



Tango

Business from knowledge

Karl Erik Sveiby

The Knowledge Organization


CELEMI
THE POWER OF LEARNING

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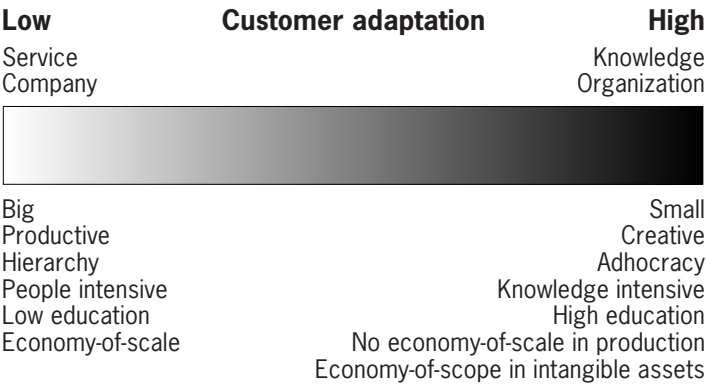
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1. The Knowledge Organization

The Knowledge Organization belongs to a subgroup within the service sector. The service sector is not a discrete phenomenon but rather a spectrum of company types ranging from those organizations totally adapted to their customers – the knowledge organizations – to organizations that have refined and packaged their output. The latter have more in common with manufacturing companies.

In the companies at the far left, service is industry; the **business logic** is based on efficient, industrialized pre-programmed production aimed at a mass market. The McDonald’s fast-food chain exemplifies this type, where even the smile we get as a customer is pre-programmed in the employee’s manual.

The companies at the far right, however, are more or less their opposite. The “service” emerges as an ongoing process of *problem solving* between the **customers** and **teams** of experts. They therefore have to treat their customers as individuals. Because the knowledge organization cannot force its customers to adapt to it, it must perforce adapt to them.



Non-manufacturing organizations categorized according to level of customer adaptation.

Therefore, the rapport or the **chemistry** between the client and the teams is important.

The “production” of the Knowledge Organizations is solving problems that are hard to solve in a standardized manner. The staff (**key people**) tend to be very **competent**: highly educated and/or with long experience in a profession often involved with information processing.

The **business logic** depends on how the managers of the Knowledge Organizations regard their **assets**, their **key people** and their **customers**, how they **attract** them and how they **match their capacity** for **problem solving** with the needs of the customers.

The business logic of the Knowledge Organization is thus in short:

1. Attract the Personnel.
2. Attract the Customers.
3. Match the Capacity and the Chemistry of the Personnel and the Customers.

2. The Market Value

A Knowledge Organization normally has few tangible assets. Some computers perhaps, but even the office space is often leased. Tangible assets are owned by the company and are usually the only assets that the accountants are allowed to bring into the balance sheet. The real assets of a Knowledge Organization are mostly intangible.

What is the market value of intangible assets? Many have tried to answer this question. No one has found a good answer. The problem is that the value of intangible assets cannot be displayed in normal market transactions, like physical goods. That there **is** a value everyone agrees. However, the value is shown only indirectly:

- The prices paid for shares on the stock exchange for companies of this kind are mostly far above the visible equity measured solely on the value of the tangible assets.
- Even if many of the most valuable employees leave, the name lasts and, if properly managed, the company may revive.

The balance sheet of the Knowledge Organization consists of a tangible/visible part and an intangible/invisible part.

The tangible/visible part is the “normal” balance sheet which one can find in the Annual Accounts. It shows the **tangible assets** and how they are visibly **financed**.

The visible finance is generally quite simple in a Knowledge Organization. Short-term debt, some long-term loans and shareholder equity. Long-term loans are often difficult to get since the banks tend to frown at the collateral (the few tangible assets).

Intangible assets are not very liquid, and unlike the fixed assets they are both *owned and not owned* by the company. The simulation model assumes three kinds of intangible assets, **Corporate Knowhow**, **Corporate Image** and **Personnel Competence**.

Their counterpart on the finance side is mostly an **invisible equity**. Since banks are unwilling to lend money to investments in intangible assets, most of the business development is self-financed.

