

*Invisible Advantage:*  
How Intangibles Are Driving  
Business Performance

INVISIBLE  
ADVANTAGE

HOW INTANGIBLES  
ARE DRIVING  
BUSINESS  
PERFORMANCE

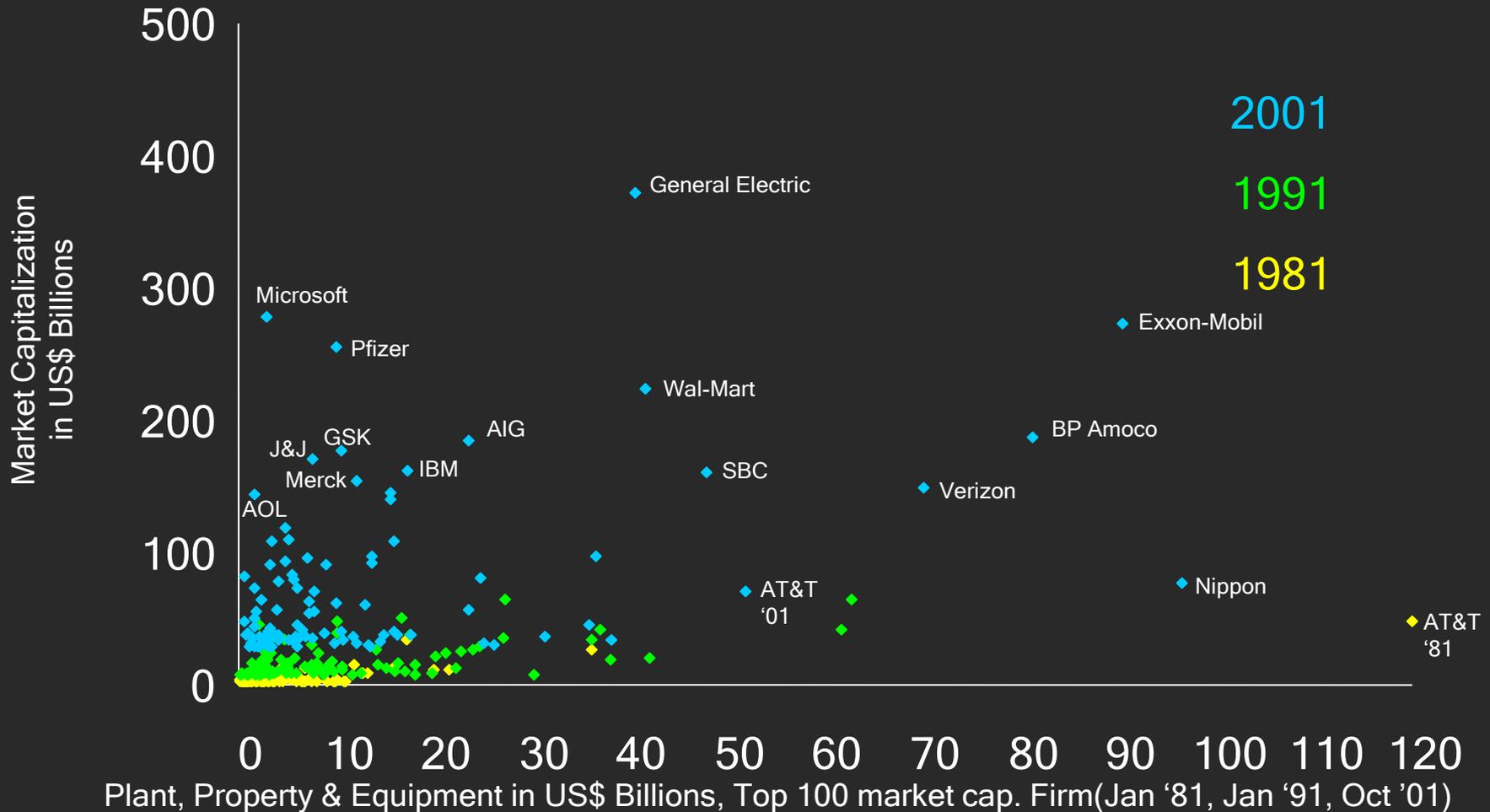
Jonathan Low

Federal Reserve Bank of New York

July 11, 2002

The markets are  
valuing your  
intangibles every day –  
whether you want  
them to or not.

