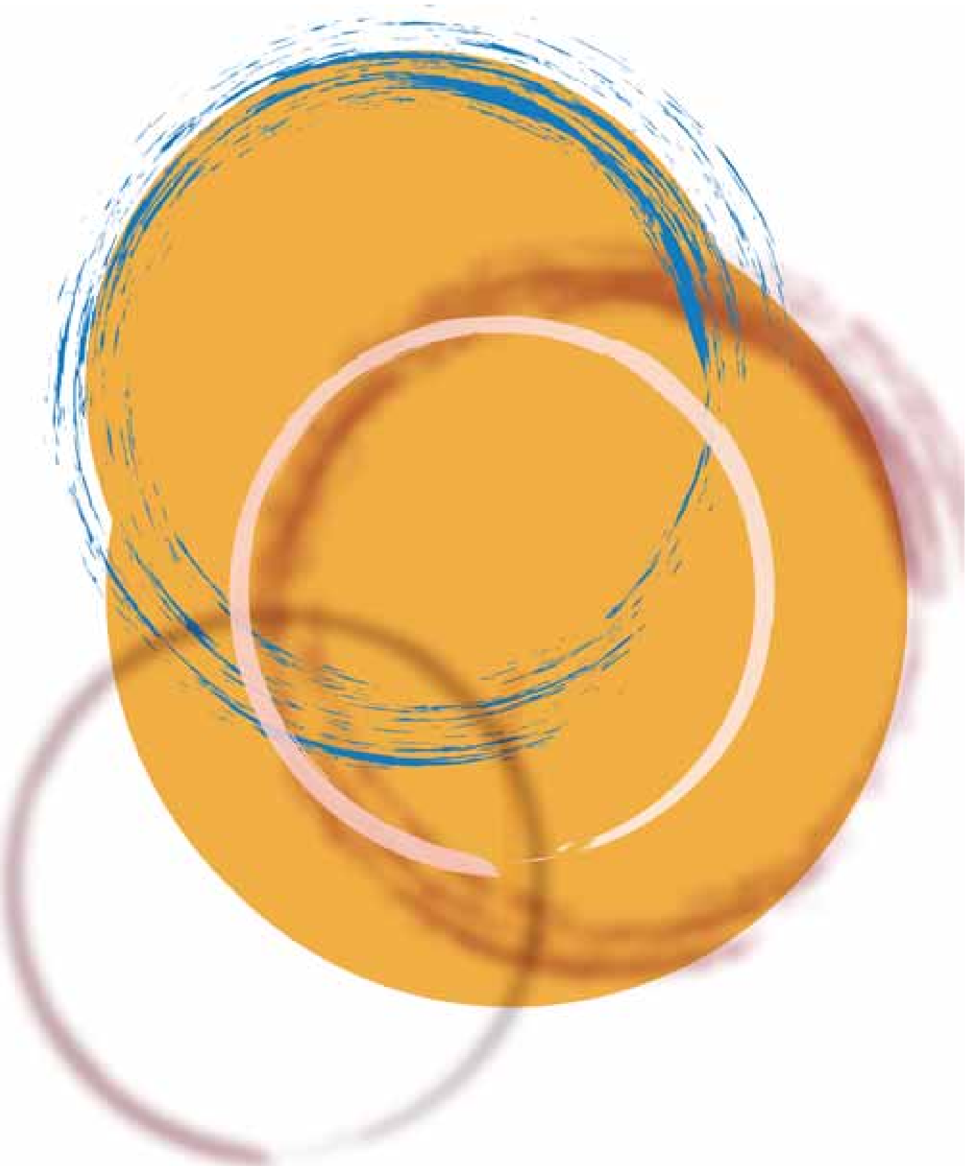
The International Journal of Knowledge, Culture and Change Management

