A review of the strategic management literature: The importance of intellectual capital in the non-profit sector

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Abstract

Purpose – Very little systematic research has reviewed the applicability of strategic management concepts including SWOT (strengths, weaknesses, opportunities and threats) analysis, industrial organisation (I/O), resource-based view (RBV), knowledge-based view (KBV), balanced scorecard (BSC) and intellectual capital (IC) in the non-profit context. The main objective of this paper is to examine the above concepts in the light of the unique non-profit environment in the knowledge economy and determine which one is most applicable to non-profit organisations (NPOs).

Design/methodology/approach – This paper reviews the strategic management literature with a focus of the above concepts within the non-profit context.

Findings – The IC concept is more effective as compared to other strategic management concepts within the non-profit context. IC is an important resource that NPOs need to develop in order to gain sustained strategic advantages.

Research implications – This paper helps to build a nascent body of literature suggesting that IC can be utilised as a competent strategic management conceptual framework in NPOs. The increased awareness of the IC concept in NPOs, as a result of this paper, likely generates further research from both non-profit practitioners and scholars.

Originality/value – The paper is considered as a starting point and serves as a milestone in applying IC as a strategic management conceptual framework in the non-profit sector. Also, the paper informs non-profit leaders that IC is the most appropriate strategic management concept in the non-profit sector.

Keywords – Intellectual capital (IC); non-profit organisations (NPOs), strategic management

Paper type – Literature review

Introduction

The famous phrase '*Knowledge is power*' (Kaplan, 2002, p. 166) which originated by Sir Francis Bacon in 1597 resonates with even more pertinence in today's knowledge economy. An Organisation for Economic Co-operation and Development (OECD) report, *The Knowledge-Based Economy*, states that '(t)he determinants of success of enterprises, and of national economies as a whole, is ever more reliant upon their effectiveness in gathering and utilising knowledge' (OECD, 1996, p. 14). Researchers have highlighted the importance of knowledge as a key organisational resource that can lead to competitive advantages for an organisation (Allee, 1999; Wall *et al.*, 2004; Wright *et al.*, 2001). Thus, accumulated, applied and shared, knowledge enables an organisation to become a leader as opposed to a follower and to succeed rather than fail in a knowledge-based economy.

Sir Francis Bacan’s famous phrase is equally applicable in non-profit organisations (NPOs). Prior to the 1980s as the backbone of a government’s social service delivery, NPOs enjoyed financial support through grants from government (Alexander, 1999). Since the 1980s the non-profit sector has been subject to radical change (Courtney, 2002; Hudson, 1999). The introduction of new public management (NPM) in both developed and developing countries contributed the main reason for the change. The NPM was a reform agenda aimed at restructuring the public sector according to for-profit sector principles but this has dramatically altered the expectations on how NPOs should be managed (Alexander, 2000; Courtney, 2002). As a consequence, NPOs are now expected to abandon traditional public administration methods and adopt for-profit strategic management models to foster organizational efficiency and effectiveness in the sector (Alexander, 1999; 2000; Courtney, 2002). The need for organizational efficiency and effectiveness adds significant strategic pressures to the management of NPOs.

NPOs pursue their mission to meet social needs, no matter how broadly or narrowly that mission might be interpreted (Liebschutz, 1992). However, NPOs are commonly operating in a highly competitive environment today that is characterised by increasing demand of services from the community, growing competition for contracts with the public and for-profit sector (Ramia and Carney, 2003), declining volunteer support (Lyons, 2001) and a generally tighter government funding source (Craig *et al.*, 2004). The competitive environment has forced NPOs to adapt for-profit strategy concepts. This concepts are often criticised for being ineffective in NPOs (Alexander, 2000; Chetkovich and Frumkin, 2003; Mulhare, 1999) as the primary objectives of NPOs is investing in people rather than profit (Herman and Renz, 1999; Ryan, 1999). As a result, NPOs have not been able to make use of the strategy concepts in order to take advantage of the knowledge economy and increase their effectiveness in serving their stakeholders. The need for competent strategic management concepts that are able to fit in the unique non-profit environments has become widely accepted (Courtney, 2002; Salamon *et al.*, 1999; Stone *et al.*, 1999).

Originally derived from for-profit strategic management techniques, IC has become a conceptually robust framework for NPOs. Unlike many other for-profit strategy concepts, IC stresses qualitative, non-financial indicators for future strategic prospects and may be harnessed to co-ordinate with the unique environment in which NPOs operate. IC contributes to NPOs’ strategic positioning by providing enhanced understanding of the allocation of organisational resources. Simultaneously, IC enables NPOs to enhance their performance by providing meaningful information to organisational stakeholders. In these ways, IC aids the organisations in their attempts to reconcile their social and commercial objectives.