# The Rise of the Intangibles Economy



# The Measures That Matter

- Management

- Leadership
- Strategy Execution
- Communication & Transparency

- Relationships

- Brand Equity
- Reputation
- Alliances & Networks

- Organization

- Technology and Processes
- Human Capital
- Workplace Organization & Culture
- Innovation
- Intellectual Capital
- Adaptability

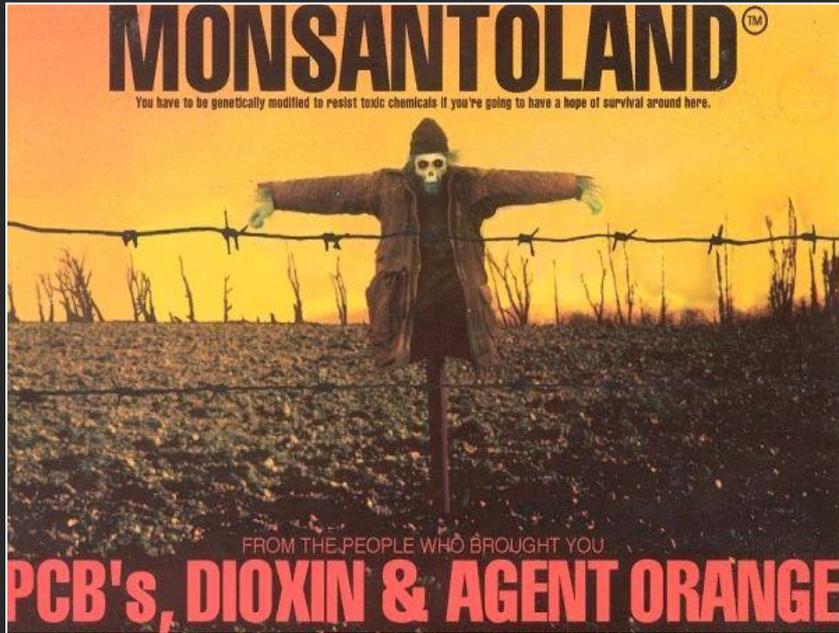
# Organization: Innovation

## Pfizer's blockbuster drugs

- Pfizer Global Research and Development is the world's largest private biomedical R&D operation
- Viagra discovered during trials for new heart medicine
- Only 1 of 8 Pfizer drugs generating more than \$1 billion in revenue per year



# Relationships: Reputation



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# Measures That Matter Insights

*A company's non-financial performance plays a critical role in how the company is valued.*

- Non-financial performance accounts for 35% of institutional investors' valuation
- The more sell-side analysts rely on non-financial performance, the more accurate are their earnings forecasts
- Consistent set of non-financial drivers that analysts rely on:

- ◆ **Strategy Execution**
- ◆ **Management Credibility**
- ◆ **Quality of Strategy**
- ◆ **Innovativeness**
- ◆ **Ability to Attract Talented People**

- ◆ **Market Position**
- ◆ **Management Experience**
- ◆ **Quality of Executive Compensation**
- ◆ **Quality of Major Processes**
- ◆ **Research Leadership**

# IPO Transformation Insights

*Intangibles are the most significant differentiator between successful and unsuccessful IPOs.*