Volume 3

Article: MC03-0036-2003

Edited by Mary Kalantzis and Bill Cope



Using Intellectual Capital as a Strategic Tool for Non-profit Organisations

Eric Kong

Proceedings of the Management Conference 2003

International Journal of Knowledge, Culture and Change Management,

Volume 3

www.ManagementConference.com

www.theHumanities.com

This journal and individual papers published at http://ManagementConference.Publisher-Site.com/
a series imprint of theUniversityPress.com

First published in Australia in 2003/2004 by Common Ground Publishing Pty Ltd at
http://ManagementConference.Publisher-Site.com/

ISSN: 1447-9524 (Print)
ISSN: 1447-9575 (Online)

Cover design by Common Ground

Papers presented at the Third International Conference on Knowledge, Culture and Change in Organisations, Bayview Beach Resort, Penang, Malaysia, 11-14 August 2003.

Using Intellectual Capital as a Strategic Tool for Non-profit Organisations

Eric Kong

Department of Management, Monash University, Australia

Abstract

Despite the ongoing development of strategic management research over the last few decades, there is a relative shortfall in the state of knowledge on strategy in the non-profit sector. Non-profit organisations (NPOs) are distinct from for-profit organisations as they invest in people rather than in profits. For-profit strategic management techniques that are brought to NPOs are often criticised for being ineffective in the sector. Consequently, the need for competent strategic management in NPOs is urgently needed. One way of addressing this shortfall is to examine strategic management in NPOs through the lens of intellectual capital (IC). Encompassing three primary interrelated components named as human capital, structural capital and relational capital, IC promotes the creativity possessed by all organisational members to account for an organisation's future non-financial prospects. This paper argues that IC allows NPOs to keep their values, identity and distinctiveness in the non-profit sector. Consequently, value would be added to strategic decision-making processes in NPOs.

The Need for Competent Strategic Management in NPOs

Civil society is the social space between state, market, and family in modern societies (Baubock, 1996). It is described as a space occupied by a plurality of associational relationships that include political parties, trade unions, clubs and non-profit organisations (NPOs) (Zappala, 2001). The non-profit sector, as a subset of civil society, is a collection of organisations that conform to several criteria: an institutional presence and structure; institutionally separate from the government; not profit-seeking in purpose; self-governing and involving some degree of voluntary participation, hence justifying the oft-used term, 'voluntary sector' (Salamon, Anheier, List, Toepler, Sokolowski and Associates, 1999). Prior to the 1980s as the backbone of a government's social service delivery, NPOs enjoyed monopolies by gaining financial support through grants from the government (Alexander, 1999; Kearns, 2000). However, since then, the non-profit sector has been subject to a series of rapid and far-researching changes which have fundamentally affected the environmental interactions of NPOs in the non-profit sector (Courtney, 2002).

The major reason for such changes could be traced back to the introduction of new public management (NPM) which was a reform agenda firstly aimed at restructuring the public sector according to private sector principles. However, this has dramatically altered the values and methods that traditionally characterised the non-profit sector (Ramia and Carney, 2003; Ryan, 1999). There are two basic assumptions in NPM. Firstly, it assumes the efficiency of markets and the value of competition as a strategy for improving organisational performance (Alexander, 1999; Alexander,

International Journal of Knowledge, Culture and Change Management, Volume 3 ● www.ManagementJournal.Publisher-Site.com
 ISSN ● 1447-9524 (Print) ISSN 1447-9575 (Online)
Paper presented at the Third International Conference on Knowledge, Culture and Change in Organisations, Bayview Beach Resort, Penang, Malaysia, 11-14 August 2003 ● www. ManagementConference.com

2000). Secondly, NPM asserts that for-profit sector practices and technologies are superior to those of the public sector, but that management is a generic set of practices transferable across sectors (Kaboolian, 1998). This NPM requires entrepreneurial leaders who stress the values of efficiency, economy, and effectiveness (Terry, 1998).

