# Brain-Power—Use It Or Lose It!

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*Based on a speech given by Benny Browne at the LESI Conference, Osaka, Japan, on April 7th, 2002.*

This paper looks at brain power and human relations and how we can effectively capture the brain power and how we can use it for the benefit of mankind. So brain power, use it or lose it.

Over the last ten years we have seen an enormous shift in importance from tangible assets to intangible assets. For example, you've seen people like Microsoft with a market capitalization of many billions of dollars, but when you actually look at their hard tangible assets they are around 30% of the total so you've seen a moving from tangible to intangible assets.

There's been a move from domestic to international focus through to global focus and from tangible asset backed economies through to information economies and that's about where we are now. So how do we work with this and what do we do about it?

Everybody knows that you can identify and protect the traditional intangible assets such as patents and trademarks and copyrights to a certain extent, but it's much more difficult to protect what is in the head of the knowledge workers, as they are called.

I'd like to have a look at effective ways of protecting the knowledge and ensuring that the investment in the workers' heads is not lost to competitors.

A great Australian, Rupert Murdoch, the Executive Chairman of News Corporation, in October last year, gave the Inaugural Keith Murdoch oration in Melbourne. His speech was entitled, "Brain Power Shake Up Urged." You may think that this applies to Australia alone, but it doesn't. It really applies across the board. This is what he said:

"Australia is steadily slipping in the current race to create and attract human capital. We must realize that the financial assets of any country comprise less than 30% of the national balance sheet. According to the world's foremost social scientists, 70% of the real value of any society lies in its human capital. The key to the future of any country is not in its physical resources or industrial capital, rather it is the human capital which will fund the health and growth of nations in the next 100 years."

So having become very philosophical, let's have a look at what I'd like to cover. I want to have a look at:

What brain power is, or what I call brain power.

- Why it's important today.
- How best to manage it.
- Employer / employee loyalty.

The problems that we have today with accounting standards which don't allow us to capture brain power in balance sheets are:

- How you actually harness it,
- How you protect it; and
- Some emerging Australian trends in the law as far as protection is concerned.

Intellectual capital is what we are talking about and it's made up really of four elements. They are:

- Brain power (which some people call human capital),
- Structural capital - for example, patents, trade marks,
- Customer capital, and
- Other capital.

To emphasize the importance of Intellectual Capital I will relate what was told to me by the Chairman of a public company, Geoff Brash, many years ago: The four most important things in a successful company are the shareholders, the customers, the suppliers and the staff. In order to maintain the success of the company, equal attention must be paid to all four. What Geoff was saying, in essence, is that without people a company could not be successful.

Brain Power consists of:

- Competencies (your staff competencies), skills;
- Knowledge and experience and in particular how they have been applied to create value for others;
- What's in the mind of the knowledge workers.

Some years ago I was invited to go to the Toyota factory in Melbourne which is an enormous factory. It takes about 3 hours to get around the whole factory. The man who was going to take us around the factory was a retired employee and had been with the company for something like over 40 years. He had never had any position of extreme management responsibility, he had been somebody who had worked his way up but had never got to the very top. And his job now was to take international and other visitors around the Toyota factory. I asked

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my host, "Why is this man doing this job?" and he said, "Because he has been around for 40 years, he knows everything there is to know about this factory." This is corporate knowledge at its best. It's something which is being used in the best way possible because this man can tell you everything that's happened in the factory, how it has grown, what they do there, the introduction of robotics, etc. It's really something very important and Toyota saw it and picked it up and worked with it.

Structural capital encapsulates methods that have been developed, systems and processes and personal networks. Karl Sveiby, a famous writer in this area, describes structural capital as that which is left after the employees go home for the night. So when the factory is empty, what's left is the structural capital.

One of the biggest industries in the world today, franchising, makes extensive use of structural capital. It is based around the licensing of systems, trade secrets and trade marks. But its principal focus is in the licensing of systems.

Customer capital comprises the number and depth of personal customer relationships. These give rise to an organization's reputation. A reference written by a customer of an organization is always more valuable than a reference written by the organization itself. Shakespeare, in the play "Othello," puts these words into the mouth of the character Othello: "He who steals my purse takes nothing. 'Twas mine, 'tis his and has been slave to thousands. Yet he who robs me of my good name takes that which not enriches him but makes me the poorer indeed."