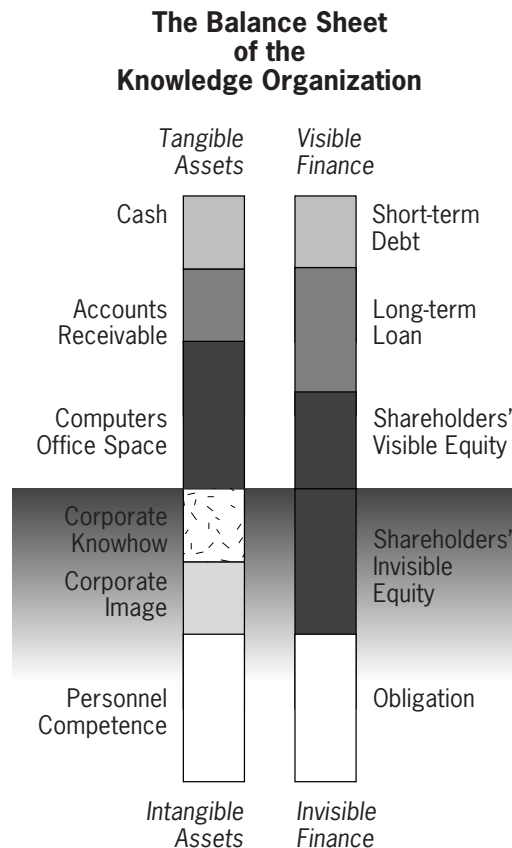
There are few “machines” except the employees, the key people. The researchers, the programmers or the consultants are the “machines” of the Knowledge Organization. The members of the personnel thus make up the problem-solving **Competence**.

The Personnel Competence is of course not owned since the people are voluntary members of our organization. However, there exists a bond of loyalty between the personnel and the company, created by ethics and culture, which acts as a “glue”. People tend to feel a certain amount of loyalty if

treated honestly and fairly. Thus competence does represent a value for the company, even if it is not owned in the usual sense. The company therefore often agrees to pay an amount of money in case of redundancy.

This agreement is not entered into the books but is a kind of **obligation**. One might compare it with the obligation of a lease contract. This unpaid obligation is an invisible finance too.

All assets mentioned above will be handled during the simulation. The total Market Value is calculated in the simulation and used as a **measure of success**.



3. The Personnel

The personnel fall into one of four distinct categories.

The “Professionals”

The professionals (sometimes called Knowledge Workers) work directly with the customers. They are intelligent and sometimes arrogant. They love their job and tend to be workaholics. They don't give a damn about the company “bureaucracy” and are loyal to their organization only if they can feel proud of it. They like to work with other highly competent people. They are both unable and unwilling to manage other people; they are interested mainly in the freedom to develop their own professional skills.

The “Managers”

There are few typical managers in the Knowledge Organization. In smaller knowledge organizations, the accountant is often the only traditional manager. The managers like to work through other people, are team oriented, like to exert their influence in an organization and want to feel a loyalty towards the organization they are entrusted to manage. The managers lack the professionals' Knowhow, which the customers demand, but are strong in managing the business.

The “Clerical Staff”

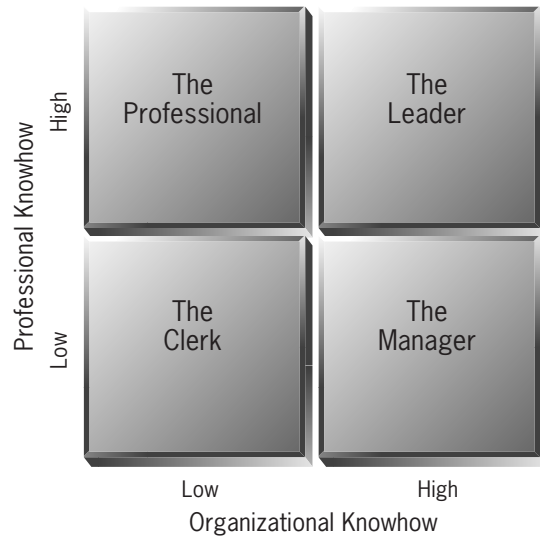
The clerical staff are the professionals' support. They lack both the Knowhow of the professionals and the formal position of the managers. They are powerless and therefore often experience problems – frequently caused by the professionals. They tend to be prevented from developing themselves in a management career because there are very few such opportunities.

The “Leader”

The leader is the driving force of the Knowledge Organization and is more or less irreplaceable. He or she has often founded the company and is an ex-professional who has developed organizational skills and interests. The leader must

be able to handle and steer the driving forces in the Knowledge Organization. The leader must also be able to balance the forces between the categories of personnel who might easily become antagonistic towards each other if left free of leadership. Because leadership in knowledge organizations is a very difficult task, one often finds that a kind of dual leadership emerges: one leader in charge of the professionals, the other in charge of the organization.

Four Categories



4. Corporate Knowhow

Corporate Knowhow in a Knowledge Organization is of two kinds: Professional and Organizational.

Professional Knowhow consists of the systems, rules, programs, manuals, concepts etc. that have been developed by the professionals as Research & Development projects or in cooperation with their customers. In the law firm it might be standards for contracts, in the laboratory it might be mechanical or electronic systems for testing. The important feature of this knowhow is that the systems cannot be acquired from outside suppliers: they are unique for this particular organization and **owned** by the company. Much of the success of the Knowledge Organization depends on how skilled the professionals are in utilizing this knowhow compared to their professional colleagues employed by their competitors.