This paper is divided into three main parts. Firstly, it provides a brief outline of the development of strategic management in today’s non-profit environment in the knowledge economy, including SWOT (strengths, weaknesses, opportunities and threats) analysis, industrial organisation (I/O), resource-based view (RBV), knowledge-based view (KBV) and balanced scorecard (BSC). It is argued that the concepts are inapplicable in the non-profit sector. Secondly, an overview of the emergence, the concept and the three component parts of IC is presented. Finally, the importance of IC in NPOs is reviewed. This paper argues that IC is an alternative strategic management conceptual framework within the unique non-profit environment.

Strategic management in the non-profit context

Strategic management can be interpreted as a set of managerial decisions and actions of an organisation that can be used to facilitate competitive advantage and long-run superior performance over other organisations (Powell, 2001; Wheelen and Hunger, 2004). Thus strategic management involves a number of critical steps, including 'scanning the environment for information, selecting relevant data and interpreting it, building a strategic model, testing it and putting it into action' (Cray and Mallory, 1998). The development of the field of strategic management within the last three decades has been dramatic (Hoskisson *et al.*, 1999; Wright *et al.*, 1994), witnessing the transformation from a knowledge-based economy that focuses on the production, distribution, and use of knowledge and information to an industrial-based economy which emphasises product manufacturing as the necessity for the economic system (Bettis and Hitt, 1995; OECD, 1996).

Strengths, weaknesses, opportunities and threats (SWOT)

The emergence of strategic management could be traced back to the 1950s when Selznick (1957) introduced the need to bring an organisation's 'internal state' and 'external expectations' together for implementing policy into the organisation's social structure. Andrews (1971) defined strategy as the balance of actions and choices between internal capabilities and the external environment of an organisation. Weihrich (1982) further conceptualised the internal and external analysis into a structured matrix known as SWOT framework, which inquires into strengths, weaknesses, opportunities, and threats of an organisation.

The SWOT analysis remains as a strategic management framework in some organisations today because it has a long history in the strategic management field (Mintzberg *et al.*, 1998). More importantly, the framework is rather simple to adopt with basically no investment required when it is utilised and very little specialised skill involved in facilitating the strategy formulation process. This is particularly essential to NPOs because these organisations often operate under tremendous financial constraint as a result of the public sector reform movement.

However, the prevailing SWOT analysis process has been criticised for its simplicity and generalisation (Valentin, 2001), indiscriminate lists involving typical procedural guidelines that lack explicit theoretical underpinnings (Fahy and Smithee, 1999; Ip and Koo, 2004), and rigid descriptive nature of meandering haphazardly from one standalone SWOT variable to another, which often dangerously generates misleading results in the strategic management process (Hill and Westbrook, 1997; Lee *et al.*, 2000) and stifles creativity and vision in organisations (Patrickson and Bamber, 1995).

Managing a NPO strategically is arguably more difficult than in a for-profit or government organisation in today's knowledge economy because NPOs often find themselves caught in the crossfire of conflicting multiple constituencies under the public reform movement (Sandler and Hudson, 1998). Also, it requires 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 (Cunningham, 1999; Kong, 2003; Lyons, 2001). Thus the efficacy of the SWOT analysis procedure as a strategic management framework to provide sufficient strategic insights and analysis for non-profit decision makers remains questionable in the non-profit environment.

As the development of strategic management continued, the SWOT framework began to proceed down two separate ways with one path representing opportunities and threats, and the other focusing on strengths and weaknesses (Zack, 2005).

Industrial organisation (I/O)

The path of opportunities and threats is commonly known as industrial organisation (I/O) or industry economics, which emphasises the external environmental determinants of organisational performance (Porter, 1985; Porter, 1996; Porter, 1998). There are two assumptions in the environmental models of competitive advantage (Barney, 1991; Bontis, 2002). Firstly, firms within an industry are identical in terms of the strategically relevant resources they control and the strategies they pursue (Porter, 1981; Rumelt, 1984). Secondly, these models assume that resources in an industry are heterogeneous because the resources that organisations use to implement strategies are highly mobile in the market (Barney, 1991; Bontis, 2002). The I/O school of strategy stresses choosing an appropriate industry and positioning an organisation within that industry according to a generic strategy of either low cost or product differentiation (Zack, 2005).