The driving force behind NPM was the transfer of substantial functions to NPOs in the 1980s that were previously run by government agencies as a result of the perceived incapacity of state-run organisations to meet clients' and the public's changing needs (Courtney, 2002; Hudson, 1999). This has resulted in a major growth in the number and scale of NPOs' activities (Salamon *et al.*, 1999). As the number and scale of NPOs has substantially increased, NPOs are more likely competing with each other for volunteers, employees, funding and donations. Alongside other factors such as a tighter control over public expenditure and increasing social needs, an growing desire on the part of the government agencies to give local managers greater control over the management of their NPOs (Hudson, 1999), a belief that competition and contracting to deliver social services rather than through traditional public administration methods could lead to efficiency gains (Hudson, 1999), the expectations on how NPOs should be managed have changed accordingly (Alexander, 2000; Courtney, 2002).

Although for-profit management techniques were thought to be superior, the term 'management' was often considered to be a dirty word for people who were involved in NPOs as it meant business and people in NPOs prided themselves on being free of the taint of commercialism (Drucker, 1989). However, now NPOs often find themselves sharing the same territory with for-profit organisations, sometimes as competitors, and sometimes, as collaborators (Weisbrod, 1998). NPOs no longer enjoy monopolies as the sole service providers in the 'non-profit market'; rather they are now competing for public support and limited resources with for-profit organisations (Ryan, 1999). As more and more for-profit organisations are providing social services and NPOs are acting very much like for-profit organisations, the distinction between these organisations continues to be blurred (Ryan, 1999; Weisbrod, 1998). A greater emphasis on for-profit management practices in NPOs is therefore expected to foster efficiency and effectiveness (Alexander, 2000; Courtney, 2002; Sawhill and Williamson, 2001). Thus, NPOs are increasingly being forced to adopt monitoring and evaluation processes such as business process re-engineering (BPR), quality management systems and benchmarking as a result of being held accountable to funding and regulatory bodies (Courtney, 2002). All of these monitoring and evaluation processes were originally perceived to be the sole province of profit-seeking organisations (Lyons, 2001).

However, these approaches and techniques have been strongly criticised for being ineffective in the non-profit sector (Alexander, 2000; Courtney, 2002). Since the primary objectives of NPOs are 'social' rather than 'economic' (Herman and Renz, 1999; Hudson, 1999; Ryan, 1999), it is unrealistic to assume that all for-profit management techniques are a generic set of practices transferable across sectors and that techniques are to be equally applicable in the non-profit context (Alexander, 2000). Fundamental differences with the for-profit sector and that sector's own experiences, make it unwise for non-profit managers to adopt for-profit management techniques without carefully evaluating the validity of the techniques in NPOs (Speckbacher, 2003). In fact, these for-profit management techniques, if improperly applied, may lead to goal displacement and resource diffusion which in turn cause a serious threat to the basic character and identity of NPOs (Alexander, 2000). Even worse, for-profit management techniques may lead to inapt strategic priorities which could endanger NPOs as they are forced to adapt, and perhaps abandon, the very qualities that enabled NPOs to advance social causes in the first place (Ryan, 1999). It is therefore misguided to assume that the for-profit management techniques could or should be copied by NPOs without a critical analysis of their appropriateness to the sector (Speckbacher, 2003).

Despite the increasing attention given to the non-profit sector in recent times, non-profit management activity remains a mystery (Ramia and Carney, 2003; Salamon *et al.*, 1999). Within this context, the need for competent strategic management in this 'lost continent' on the social landscape of modern society has become widely accepted (Courtney, 2002; Salamon *et al.*, 1999). Nevertheless, the issue is rendered complex, because competent strategic management techniques must allow NPOs to keep their values, identity and distinctiveness, while at the same time, also being able to enhance organisational performance by providing meaningful information to their stakeholders. IC encompasses three primary interrelated components named as human capital, structural capital and relational capital to promote the creativity possessed by all organisational members to underpin an organisation's future non-financial prospects (Mouritsen, 1998). As will be seen further on in this paper, it is argued that IC is an important strategic management technique for NPOs.