In the simulation model, the Professional Knowhow is measured as expenditure on salaries and other direct costs in R&D projects.

Organizational Knowhow is also needed, otherwise the Knowledge Organization will not survive. It includes strategy making, marketing, planning, accounting, management – i.e. “the rest”. The value of Organizational Knowhow is measured by its ability to maintain and increase the value of the total organization.

In the simulation model, the Organizational Knowhow is represented by the **totality of all that you bring with you and that you will learn during the simulation**. The Organizational Knowhow is the combined efforts of the simulation team – of which you are one of the members. The model is intended to simulate the Organizational Knowhow needed in order to run a Knowledge Organization.

5. Corporate Image

Corporate Image is the reputation that the Knowledge Organization gains from solving the customer's problems successfully. It is thus the external image of Corporate Knowhow. The Corporate Image is the value of the organization's name and customer network. It is an important asset because customers cannot know what solution they will get until they get it. Customers therefore must buy on reputation.

Image is intangible and not easy to control. There is always an element of **chance** involved. However, unlike Knowhow, management cannot invest in the Corporate Image by starting PR projects or by advertising. The only way to gain a long term high Corporate Image is **to be good at what we are doing**. In the long run the **customers decide** whether the Knowledge Organization gains or loses in corporate image.

Corporate image is difficult to measure on even a yearly basis. *The simulation model* assumes that results from the difficult projects will be made known on the market. We further assume that management makes a standardized customer survey after each such difficult project and that the results from that measure our Corporate Image. The results are indexed into an amount of money and shown as an intangible asset.

6. Investing in Intangible Assets

All investments involve a transfer of liquid funds (cash) into less liquid funds.

When a Knowledge Organization acquires **tangible assets** like a machine, the cash is used and the corresponding value is shown as an asset in the balance sheet. In accountancy terms, there has been a negative cash flow but neither profit nor loss in the Profit & Loss Account.

When a Knowledge Organization invests in **intangible assets** like Knowhow, accountants in many countries do not allow the company to bring the value into the balance sheet. The investment therefore is regarded as an “invisible” equity. The investment appears as *both* a negative cash flow and a loss in the Profit & Loss Account.

Both kinds of investment have the same effect: they sacrifice short-term profitability for long-term (higher) profitability. But the difference in accounting practice confuses the management. Knowledge Organizations’ investments are mostly in intangible assets. They can be made by sacrifices like:

- 1. Cash outlays (which increase costs for interest).
- 2. Giving up capacity that would otherwise bring in revenue i.e. allowing the Personnel to work on internal R&D rather than with customers, or accepting assignments that bring knowhow but little revenue.
- 3. Paying “more than necessary” for solving the customer’s problems i.e. using over-qualified personnel or being careful when assigning personnel to the teams.

In the simulation model all three kinds of sacrifices are shown.

Investment in Knowhow is a combination of 1) and 2) above. Investment in Corporate Image is an example of 3).

7. Attract the Customer

Customers in general wish to use the capacity of Knowledge Organizations for any of three purposes:

1. **Solving** short-term **difficult problems** which they cannot solve themselves.
2. **Adding capacity** for relief of short-term pressure on **simple projects** that the customer could in principle solve himself, so called “body-shopping”.
3. Long-term **contracts** out of non-core business – also a kind of “body-shopping”.

The best customers are always in short supply. If we wish to have them as our customers we must **attract** them **in competition** with other Knowledge Organizations.

The Knowledge Organization does not use many of the traditional means of “marketing” itself. The art of marketing our Knowledge Organization lies in making ourselves so attractive that the customer comes to us, rather than the other way round.

Whether a potential customer will find our organization attractive depends on:

- Whether our organization or key people are previously well-known to the customer. Customers are **loyal** to people who have come up with good solutions before.
- Whether our organization has a sufficient level of unique **Knowhow**.
- Whether our project team has a sufficient level of **competence**.
- What **corporate image** we have gained from actual work with other customer projects.

The customer is an individual and thus also wishes to work in teams with whom he or she feels a mutual chemistry.

If these conditions are fulfilled the customer is likely to be flexible and even willing to accept delays if **unexpected difficulties** (called “**clogs**” in the simulation) occur. The customer is also likely to contribute to the increased experience of our own team and the individuals’ **competence** levels.

By mixing the right team and attracting customers with a chemistry that fits ours and projects that fit the team’s competence, the customer is likely to “spread the word” which will result in an improved **corporate image**.

The plan for attracting new customers is to be included in the strategy. See Chapter 13, Customer Strategies.

8. Attract the Personnel

The best professionals are always in short supply. They can have their pick of employers. If we wish to have them as employees we must therefore regard them as voluntary **members** of our staff. We must **attract** them **in competition** with other Knowledge Organizations.

Whether a potential employee will find our organization attractive depends on:

- What **Corporate Image** we have gained from actual work with customer projects.
- Whether we have a high level of unique **Knowhow** from which the new person will **gain in competence**.
- Whether we pay a competitive remuneration package, of salaries and **bonuses**.