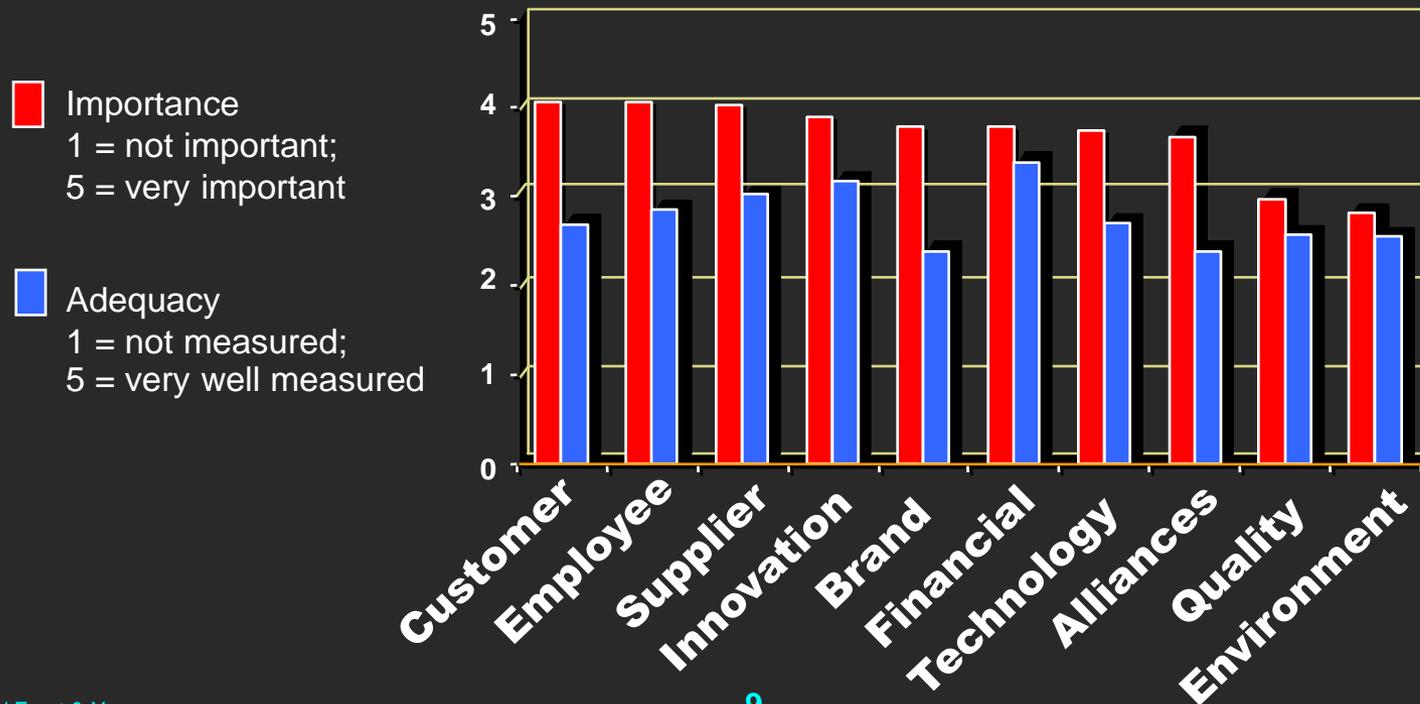
- **Characteristics of Successful IPOs**

- Internal systems and employees' interests are realigned with corporate strategy early in the IPO process
- Strategy is executed in a fashion superior to competitors'
- Non-financial strengths are communicated along with financial position to stakeholders and to the market