However, the I/O school of strategy induces NPOs to demonstrate, using market logic, their differences from competitors in their field (Barman, 2002; Crouch, 2003; Goold, 1997). They are urged to do a better job of positioning and differentiating their services in the sector (Chetkovich and Frumkin, 2003) so that they can convince their stakeholders, especially fund providers, that they deserve resources more than their competitors (Barman, 2002). Differentiation leads to the construction of a hierarchy of comparison between NPOs and their competitors according to certain measures or criteria such as cost and benefit calculus or bottom-line measurement, in which NPOs attempt to come out on the top of the hierarchy (Barman, 2002). However, the organisations often have goals that are amorphous and offer services that are intangible (Forbes, 1998). Accordingly, the success of NPOs cannot be measured by how closely the organisations keep to budgeted spending (Barman, 2002; Kaplan, 2001).

Also, the I/O school has been criticised for focusing primarily on the environmental determinants of organisational performance and missing the significance of the unique characteristics of individual organisations such as managers' capabilities to contribute to organisational performance (Barney, 1991; Wright *et al.*, 1994; Zack, 2005). In today's knowledge economy, non-profit organisational members' knowledge and skills are critical to their organisations. For this reason, the I/O school of strategy is deemed to be inapplicable in the non-profit landscape.

With the emerging role of internal organisational capabilities, the pendulum of strategic management development has swung from external to internal aspects of an organisation (Collis and Montgomery, 1995; Hoskisson *et al.*, 1999).

Resource-based view (RBV)

A new entrant that emerged in the early 1980s but was increasingly noticeable in the 1990s was the resource-based view (RBV) which stressed the internal capabilities of firms (Barney, 1991; Conner, 1991; Peteraf, 1993; Wernerfelt, 1984). The underpinning concept of the RBV is that no two organisations are identical because no two organisations have acquired the same set of organisational resources such as capabilities, skills, experiences, and even organisational cultures (Collis and Montgomery, 1995). Thus, organisations must possess organisational resources with attributes that are rare, valuable, costly to imitable, and non-substitutable, which allow them to hold the potential of sustained competitive advantage over other competitors (Barney, 1991; Hoskisson *et al.*, 1999). A resource-based approach to strategic management focuses on the costly-to-copy attributes of an organisation as the fundamental drivers of performance and competitive advantage (Bontis, 2002; Conner, 1991; Michalisn *et al.*, 1997; Peteraf, 1993; Wernerfelt, 1984).

The theory of core competence, which allows organisations to rethink, identify, exploit what they can do to make growth possible in global competition, began to emerge as a subset of RBV of a firm (Hamel and Prahalad, 1994; Prahalad and Hamel, 1990). Prahalad and Hamel (1990, p.79) define a core competence as 'the collective learning in the organisation, especially the capacity to coordinate diverse production skills and integrate streams of technologies'. Thus competencies include a bundle of human resource elements such as experience, skills and education (Bontis *et al.*, 2000). It is the emphasis of competencies and capabilities on the organisational processes that is difficult for competitors to reproduce or imitate (Guerrero, 2003).

However, RBV and core competency have their limitations. Both theories predominantly focus on the internal aspects of organisations (Bontis, 1999; Bontis, 2002; Roos *et al.*, 1997). Peppard and Rylander (2001b) argue that RBV does not provide a holistic perspective for understanding how resources can be put into practice to create value for organisations, which has limited the theory as mostly a conceptual framework. The theory of core competence views that the 'value of the talented people' is more valuable because it is part of an organisational system (Mouritsen, 1998, p.468). Accordingly, the value of non-human aspects of an organisation, such as information technology, is often overlooked.

The strategic management process in NPOs is more complex (Chetkovich and Frumkin, 2003) as a result of the special characteristics of the organisations such as the combination of paid staff and volunteers and accountability of multiple constituents. Thus the theories of RBV and core competence which stress internal capabilities may not be able to provide a balanced picture of how a NPO is performing.

As the development of strategic management continued, the demand for a strategic management framework that was able to blend internal capabilities and external environment increased. Some strategic management theorists such as Liebeskind (1996), Sveiby (2001), von Krogh and Roos (1995, p.62) and Zack (1999; 2005) have proposed a link between knowledge and strategy, arguing that knowledge helps to improve internal strengths and maximise external opportunities of an organisation. As will be seen in the next section, knowledge is the strategic resource for all organisations.