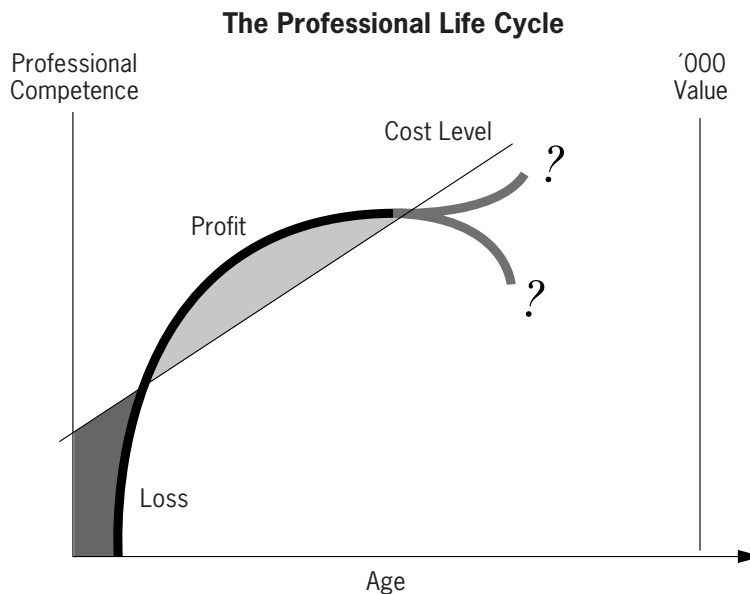
Attracting new personnel is in many ways similar to attracting new customers. This means that the Knowledge Organization must develop a strategy not only for the customer market but also for the personnel market. See Chapter 14, Personnel Strategies.

9. Develop Personnel Competence

The **competence** of each individual person is dynamic and tends to move along a **Life Cycle**.

Key people want to feel that they **grow in competence**, so they wish to gain **experience** from working on **challenging** projects together with other experienced professionals with whom they feel a positive personal **chemistry**.

The junior professional is a novice who usually costs more in supervision, training and assistance than he or she is able to create in revenues. The capacity to create added value increases rapidly with experience, but so do the costs for remuneration, secretaries, fringe benefits etc. The rapid growth in experience is itself motivating. Creative work is, however, very demanding on human nature, and at some stage in the career there comes a creative plateau.



There are three possible management reactions to this plateau:

- 1. To do nothing, which will probably *incur future losses*.
- 2. To fire the professional, which will often entail a redundancy payment *but eliminate future losses*.
- 3. To find an alternative use for the capacity, i.e. create an alternative professional career – as a mentor, teacher, networker etc. – which might *create revenues*.

The first two managerial answers to this universal problem are traditionally more common than the third.

One familiar situation is that a professional feels the threat of a non-growth plateau approaching and attributes this to mistakes by the management – not to him/herself. If our organization has lost image, not allowed the members to gain experience, or grown into an organization with a chemistry in which they feel alienated, they might reconsider their membership and respond to **head-hunting**.

The competence of the personnel is an asset not owned by the company, but it may enhance the **corporate image** if used properly. Customers are sensitive to the reputation of the company's best people, so one way of increasing the reputation is to recruit or develop real **high-flyers** who are able to more than fulfil the customers' demands.

10. Utilizing Capacity

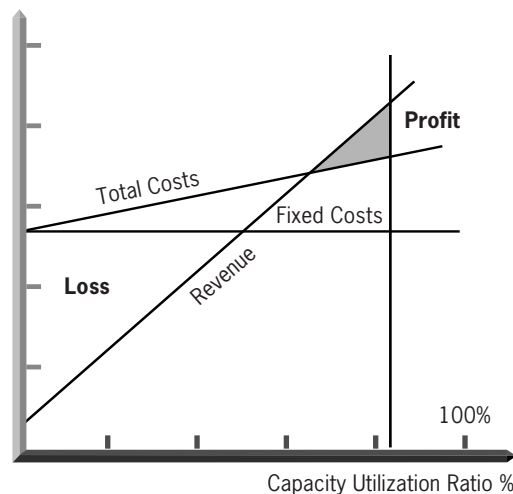
Just like other non-manufacturing or service operations, problem solving cannot be stored and then sold later. An unsold hour never returns. This is of vital importance for steering short-term profitability, because **utilization of capacity** is one of the most critical issues in both cutting costs and increasing revenues. Once our personnel are aboard it is therefore the capacity utilization that decides our short term profitability. There are two ways to increase capacity utilization:

- By adapting our capacity to the demand (by **subcontracting** in extra personnel when demand is highest or subcontracting out our own personnel when demand is lowest).
- By **adapting the demand** to our capacity (adding less profitable projects or projects with higher risk).