# Decisions That Matter Insights

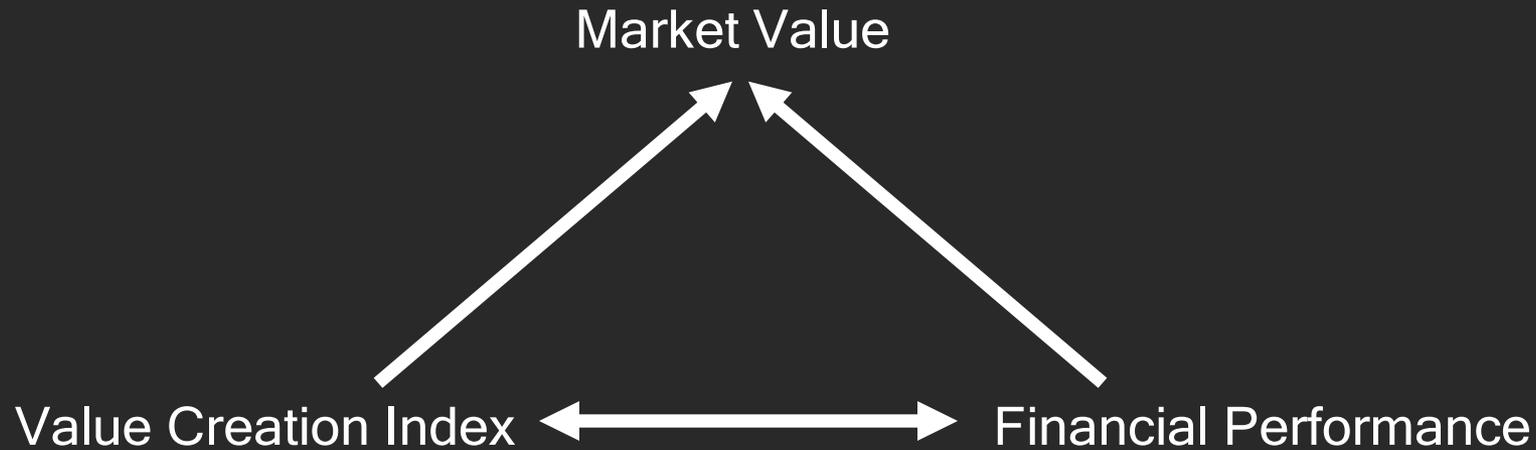
*Corporate performance measurement systems are inadequate for intangibles management.*

- 81% of respondents stated that their performance measurement system is not well aligned with their corporate strategies
- Gaps in intangibles measurement are correlated with financial performance measures such as ROE, 1 & 3-year stock returns, and 5-year sales growth