Knowledge-based view (KBV)

In many respects, the development of strategic management thinking at least to some extent has been influenced by the significance of the economic role of ‘knowledge’. According to Polanyi (1997), knowledge has tacit and explicit forms. Tacit knowledge refers to the knowledge that is ‘non-verbalized, or even non-verbalizable, intuitive, unarticulated’ (Hedlund, 1994, p.75) and thus is not easily expressed and formulated (Baumard, 2002; Yates-Mercer and Bawden, 2001). Explicit knowledge is specified ‘either verbally or in writing, computer programs, patents, drawings or the like’ (Hedlund, 1994, p.75). Both tacit and explicit knowledge exist in individual, group, organisational and inter-organisational domains (Davenport and Prusak, 1998; Hedlund, 1994).

As valuable, rare, and inimitable resources are usually intangible and implicit in nature, value creation is increasingly dependent on the tacit knowledge that an organisation controls (Kaplan and Norton, 2001). Tacit knowledge has become the central theme in the strategic management literature not only because it is a meaningful resource for organisation, but also is a critical strategic source of sustained competitive advantage which enhances organisational performance (Ambrosini and Bowman, 2001; Conner and Prahalad, 2002; Mertins *et al.*, 2001; Michalisn *et al.*, 1997).

Organisations that are able to effectively utilise knowledge, notably tacit knowledge, are more likely to coordinate and combine their traditional resources and capabilities in new and distinctive ways, providing more value for their customers than their competitors (Teece *et al.*, 1997). The perspective of utilising knowledge as the primary source of competitive advantage became known as knowledge-based view (KBV); an extension of the RBV (Bontis, 2002; Conner and Prahalad, 2002; Grant, 1997; Spender, 1996b; Wiklund and Shepherd, 2003).

Spender (1996a, p.59) argues that a KBV ‘can yield insights beyond the production-function and resource-based theories of the firm by creating a new view of the firm as a dynamic, evolving, quasi-autonomous system of knowledge production and application’.

However, the limitation of KBV is that it conceives both tacit and explicit knowledge as an objectively definable commodity (Empson, 2001). KBV implies that knowledge is a static internal resource in organisations which can be controlled, exploited, and traded like most physical resources (Styhre, 2003). As a result, information systems are often developed attempting to capture, store, retrieve and transmit knowledge between units, departments, organisations, and between individuals (Bettis and Hitt, 1995; Styhre, 2003).

Though the knowledge-based perspective views knowledge as an asset is an important concept, the perception, to certain extent, becomes distorted as too much focus is on the development of information technology (Hendriks, 2001; Ipe, 2003), which limits the growth of visualising and understanding of intellectual aspects, particularly tacit knowledge, for value creation in organisations, including NPOs.

Various methods have been suggested to visualise and understand organisational intellectual resources including the Balanced Scorecard™ (BSC), human resource accounting (HRA), market-to-book values, Tobin’s Q and economic value added (EVA™) theory, etc. Of these, only the BSC will be discussed in this paper. There are three justifications for this focus. Firstly, some attempts have been made to apply BSC in the non-profit sector, although requiring some modifications (Kaplan and Norton, 2004; Niven, 2003). However, the state of knowledge on the role of BSC as a strategic management method in the non-profit sector is not well developed. There is a need to examine the effectiveness and suitability of BSC in NPOs, particularly with the emerging importance of knowledge and skills in the non-profit sector.

Secondly, BSC is the only method which does not pre-dominantly focus on intellectual resource measurement or intangible assets valuation. The issue of measurement is important. However, evaluating the financial value of intangible assets in NPOs not only is difficult, but also is incompatible with the primary objective of NPOs. For instance, it is very difficult and yet possibly against the social objective of a child-care NPO to focus on evaluating the financial outcome of bringing joy and happiness to children with life threatening illness.

Finally, the measuring aspect of intellectual resources in NPOs is not within the scope of this research study. Thus, BSC is the only strategic management method that is reviewed in relation to its applicability in NPOs in this paper.

Balanced Scorecard (BSC)

The Balanced Scorecard™ (BSC) was first introduced by Robert Kaplan and David Norton as a tool for business organisations to convert intangible assets such as corporate culture and employee knowledge into tangible outcomes (Kaplan and

Norton, 2000). It includes a set of measures to monitor organisational performance across four linked perspectives: *financial*, *customer*, *internal process* and *learning and* growth (Kaplan and Norton, 1992; Kaplan and Norton, 1996; 2000).