And then there is other capital such as things which we can't touch but we can identify them and see in the form of patents, etc.

Question: So why is brain power important?

Answer: Because it delivers results and the results are what you see around you in your office.

If your offices were stripped of people there wouldn't be one iota of worth in the chairs and all the other things. What's in your office is extremely important.

There is a Columbian university which has conducted a study and they say that the spending on intangible assets like R & D and employee education results in a return of 800% greater than an equal investment in new plants and equipment. Why? Well, new machinery only allows incremental improvements but R & D and employee education leads to innovation that creates revolutionary ideas.

There's a body called the Conference Board which has conducted a survey of 200 senior executives, and this survey shows that 80% of companies have some knowledge management efforts under way. 60% of these senior executives use knowledge management enterprise wide and 60% expect to in five years, so it's an increasing trend. Twenty five percent have a Chief Knowledge Officer or a Chief Learning Officer and 21% have a communicated knowledge management strategy.

They have also reported the following gains from Knowledge Management. Buckman Labs has increased its new product sales by 50%, Dow Chemical has saved 40 million dollars a year in the re-use of patents - they did a huge patent audit and brought about this enormous amount of revenue saving. Ford Motor Company and BP Amoco saved more than US$600 million in the past three years by employing knowledge management techniques. Hewlett Packard reduced its cost per call by 50%. Rank Xerox reduced its dispatches by 15%. Roche can send out its products for FDA approval six months faster and Sequent registered 10% higher sales for new sales reps after 6 months.

You'll see adverts in the papers these days, "Knowledge Officer Sought." I saw one last year for a very big research and development corporation in Australia called the CSIRO - they were advertising for a Knowledge Officer.

There is a body called Best Practices LLC in the United States. They say that this is what ought to be happening: formally define the role of knowledge in your business and in your industry. All of us know it's there, but nobody has defined it. Understanding what knowledge in the company is will allow you to focus on finding and capturing intellectual capital and that will allow the company to excel above others.

Divide the intellectual capital into the strategic areas, for example:

- Brain Power,
- Structural capital,
- Customer capital, and
- Other capital.

Develop management systems to assist in benchmarking efforts. You need to be able to measure things because what gets measured gets managed.

Turning next to the employer / employee relationship. Employees are the key to success to a company's exponential growth.[1] It is absolutely essential to have employee / employer loyalty. Some years ago I was listening to an audio tape of David Suzuki who, most of you know, is the famous environmentalist and philosopher based in Canada. He said a striking thing, and I thought, this guy is good. He said, "Why is it that in our universities we teach mathematics, we teach science, we teach arithmetic, reading and writing and yet nobody teaches relationships?"

In our lives we have constant relationship interactions with our families, with our outer families and with other people, but nobody teaches anybody how to relate. And as a result, my bet is that there would be a lot less dispute and war and so on in the world if relationships were better taught.

Bad employees, as everybody knows, can cause a business to fail. Choosing an employee is somewhat like choosing a house. When one chooses an employee, the interview lasts perhaps an hour. When one chooses a house, the inspection lasts

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1. *Deal Consulting*, "Creating Employee Loyalty."

perhaps an hour. After that hour, on both occasions, we make up our minds as to whether to proceed or not. People get employed it's like buying a house. Yes, in the employment situation, there are things like six months probation, but if there were a better strategy to assess what you are taking on, the end result would be much better. It's like a marriage, you need to know with what you are getting involved.

Bad employees obviously can cause businesses to fail and we've seen that. I won't mention any names, but a very large accounting firm in America springs to mind.

Mediocre employees. Well, there are lots of people who fall into this category. As Spike Milligan once said, "In the army all you have to do is walk around with a broom in one hand and a piece of paper in the other and nobody will ask you what you are doing because you seem to be employed."

Good employees can really make a business go through the roof.

Now how do you keep the best employees in your business? Well, pay is something which is very important, but it is not always the most important. One of our employees in our law firm was working from home, he had a wife and a very small child and he wanted to spend time with them. His productivity, when measured against his work at the office, was much higher than it had been before. He was at home in the morning to play with his child. At ten in the morning, when the child went back to sleep, he started work. Through a staggered working hour day it turned out that he was working many more hours and much more productively from home than he had been when working all day at the office. So pay isn't always the most important thing. It's only a benchmark to value an employee's worth. It is important to note, however, that wages below market rate result in bad employees. You get the worst employees out of the pool.