Using a part of the capacity for internal **R&D projects** or training is also a method of maintaining high capacity utilization but it means a transfer of liquid funds into less liquid, since we do not receive payment for investment until later.

Key people are individuals with individual personalities. When organized in teams the key people prefer to work with some and dislike the company of others. Their **chemistry** functions more or less well together. This may make the team more or less flexible and creative in finding solutions when unexpected clogs appear in the projects. The capacity of a team may therefore vary considerably depending on its composition.

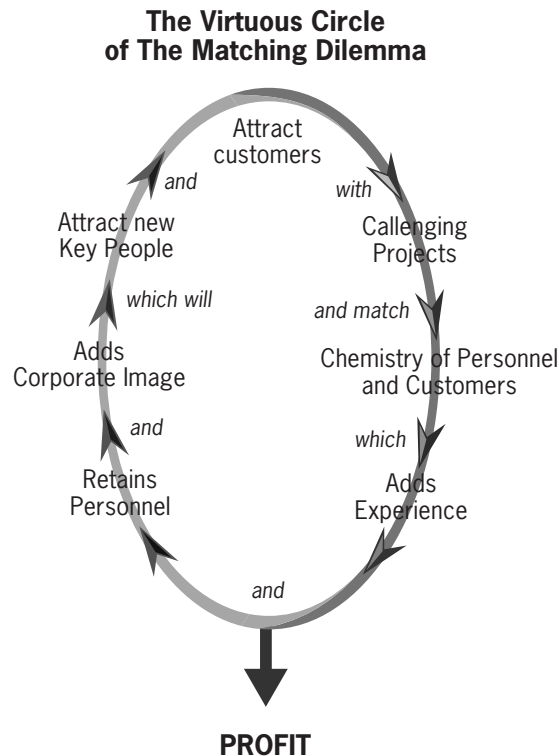
There are two parties in a problem-solving process which affect the outcome – the Customer is also an individual with his or her chemistry. To combine the right team for the right customer is therefore an *art* in the true sense.



11. Matching Capacity and Demand

The **matching of capacity with customer demand** is a very tricky problem for the Knowledge Organization. It involves a number of dilemmas and it is how the management solves this problem which in the end determines whether the organization enters a **Virtuous Circle** or finds itself trapped in a **Vicious Circle**.

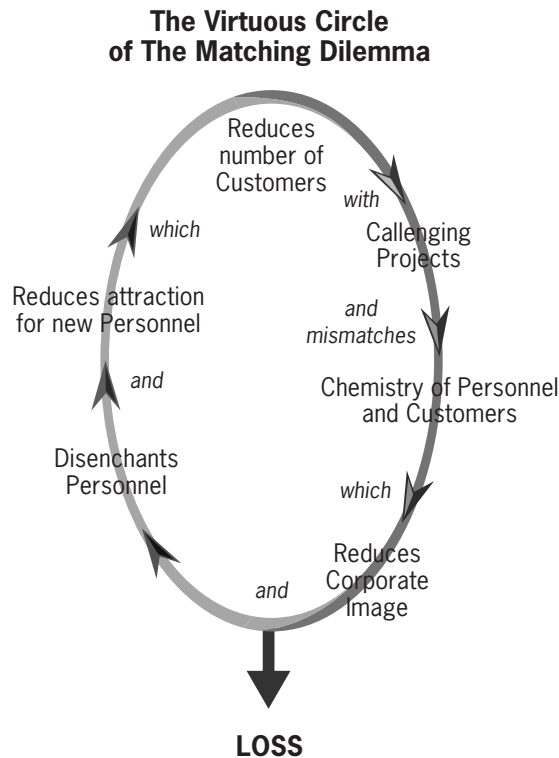
The virtuous circle reinforces itself. The problem of attracting customers and key people becomes easier and easier, the management of the Knowledge Organization finds the projects easier and easier to match with competent teams ...



The Vicious Circle

Unfortunately the vicious circle also reinforces itself. The management finds it increasingly difficult to find attractive customers and competent key people. The chemistry of the teams and the customers are more and more difficult to match, so the projects are more and more often solved unsatisfactorily, which reduces the attraction on the markets ...

Managing the Knowledge Organization usually means maintaining a balance between the two dynamics: the virtuous circle and the vicious circle.



12. Managing the Strategic Dilemma

The Knowledge Organization often finds itself pulled in two directions. One direction is pointing towards the paradigm of the industrialized “Service Company”. (To the left in the figure.) The other direction is pointing towards the “Knowledge Organization”. (To the right.)

The forces that pull towards the left tend to come from the *managers* in charge of the organization. They wish to guard the survival of the organization, reduce uncertainty and work efficiently. They therefore:

- Replace staff with computer systems.
- Standardize service into packages that can be handled by less experienced and less costly personnel.
- Look for growth in volume rather than competence.
- Look for larger profits.