IC Perspective and IC in NPOs

The IC perspective has its roots firmly grounded within the practitioner community by placing greater emphasis on resources in action. However, some theoretical underpinnings of the IC literature also draw on aspects of resource-based theory (RBT) from the strategic management literature (Barney, 1991; Wernerfelt, 1984). The practical applications and the pragmatic approach of the early IC researchers provide a basis for practical managerial tools and methodologies, and therefore, the IC perspective helps to bridge the gap between the conceptual thinking of RBT and a practical approach necessary for the adoption of the framework by managers (Peppard and Rylander, 2001).

Stewart (1997) defines IC in terms of organisational resources relating to wealth creation through investment in knowledge, information, intellectual property, and experience, while it is defined by Edvinsson and Malone (1997a) as the possession of knowledge, applied experience, organisational technology, customer relationships and professional skills that provide a competitive edge in the market. However, despite IC researchers using different terms to describe IC components, it is generally accepted that IC encompasses three primary interrelated non-financial components: human capital, structural capital and relational capital (Bontis, 1998; Roos, Roos, Dragonetti and Edvinsson, 1997; Stewart, 1997; Sveiby, 1997).

Human capital subsumes tacit knowledge, competencies, experience and skills, and the innovativeness and talents of people within an organisation (Bontis, 1998; Department of Industry Science and Resources, 2001). Bontis (1999) argues that human capital is important to organisations because it is a source of innovation and strategic renewal, and encapsulates the sheer intelligence of organisational members (Bontis, Keow and Richardson, 2000). On the other hand, structural capital is seen as the supportive infrastructure for human capital (Bontis, 1998; Department of Industry Science and Resources, 2001), which includes all of the non-human storehouses of knowledge in organisations such as databases, process manuals, strategies, routines, culture, publications, copyrights and anything whose value to the organisations is higher than its material value (Bontis et al., 2000). Relational capital refers to the knowledge of market channels, customer and supplier relationships, as well as a sound understanding of governmental or industry association impacts (Bontis, 1999; Department of Industry Science and Resources, 2001).

Although IC was firstly developed as a framework to analyse the value contribution of intangible assets in for-profit organisations (Roos, Bainbridge and Jacobsen, 2001), it is as important in NPOs, where maximising profits is not the primary objective, as it is in for-profit organisations. Revenue in NPOs is drawn from a wide range of sources which include consumers of services, membership fees, fundraising, government funds, interest or rents from investments and many others (Lyons, 2001). It is a difficult task to manage and oversee such wide ranging activities and stay financially sustainable at the same time (Kong, 2003). The ability of NPOs to achieve their objectives therefore depends almost entirely on the knowledge, skills and experience of their paid employees and volunteers (Hudson, 1999). Moreover, it takes more knowledge and skills to effectively manage the combination of both paid employees and volunteers in NPOs than it does to manage an entirely paid staff or a staff comprised solely of volunteers (Lyons, 2001). IC encompasses the intelligence found in human beings, organisational routines and network relationships within organisations (Bontis, 1999), which serve as an important framework for NPOs to cope with new challenges. As can be seen later on in this paper, the validity of IC in NPOs will be carefully evaluated and it is argued that IC is the only strategic tool that allows NPOs to keep their values, identity and distinctiveness without causing goal displacement and resource diffusion.

IC as a Strategic Tool

Unlike for-profit management techniques which are criticised as alien systems that are being imposed on an ‘unwilling sector’ (Alexander, 2000; Courtney, 2002), IC shifts strategic focuses to intangible resources such as knowledge, skills and experience within NPOs. This means that strategic activities and changes that are brought to NPOs will be mainly driven by internal initiatives rather than external practices. Besides, since IC focuses on three interrelated non-financial measurements, resistance to strategic activities and changes will be less than those imposed from another sector. Hudson (1999) argues that those NPOs which have the strongest base of skilled and experienced people are in the best position to raise the largest sums of money and deliver the best-quality services and campaigns. IC helps to find solutions that best suit NPOs without giving up their core value and distinctiveness.