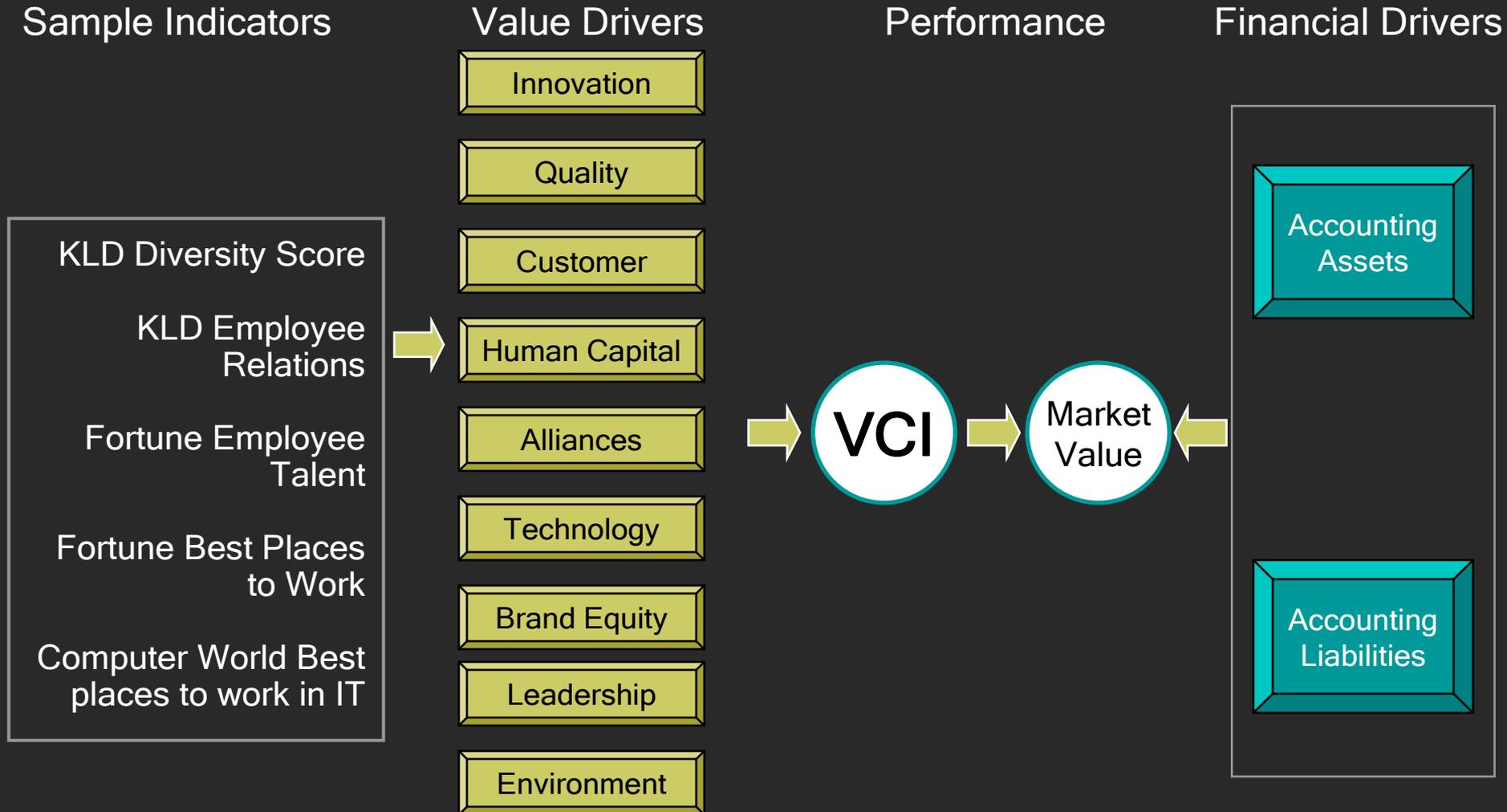
# Value Creation Index Insights

- The VCI is highly correlated with the market value of equity



- The R-squared values indicate that the VCI is as powerful as financial performance in explaining variance in market value
- The VCI is quite elastic - a 10% change in the VCI is associated with a 5% change in the market value of equity, after controlling for financial variables

# Nondurable Manufacturing Value Creation Index Model



# Rank of Value Driver Categories: Nondurable Manufacturing

Nondurable Manufacturing  
Value Driver Category

Importance  
Rank

Networks & Alliances	1 (high)
Brand Equity	2 (high)
Technology & Processes	3 (high)
Human Capital	4 (high)
Innovation	5
Quality	6
Leadership	7
Customer	8
Environment	9

# Top Value Creating Firms: Nondurable Manufacturing

1. Procter & Gamble
2. Dupont
3. Merck & Co.
4. Pfizer
5. Coca-Cola Company
6. Eli Lilly and Company
7. Unilever
8. Bristol-Myers Squibb
9. Philip Morris Companies
10. Johnson & Johnson

# The Convergence of Private Interest and Public Policy

“Intangibles such as R&D and proprietary know-how, intellectual property, workforce skills, world-class supply networks and brands are now the key drivers of wealth production, while physical and financial assets are increasingly regarded as commodities.”

October 2000 report to European Commission on the Intangible Economy

“Protection of intellectual property [is] necessary to encourage creativity and investment within the EU, both of which are crucial for job creation and long-term competitiveness.”

Mario Monti, EU Competition Commissioner

“An ever increasing share of GDP has reflected the value of ideas more than material substance or manual labor input.”

Alan Greenspan, Chairman, U.S. Federal Reserve Board

"As intangible assets grow in size and scope, more and more people are questioning whether the true value--and the drivers of that value--are being reflected in a timely manner in publicly available disclosure."

Arthur Levitt, Chairman 1993-2001, U.S. Securities and Exchange Commission