The forces that pull in the other direction usually come from the *professionals*. They :

- Prefer to work in small units.
- Want non-standardized challenging problems.
- Want to work together with colleagues of high competence.
- Prefer close relationships with demanding customers.
- Desire support from sufficient financial resources for R&D.

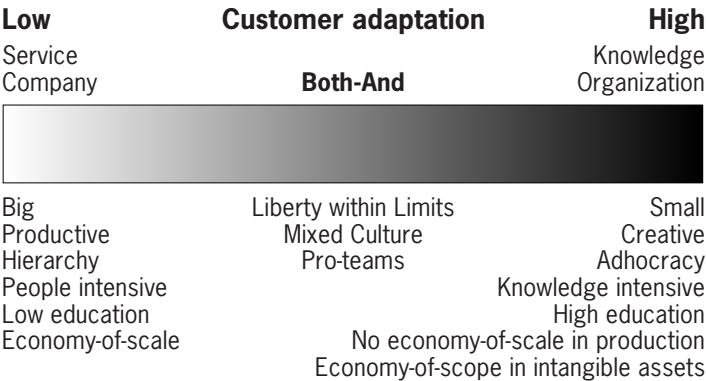
This means that there are in principle *two strategic paradigms available* for the Knowledge Organization. Shall the Leader listen to the professionals or to the managers?

Steering the company along the organizational track means that the managers utilize their organizational knowhow for growth. A common action is to acquire other companies in other professional fields.

Steering along the professional track means the strategy is more in the hands of the professionals or based on the professionals’ values. They tend to add new ventures utilizing the existing professional knowhow but adding new organizational knowhow.

Both roads might lead to long term profitability. It depends on the business logic of the particular industry.

The dilemma is even greater if the organization has a bit of both, needs both routine and creativity, needs both customer adaptation and standardized behaviour, as “*Both-And*” indicates in the chart below. The choice is then either one of the two above with the risk of losing the advantages of the other, or a *third strategic paradigm* which is to balance the two paradigms within the same organization, trying to develop a mixed culture which combines Liberty within Limits and small creative “Pro-teams” within larger units. This is a common (often implicit and enforced) strategy of large Knowledge Organizations.



The three strategic paradigms.

13. Customer Strategies

The Knowledge Organization competes in two markets: for **Customers** and for **Personnel**. We therefore need to develop two strategies: one for attracting and keeping customers and one for attracting and keeping key people. They are closely linked and it is detrimental to success if the two do not match.

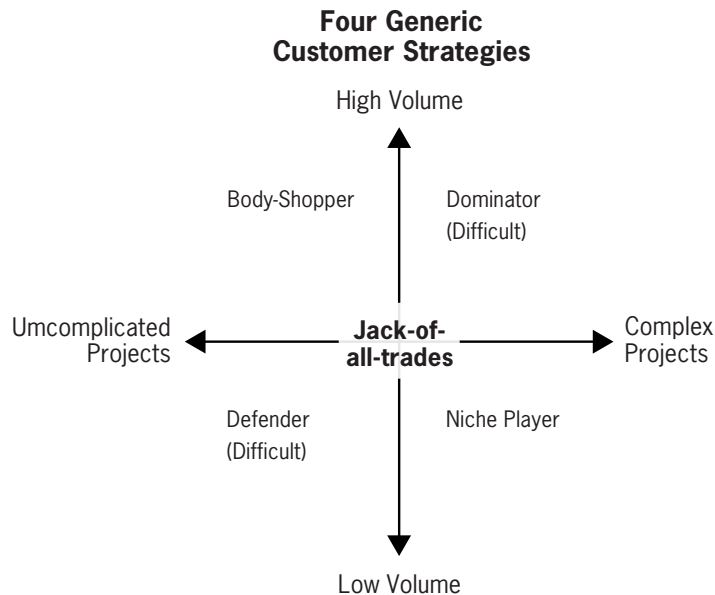
Customer strategies can be generalized into seeking advantages along two dimensions: volume and complexity.

The volume dimension is to aim at high volume **dominance** or a small volume **niche**. High volume companies can spread their investments in Knowhow and Corporate Image over a larger volume, because there exists a **positive economy-of-scope in intangible investments**. Big companies are more visible and can therefore add Image more easily. They can also spread their investments in corporate knowhow over a larger volume.

The complexity dimension is to aim at either demanding customers with challenging, complex projects or at less risky “body shopping” projects.

Companies aiming at **high volume strategies** must be good at attracting and keeping personnel and be very good at matching teams and customers. They must also be prepared to compete in pricing in order to win most projects available on the market. The reason why **niche players** can be a successful strategy despite the lower economy-of-scope is that there exists a **negative economy-of-scale in creative production**. First of all, it is easier to manage a small operation. There are also many competent key people who prefer to work in small units with good **chemistry** and individual treatment.