Young (2001) argues that identity is a distinct yet holistic notion that integrates, supports, and indeed drives a number of operative concepts guiding the long-term direction and character of an organisation. Organisational identity is likely to affect organisational success. It is therefore important for organisations to have a clear identity. An unclear identity leads to uncertainty over strategic priorities and resources allocation; as a result, decisions may be driven by other factors (such as environmental pressures) or just fall into an unclear rationale (Young, 2001). As the distinctions between non-profit and for-profit organisations continue to be blurred (Ryan, 1999; Weisbrod, 1998), the basic character and identity of NPOs are threatened by the for-profit management techniques as the bottom line of the techniques is to maximise profits. Therefore, even NPOs are willing to adopt the for-profit management techniques, it is possible that such techniques obviously contradict the principle of NPOs of investing in people (Hudson, 1999; Ryan, 1999).

IC, however, is concerned with accounting for a firm's future prospects, and not past performance (Edvinsson and Malone, 1997b; Mouritsen, 1998). It focuses on processes, not financial results (Edvinsson and Malone, 1997b). It stresses competence-enhancement, and not cash flow improvement (Mouritsen, 1998). Finally, it concentrates on intangible resources, not tangible resources (Stewart, 1994). IC promotes the creativity possessed by all organisational members to underpin the future non-financial prospects of an organisation (Mouritsen, 1998). Therefore, IC can easily fit into NPOs where the primary objectives of NPOs are 'social' rather than 'economic' (Hudson, 1999; Ryan, 1999). Unlike for-profit management techniques, an identity threat to NPOs is preventable if IC is used as a strategic tool in NPOs.

The main objective of for-profit organisations is to maximise profits. Profits often serve as a simple common language for communication, delegation and co-ordination (Speckbacher, 2003). Besides, profits help to measure organisational success and benchmark performance against competitors (Sawhill and Williamson, 2001). NPOs, however, have no relatively simple financial goal that can be translated into sub-goals and used as a means of communication to compare goods and services that NPOs produce (Speckbacher, 2003). Sawhill and Williamson (2001) argues that the success of a system of non-profit measures is directly proportional to the simplicity of the system itself. Encompassing three primary interrelated non-financial measurements, IC serves as a simple common language that requires relatively little interpretation for staff members, donors and key stakeholders to see how their organisations are performing.

Moreover, service beneficiaries of NPOs are typically different from those who provide material support. NPOs are therefore accountable to multiple constituents (Brown and Kalegaonkar, 2002). In other words, people are working towards different goals within the same organisation. Letts, Ryan and Grossman (1999) also admit that the biggest challenge in NPOs is to channel people's energy towards the same organisational mission and goals. Furthermore, NPOs are competing with competitors from both non-profit and for-profit sectors. Similar to for-profit organisations, the staff members, donors and key stakeholders of NPOs need useful information to benchmarking performance against other competitors. Edvinsson and Malone (1997b) argue that IC bridges the 'traditional gap' between non-profit and for-profit organisations. IC therefore helps to compare organisational capability with competitors across sectors and drive the attention of all key stakeholders towards the organisational mission and goals in NPOs. In short, IC is an important strategic tool for strategic directions with reference to the organisational mission and goals in NPOs.

IC not only allows NPOs to keep their values, identity and distinctiveness, but also helps them to focus on strategic priorities by emphasising the future non-financial prospects in the non-profit sector. It becomes one of the most important elements in NPOs. Bontis, Dragonetti, Jacobsen and Roos (1999) argue that those managers who do not take IC into account run the risk of making poorly informed decisions, and thus, negatively affecting organisational performance. However, organisations cannot create knowledge on their own, but rely on individuals (Nonaka and Takeuchi, 1995). Therefore, it is inevitable to apply IC as a strategic tool in NPOs if they want to survive in the 'competitive market' in the sector.