Benefits provided by a company operate in a similar way to wages. Some years ago I visited a company in Australia called Southern Dental Technologies. I was being shown around the plant and talking to the Managing Director and asked him, "How do you keep the people in your R & D section, you know you are in a very competitive business, what do you do to keep these people?" And he said to me, "You know we sign confidentiality agreements, but they're as good as the paper they are written on. If somebody really wants to get out there and break up your business, they will." And I said, "What do you do?" And he said, "We treat our employees very well." In this respect the benefits provided by a company to its employees forms part of this question: "How do you treat your employees?" You'll have to match your competitors, that's obvious. If you don't, you're not going to keep the people.

Training. Training today is very important because things are changing so fast in the world, we've got to have continuous training which is dynamic and is exponential and allows employees to feel as though they are climbing the career ladder. The training shouldn't be limited to just technical sorts of job skills, but it should be wider. It should include items such as like foreign languages, computers and other types of courses, which in a wider life sense will make the employees better employees.

A learning environment where people feel mentored. In a lot of the law firms, and I can really speak about law firms because, as I said before, I am a lawyer. There are employees who, when you talk to them, will say, "I really feel great about working here because I, as a junior person, get to work with a partner and I really feel great about being in this company because I am involved in what's going on. I get to work with the managers."

Career plans. Obviously there are some places where they've got career plans for their lowliest workers right the way through.

Evaluations and reviews. Now these are very sensitive issues and sometimes they can cause a lot of damage, but they must focus on the individual and how they fit into the company and not so much on what they are doing wrong. It's not another one of those "OK, lets bash her / him" sessions. The reviews should be used as a method to keep good employees and not to weed out bad ones.

Regular business meetings. I know of some firms which have meetings where every one of the legal secretaries are brought into the meetings as well because they have a lot to contribute - they are important people. I have always maintained that the garbage man who comes around the streets early in the morning removing the garbage is one of the most important people, because without him we would have this garbage stacked up everywhere. Everybody in the whole chain is very important and they need to know that, and they need to feel that they are very important. And obviously if you recognize and reward good work, your employees are certainly going to appreciate what you are doing for them and with them. You've got to provide good working conditions because without good working conditions people will see the green on the other side of the fence and will leave.

Now, I was talking about the accountancy problem before. There has been a move worldwide, globally to allow human capital to be recorded on balance sheets of companies. I know a chap called Sam Khoury, he is a LES member. He was working with Dow Chemical and he did his doctorate on the valuation of what is in people's heads. Being able to value what is in people's heads is one thing, however, unless that valuation can appear on the balance sheet as an asset, it is worthless from a financial point of view. Global accounting standards are trying to get to grips with this but I don't believe it will happen in my lifetime. There are too many things which will mitigate against it. In Canada there has been the strongest push to try and

have this happen but even they have struck a blank wall.

Why have Brain Power valued on the balance sheet? Because you can go to the bank and say, "I've got this asset, I want a leverage against it." Or, "I'm selling my company, I have this asset and you will get the employees, you will get the people to go with it."

Harnessing it? Well, you heard it said before that intellectual property audits are valuable in identifying and harnessing brain power. However anecdotally, corporations and government bodies pay very little attention to what the people do within the organization. By using the intellectual property audit it can be pointed out to management what the corporation or government body has in the form of brain power, that it is an important asset and that it must be nurtured. If a company develops a knowledge management system, it will certainly help in harnessing it and bringing it to account. Obviously, if we could introduce new global accounting standards, that would be great, but that's on the wish list and it's not something which is going to happen over night.

Protecting it. One of the ways of protecting it can be in the form of restraint of trade. Now restraint of trade will be a term familiar to the lawyers. All it means is that you say to an employee you may not go out and work with a competitor for a period of time in a certain area. Those restraints are, in the western world at least, illegal and they can only be made legal if they are reasonable in relation to how long, what geographic area and what type of restraint it is. So there is a way of protecting brain power, but it is still limited.