Companies with complex project strategies must be good at attracting and keeping the most demanding key people and the most demanding customers. They must therefore guard their **Corporate Image** very carefully and invest in the **Knowhow** and **Competence** of their personnel.



The **Dominator** strategy is difficult because it demands very skilled managers, large markets and time to develop, but for those who succeed it is probably the most profitable. The niche strategy is less risky, but the smaller resources make finance a strain.

The **Defender** strategy is very difficult, since the defender can make use neither of the positive economy-of-scope nor of the negative economy-of-scale by being a small, highly competent niche player.

Usually, the worst strategy is to dabble in everything, to be a jack-of-all-trades who may be versatile but who excels at nothing.

Most markets allow all strategies. The simulation model mirrors all four generic strategies.

14. Personnel Strategies

We must have an idea of whom to recruit and why. We must also be prepared to compete with other knowledge organizations for the best key people, so we must have an idea of how to be as attractive as possible to the particular people that we want. The strategy for attracting and maintaining Personnel can be called our **Personnel Strategy** and it must be compatible with the Customer Strategy.

Complex projects demand highly competent teams, which implies investment in Knowhow, and training, as well as guarding the Corporate Image. This is the Personnel Strategy of the “Niche Player” and the “Dominator”.

Less complicated projects can be handled by cheaper, less competent personnel. This implies careful monitoring of expenditure levels in investment and other costs, as well as less sensitivity to staff turnover. This is the Personnel Strategy of the “Body-Shopper” and the “Defender”.

The professional **life cycle** is also important for personnel strategy. One strategy is to nurture our own personnel from the junior stage and up. The other is to be more opportunistic by attracting (head-hunting) more competent key people higher up in their life cycle when they are more profitable. Both strategies are frequently used and both have their pros and cons.

The simulation model allows all the personnel strategies mentioned above and all combinations.

The worst combinations of Customer and Personnel Strategies are:

- The Dominator strategy combined with low competence teams, because this reduces the number of projects available and also easily results in reduced Corporate Image.
- The Defender strategy combined with high competence teams, because the most competent members will leave.

- The Niche Player strategy combined with low competence teams, because this reduces the opportunities to find the best fit between teams and customers.
- The Body Shopper strategy combined with high competence teams, because competent key people are too costly (and will also leave).

15. Pricing

What is the value of an idea that comes like a bolt from the blue but is based on a whole working life of experience? Basing the value of creativity on time spent is seldom correct.

Since time and capacity utilization are so crucial for profitability, many Knowledge Organizations have managed to avoid a direct link between time spent on a project and payment.

Here are some possibilities.

1. Payment per Assignment

Some customers use tender procedures. The vendor thus offers a fixed price irrespective of the time involved. This is both a threat and an opportunity.

Head-hunters often charge a percentage of the salary of the new employee.

Some big consulting firms charge a fixed amount per team rather than per consultant. This is a method of lifting the charges of the lowest paid associates.

2. Commission on Cost

Advertising agencies often charge a percentage of the total space cost of an advertising campaign.

3. Profit Sharing

Sharing in the profit of the solutions implemented is an attractive method in theory but often difficult to use, since implemented results can be hard to distinguish. Advertising agencies sometimes use it when designing marketing campaigns, and management consultants in cost-cutting projects.

4. Ownership in Customer

Instead of charging a fee in cash, the consulting firm might transfer all or part of the fee into shares in the company they advise. This is similar to profit sharing although the involvement and the risks become much greater. The Knowledge Organization may suddenly find that valuable cash is tied up in a different business.

5. Insurance Premium

Receiving payment as a kind of indirect payment or insurance premium is a common system. The public sector can be seen as an insurance system. They are allocated an amount of money from somebody other than the customer. It is also common in the private sector, for instance in the financial sector. For example, underwriters charge a fee to the new shareholders when they advise the company on making a new share issue.

The retainer system applied by the ancient Chinese doctors also belongs in this category. The patients pay as long as they are well but expect to be treated for no cost when taken ill!

6. Make the Solutions Visible or Tangible

Many consulting firms try to make their solutions visible in order to simplify the sales process. Much of the conceptual development made by management consultants belongs in this category. Concepts like “Total Quality”, “Service Management”, “7S” and “Learning Organization” are just a few examples.

16. Some Critical Incidents

1. Too high or too low Staff Turnover

A “normal” staff turnover varies between 5% and a maximum 15-20%, i.e. the key people stay between 5-7 years and 20 years.

High turnover is a sign of discontent. The reason for high turnover might be:

- The key people do not grow in competence.
- The key people do not like the chemistry in the teams.
- The corporate image is shrinking.

A very low turnover is a sign of a stagnant or shrinking organization or overly complacent personnel. This is not satisfactory either, since it reduces the dynamics of the organization.