Conclusion

Encompassing three primary interrelated components named human capital, structural capital and relational capital, IC promotes the creativity possessed by all organisational members to account for an organisation's future non-financial prospects rather than stressing the financial performance of an organisation. This paper argues that value would be added to strategic decision-making processes if IC is used as a strategic tool in NPOs.

Bibliography

Alexander, J. (1999), "The impact of devolution on non-profits: A multiphase study of social service organisations", Non-profit Management and Leadership, Vol.10, No.1, pp.57-70.

Alexander, J. (2000), "Adaptive strategies of non-profit human service organisations in an era of devolution and new public management", Non-profit Management and Leadership, Vol.10, No.3, pp.287-303.

Barney, J. B. (1991), "Firm resources and sustained competitive advantage." Journal of Management, Vol.17, No.1, pp.99-120.

Baubock, R. (1996), "Social and cultural integration in a civil society", in Baubock, R., Heller, A. and Zolberg, A. R. (Eds.), The challenge of diversity: Integration and pluralism in societies of immigration, Avebury, Aldershot.

Bontis, N. (1998), "Intellectual capital: An exploratory study that develops measures and models", Management Decision, Vol.36, No.2, pp.63-76.

Bontis, N. (1999), "Managing organisational knowledge by diagnosing intellectual capital: Framing and advancing the state of the field", International Journal of Technology Management, Vol.18, No.5/6/7/8, pp.433-462.

Bontis, N., Dragonetti, N. C., Jacobsen, K. and Roos, G. (1999), "The knowledge toolbox: A review of the tools available to measure and manage intangible resources", European Management Journal, Vol.17, No.4, pp.391-402.

Bontis, N., Keow, W. C. C. and Richardson, S. (2000), "Intellectual capital and business performance in Malaysia industries", Journal of Intellectual Capital, Vol.1, No.1, pp.85-100.

Brown, L. D. and Kalegaonkar, A. (2002), "Support organisations and the evolution of the NGO sector", Non-profit and Voluntary Sector Quarterly, Vol.31, No.2, pp.231-258.

Courtney, R. (2002), Strategic management for voluntary non-profit organisations, Routledge, London.

Department of Industry Science and Resources (2001), Invisible value: the case for measuring and reporting intellectual capital, Department of Industry, Science and Resources, Business Competitiveness Division, Commonwealth of Australia, June, Canberra.www.isr.gov.au/industry/kbe/publications/index.html.

Drucker, P. F. (1989), "What business can learn from non-profits", Harvard Business Review, July/August, pp.88-93.

Edvinsson, L. and Malone, M. (1997a), Intellectual capital - Realizing your company's true value by finding its hidden roots, HarperBusiness, New York.

Edvinsson, L. and Malone, M. (1997b), Intellectual Capital - The proven way to establish your company's real value by measuring its hidden brainpower, Judy Piatkus (Publishers) Limited, London.

Herman, R. D. and Renz, D. O. (1999), "Multiple constituencies and the social construction of non-profit organisational effectiveness", Non-profit and Voluntary Sector Quarterly, Vol.19, No.1, pp.293-306.

Hudson, M. (1999), Managing without profit: The art of managing third-sector organisations (2nd ed.), Penguin, London.

Kaboolian, L. (1998), "The new public management: Challenging the boundaries of the management vs. administration debate", Public Administration Review, Vol.58, No.3, pp.189-193.

Kearns, K. P. (2000), Private sector strategies for social sector success: The guide to strategy and planning for public and non-profit organisations, Jossey-Bass, San Fransisco.

