge economy to an innovation economy. And that creates a new agenda for every single company.

For most of the last century, as well as the previous one, we looked at companies as if they were comprised of only two kinds of capital: financial and structural. Financial capital obviously refers to a company's balance sheet. Structural capital is the value of its physical assets – its networks, facilities, warehouses, plants, inventory, and so on. Thus, if we had gone back and spoken to the super-rich industrialists and financiers of the late 19<sup>th</sup> and early 20<sup>th</sup> century –

such as Vanderbilt, Rockefeller, Carnegie, and Morgan – they would have told us that this was the only way to measure the worth of an enterprise. Move forward a few decades and the same would have been true if you had talked to great business builders like Henry Ford, Alfred P. Sloan, Thomas Watson Sr., or any of their corporate accountants. What counted back then was the tangible stuff that is easy to quantify and monetize on a financial statement.

In the 1980s and 1990s, that began to change. In large part because the stock market value of companies was beginning to get out of all proportion to the “book value” of their physical assets. Microsoft, for example, had an almost 8-to-1 ratio of market value to physical assets value. And when Philip Morris bought Kraft in 1988 for \$12.9 billion, the “hard assets” of the firm were calculated to be worth only \$1.3 billion. That means Philip Morris was paying a full \$11.6 billion – or 89.9% of the transaction price – for “other stuff” that wasn’t even on the balance sheet: intangible stuff like brand equity, marketing capability, and so on.

British futurologist Hugh Macdonald coined the phrase “intellectual capital” to describe these intangible assets. He defined it as “knowledge that exists in an organization that can be used to create differential advantage.” And in a seminal article in *Fortune* magazine in 1991, Thomas Stewart wrote that “every company depends increasingly on knowledge—patents, processes, management skills, technologies, information about customers and suppliers, and old-fashioned experience. Added together this knowledge is intellectual capital.”

From then on, we had three forms of capital – three basic kinds of assets – with which to measure a company’s worth. But in a new, innovation-based economy, where value-creation is the new Holy Grail, the way we define, measure and manage organizational capital is again woefully incomplete. In 2001, strategy guru Gary Hamel argued that financial, structural and intellectual capital, by themselves, do not create new wealth. And I agree with his astute observation. Think about GM. If any company on earth ever had huge amounts of money, massive dealer and supplier networks, giant manufacturing plants, countless technological patents, well-oiled management processes, tons of customer information and decades of industry experience, it would have to be General Motors. Yet where is GM today? In effect, all of those assets have proven to be almost worthless in terms of creating new wealth.

Hamel’s view is that the three traditional forms of capital are largely inanimate. In today’s competitive era, they need to be animated or catalyzed by three new kinds of organizational capital if we want to translate them into wealth. He calls these “imagination capital”, “entrepreneurial capital”, and “relationship capital”, all of which are different forms of human capital.

Consider the first one. Most companies would tell you that knowledge is a critical resource. Many large organizations have internal KM efforts aimed at sharing information and experience across the firm with a view to continuous improvement. But in a world where the pace of change has gone hypercritical, we’re finding out that success has less and less to do with learning from the past,

and more and more to do with imagining future opportunities. Knowledge has become a commodity. Let's face it, you can go online and find out almost anything with just one or two clicks. So the issue is not how much you know but how creatively you can leverage what you know. Today, the advantage increasingly goes to those firms that develop "imagination capital" – which is the capacity to dramatically reconceive what the firm is and imagine entirely new uses for its financial, structural and intellectual capital. Einstein's oft-quoted reflection that "imagination is more important than knowledge" becomes the mantra of the innovation economy.

Second, companies need to develop their "entrepreneurial capital", which means building the entrepreneurial spirit into many, many employees across the whole organization, not just in an incubator or some new venture division that exists out on the periphery of an otherwise orthodox company. It's about creating a cultural environment where the entrepreneurial spirit is everywhere; where ordinary employees can have the courage to experiment and try something new, where they can get unfettered access to the financial and human capital they need to push their ideas forward.

The third of these new kinds of capital is "relationship capital" (or what I would call "network capital"), which refers to the connections a company can make between previously isolated people, ideas, resources and domains – both across and beyond the organization. Innovation is so often about spotting the opportunities that come from recombining and blending all of these ingredients. The quality of a company's network of relationships – its ability to connect with individuals and organizations that have very different skill sets and capabilities – is becoming more and more critical to its own capacity to innovate.

Here's the sad reality: most companies don't have a clue about how to support the development of these new forms of capital. So the challenging agenda for organizations around the world will be to think about exactly what it takes to build, measure, manage and exploit what amounts to their "innovation capital" – which is so essential to creating wealth in our times.

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