2. Tough Competition in the Niche

If the competition is too tough we might have to change the strategy. A Knowledge Organization has two choices in such a situation:

- Select customers according to personnel and competence: “Inside-and-out”.
- Attract key people who will fit the most attractive customer segment: “Outside-and-in”.

3. Too Competent Personnel

A not too unusual situation is that the key people often “outgrow the customers”. What are the solutions (except allowing the people to leave)?

- Attract more challenging projects by reducing prices.
- Attract more junior key people and allow the most competent of the personnel to become project leaders. This increases capacity and is only possible if the market is favourable.

- Start R&D-projects in order to increase the competitive edge in a new area. (Possible only if there is money available.)
- Start subsidiaries or encourage spin-outs.

4. Too high Profitability

To have too high profits is perhaps not considered a very critical incident, but high profitability might be the consequence of:

- Under-investment in R&D, which is detrimental in the long run.
- “Volume sickness”, a disease which often afflicts managers and Knowledge Organizations growing along the organizational track.
- Over-utilizing personnel, which will cause burn-out.

5. The Best Have to Work too Hard

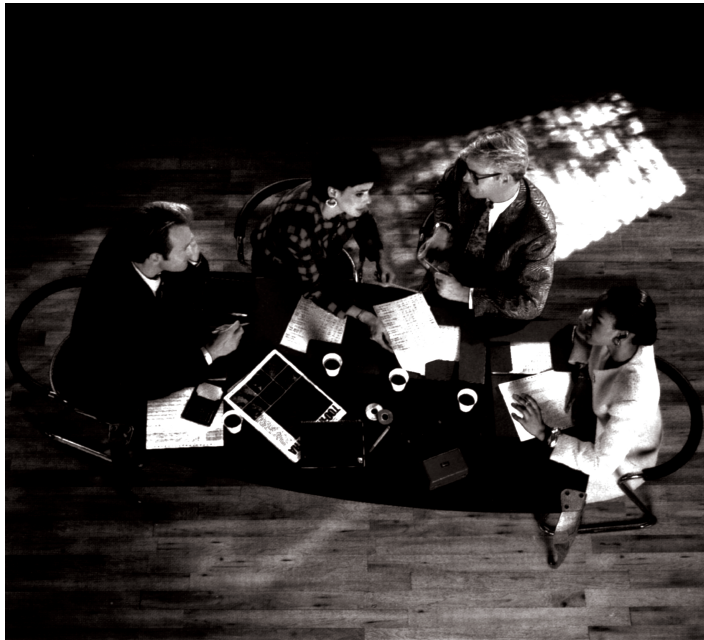
The best among the key people often work far too hard. This is partly due to their own workaholic nature, but might also be the consequence of negligent personnel planning. The best consultants are in high demand, their customers want more and they attract new customers. It is therefore far too easy to allow them to burn themselves out, which will cause both personal and company catastrophes.

6. The “Spare Tire” Effect

When left unattended, the age pyramid is certain to become distorted. The “spare tire” effect comes from the fact that the leaders tend to recruit key people of their own age. When the 25-year-olds become 35-year-olds they usually find good reasons to recruit 35-year-olds, etc ... In this way a spare tire develops round the company’s midriff, consisting of professionals of the same age and outlook who try to maintain their positions and status. The best way to avoid this problem is to have a constant inflow of apprentices who grow with the company. A growing organization can thus avoid the spare tire effect, but the non-growth organization with low personnel turnover usually finds it much harder.

7. The Proletariat of the Assistants

Most senior professionals find many logical reasons why they need lowly paid assistants or secretaries in order to increase their own expensive efficiency. The proletariat of the assistants, however, tends to increase the bureaucracy, cause sub-cultures and reduce overall efficiency. A more effective way is to recruit more senior professionals and to insist that they make their own coffee or learn word processing ...



17. Management Information

The problems of management information are great in Knowledge Organizations because present accounting practice was developed for manufacturing industries. Therefore management might easily get the wrong advice from accountants, auditors and banks.

A Knowledge Organization is more sensitive to short-term **cash flow** than to short-term profit. Investments and poor capacity utilization may, from time to time, absorb a lot of cash if the management is inattentive.

- The management information system should include measurement of **customer satisfaction** as an index which is followed up every year.
- It should measure the development of both visible investment and **invisible investment** like R&D.
- It should measure productivity in terms of **capacity utilization**, i.e. man-hours utilized compared to man-hours available.
- **Value added per person** is a much better indicator of effectiveness than profitability on visible equity.
- The **profit margin** or **value added margin on sales** is also useful as a measure of effectiveness.

In the example: Value added Year 1 = $103 - 30 = 73$. (Can also be calculated “backwards” as Operational Result + Salaries $18 + 55$.) The value added is allocated to:

Personnel	$55/73$	=	75%
Visible Capital	$(3+4)/73$	=	10%
Investment	20	=	27%
Visible Loss	-9	=	<u>-12%</u>
Total		=	100%