Restraining know-how. Now this is a new phenomenon which has come about over the last ten years. People in drafting contracts will try and restrain know-how, and I must say that you will see later that there is a trend where restraint of know-how is gaining some acceptance.

Garden leave. This is a really new concept. For those of you who think that it is something akin to garden gnomes in a garden, you are quite right. It is paying an employee a very large sum of money to sit in his or her garden and do nothing for a certain period of time. You will see later that the Australian courts are warming to this idea but it still has not met with total acceptance by the Courts. These trends through the cases show the following:

In 1972 there was a British case[2] where a man was paid ten pounds, not to go out and compete. Without any hesitation the court just said, no, you can't do it, you cannot try and restrain a person from earning a living even though you have paid him some money, it doesn't wash with us, it is something you are not allowed to do. And the real irony in this case was that the employee, after the court ruled that he couldn't be restrained, sued the company for his ten pounds because he said that it still owed him the money even though he couldn't be restrained.

There was a case in Australia in 1991[3] which involved a company which was dealing with Taiwan. The company had an employee whom they had signed up on an agreement that he wasn't going to be allowed to disclose the customer lists. Well the usual happened, and it happens all the time - he left the company and within a short time he joined the competition and he had all the information at his fingertips. His previous employer sued him and the company who was employing him, alleging that the employee had breached confidentiality. The Court held that it would allow a restraint but for reasons which are not important here. There was an Act of Parliament in New South Wales which hadn't been complied with properly, so they didn't enforce the restraint, but they were coming to the view that this was a reasonable type of thing to do, to protect the company's goodwill.

In 1997 you had a similar type of case of Kone Elevators[4] where a person who was a sales person within the company moved to another company. Just before he left Kone, Kone scheduled the release of brand new products which was attended by the employee. Kone alleged that the employee knew exactly what those products were, having been involved in the briefings. Furthermore, the employee's employment with a competitor would result in damage being suffered by Kone, were the ex-employee to divulge all the new product information to the new employer. The court held that, but for the fact that Kone had failed to comply with the New South Wales Restraint of Trade legislation, it would have granted a restraining order. So the court there was saying if you had complied, we would have allowed you to restrain him in those circumstances.

The next case was one of Arnotts Biscuits.[5] Arnotts is a very big biscuits manufacturer in Australia. The Managing Director of Arnotts had left and he had been paid something like one and a half times his annual salary not to go and work for a competitor. He left and, within the restraint period, joined Weston Biscuits. Within days of him joining Weston, Arnotts went to court seeking an injunction on the basis that they had paid a significant amount of money so that the former managing director would not join a competitor. The court wouldn't stop the man from going to Weston for reasons which are not important, but obiter the court commented that the concept of garden leave was not a bad idea. If somebody has been paid a lot of money not to go and work then that person oughtn't go and work, and the court stated that it would have enforced this particular contract against the employee if the conditions in question had been complied with. Apparently he had signed up

2. *Howard Hudson*, 1972.
3. *Wright v. Gasweld*, 1991.
4. *Kone Elevators*, 1997.
5. *Arnotts v. Weston*, 1999.

for this deal with Arnotts during his employment rather than after his employment, so it seemed to be part of his employment contract and therefore didn't fall within the reasonable restraint.

The very last case is one which is a very recent case in Australia.[6] It was a decision of the full Federal Court. A confidentiality agreement was challenged in the court as a restraint of trade. Earlier we were talking about trying to protect know- how by confidentiality agreements. This confidentiality agreement had no ending date and was completely disallowed by the Court as an unreasonable restraint of trade. When the confidentiality agreement was read in a broader sense, the employee was to be restrained from working at any time and the court disallowed this. Yet the Court indicated that restraints which are reasonable will be allowed, and really what's reasonable is what is reasonable in the community at any given time.

The emerging trend in Australia seems to be that the courts are coming to the view that garden leave may well be an acceptable practice and that know-how is not able to be restrained indefinitely through the medium of a confidentiality agreement. In my view, however, it is still going to take a long time before we get to some decision which actually points to garden leave and concludes that it, in itself, is satisfactory

So, in conclusion let me say that I've taken you through some philosophy, taken you through a bit of law, and taken you through some advice. In the end, if you don't use your brain power you will lose it.

6. *Maggbury v. Hafele*, 2001.