Kong, E. (2003), Human capital as a key component of intellectual capital in non-profit organisations, Challenging the frontiers in global business and technology: Implementation of changes in values, strategy and policy, Budapest, Hungary, Global Business and Technology Association, 8-12 July.

Letts, C. W., Ryan, W. P. and Grossman, A. (1999), High performance non-profit organisations - Managing upstream for greater impact, John Wiley & Sons, New York.

Lyons, M. (2001), Third sector: The contribution of non-profit and co-operative enterprises in Australia, Allen & Unwin, St. Leonards, N.S.W.

Mouritsen, J. (1998), "Driving Growth: Economic Value Added versus Intellectual Capital", Management Accounting Research, Vol.9, No.4, 05/09/1998, pp.461-482.

Nonaka, I. and Takeuchi, H. (1995), The knowledge-creating company, Oxford University Press, New York.

Peppard, J. and Rylander, A. (2001), "Leveraging intellectual capital at APiON", Journal of Intellectual Capital, Vol.2, No.3, pp.225-235.

Ramia, G. and Carney, T. (2003), "New public management, the job network and non-profit strategy", Australian Journal of Labour Economics, Vol.6, No.2, pp.249-271.

Roos, G., Bainbridge, A. and Jacobsen, K. (2001), "Intellectual capital analysis as a strategic tool", Strategy and Leadership, Vol.29, No.4, pp.21-26.

Roos, J., Roos, G., Dragonetti, N. C. and Edvinsson, L. (1997), Intellectual Capital : Navigating the New Business Landscape (Adardvark Editorial, Mendham, Suffolk ed.), Macmillan Press Limited, London.

Ryan, W. P. (1999), "The new landscape for non-profits", Harvard Business Review, January/February, pp.127-136.

Salamon, L. M., Anheier, H. K., List, R., Toepler, S., Sokolowski, S. W. and Associates (Eds.) (1999), The Johns Hopkins comparative non-profit sector project, Global civil society: Dimensions of the non-profit sector, The Johns Hopkins Centre for Civil Society Studies, Baltimore, MD.

Sawhill, J. C. and Williamson, D. (2001), "Mission impossible ? Measuring success in non-profit organisations", Non-profit Management and Leadership, Vol.11, No.3, pp.371-386.

Speckbacher, G. (2003), "The economics of performance management in non-profit organisations", Non-profit Management and Leadership, Vol.13, No.3, pp.267-281.

Stewart, T. A. (1994), "Measuring company I.Q." Fortune, Vol.129, No.2, p.24.

Stewart, T. A. (1997), Intellectual Capital: The New Wealth of Organisations, Currency Doubleday, New York.

Sveiby, K. E. (1997), The new organisational wealth: Managing and measuring knowledge-based assets, Berrett-Koehler Publishers, Inc., San Francisco.

Terry, L. D. (1998), "Administrative leadership, neo-managerialism, and the public management movement", Public Administration Review, Vol.58, No.3, pp.194-200.

Weisbrod, B. A. (Ed.) (1998), To profit or not to profit: The commercial transformation of the non-profit sector, Cambridge University Press, Cambridge.

Wernerfelt, B. (1984), "A resource-based view of the firm." Strategic Management Journal, Vol.5, pp.171-180.

Young, D. R. (2001), "Organisational identity in non-profit organisations: Strategic and structural implications", Non-profit Management and Leadership, Vol.12, No.2, pp.139-157.

Zappala, G. (2001), "From 'Charity' to 'Social Enterprise': Managing volunteers in public-serving non-profits", Australian Journal on Volunteering, Vol.6, No.1, pp.41-49.

About the Author

Eric Kong is a doctoral candidate and is doing research towards a Ph.D. at the Department of Management of Monash University in Australia, Melbourne. His current work focuses on examining the role of intellectual capital in the strategic management of non-profit organisations in Australia. Previously, he was a corporate training manager for an international corporation and an external management consultant for several international companies, which included retail management; finance and banking; and property management.