It is the cause-effect relationships among the four measures, both financial and non-financial, that distinguish BSC from other strategic management systems (Bontis *et al.*, 1999; Norreklit, 2000; Wall *et al.*, 2004) because, as claimed, financial measures provide information about past performance while non-financial measures are able to drive future performance (Kaplan and Norton, 1996). In short, BSC helps to bring forth intellectual resources in organisations (Bontis *et al.*, 1999; Petty and Guthrie, 2000).

Today, BSC is widely used in the for-profit and public sectors (Bryson, 2005; Wall *et al.*, 2004). Kaplan (2001) claims that BSC enables NPOs to bridge the gap between mission and strategy statements and day-to-day operational actions by facilitating a process which NPOs can achieve strategic focus. However, there are a number of reasons to suggest that BSC offers an inferior framework for the non-profit context.

Firstly, BSC proposes a strategy which is formulated and executed under the assumptions that presupposed existence of a stable target group of customers are always in place (Mouritsen *et al.*, 2005) and the maximisation of bottom-line profitability between two competing organisations always exists (Crouch, 2003; Goold, 1997). However, the concept of customers does not really exist in the non-profit context because NPOs are often accountable to multiple constituents. This means that the beneficiaries of the non-profit services are typically different from those who provide material support (Brown and Kalegaonkar, 2002; Lyons, 2001). For instance, government purchases services from NPOs and other group of people are the final users of services. Thus, NPOs do not have customers but only service recipients.

NPOs' mission is perceived as a moral absolute rather than as an economic prerogative subject to a cost and benefit calculus (Guy and Hitchcock, 2000). Serving the public is an obligation, not an option for the organisations. Accordingly, strategic management approaches that are based primarily on the notion of competitions and customers are generally unacceptable to the non-profit sector.

Secondly, there is a concern that the cause-and-effect relationships among the four BSC perspectives are logical rather than causal (Bontis *et al.*, 1999; Norreklit, 2000; Norreklit, 2003). It is always assumed in BSC that *learning and growth* drives efficient *internal process*, then that drives a high level of *customer* satisfaction, and that drives good *financial* outcomes (Norreklit, 2000). The assumption about the logical cause-and-effect relationships is less convincing in NPOs because the organisations are accountable to multiple constituents. The expectations and demands of various constituent groups associated with the organisations are often conflicting and even contradictory (Lawry, 1995). As a result of that, it almost guarantees that the cause-and-effect relationships do not work in NPOs because logical fallacies could lead to an inaccurate anticipation of performance indicators (Norreklit, 2000; Norreklit, 2003).

Thirdly, BSC is criticised for being fairly rigid because the four linked perspectives and the indicators within them are relatively limiting (Bontis *et al.*, 1999). The potential risk is that non-profit leaders and managers may be misled by focusing only on the four perspectives in BSC and may end up missing other equally important factors in their organisations (Bontis *et al.*, 1999). A fine example of this is the very reason that most NPOs exist and that is the social purpose for the betterment of the society that the organisations aim to achieve in the first place. This key factor is not reflected in the BSC model.

There are also shortcomings for the individual perspectives when applying them in NPOs. The considerations on the external environment in BSC are only limited to customers (Bontis *et al.*, 1999; Petty and Guthrie, 2000). Also, there is no clear cut human resource element focus in the four BSC perspectives. The issues in the non-profit sector are rendered complex under the public sector reform movement. Thus, the possible external indicating factors for NPOs are likely to be broader than that in the *customer* perspective of BSC and the importance of the innovativeness and talents of employees and volunteers in NPOs may be diminished significantly. As already mentioned, the ability of NPOs to achieve their objectives depends almost entirely on the knowledge, skills and experience of their paid employees and volunteers (Hudson, 1999). Many NPOs, in fact, rely heavily on voluntary labour (Hudson, 1999; Lyons, 1999). The unclear cut of human resource element focus in the four BSC perspectives may discourage talented individuals to join the organisations because they may feel that their efforts to the organisations are not recognised under the BSC model.

Finally, financial and non-financial performance indicators are likely to be negatively related because non-financial indicators focus on future investments and financial measures stress present and historical performance (Juma and Payne, 2004). Accordingly, BSC may not be appropriate in NPOs under the unique non-profit environment in the knowledge economy since it is likely to mislead non-profit leaders and managers to focus more on short-term financial objectives rather than long-term intellectual resource investments.

Even Kaplan and Norton admit that applying BSC in NPOs is different to that in business organisations because NPOs strive to deliver vague mission outcomes, not superior financial performance (Kaplan, 2001; Kaplan and Norton, 2004). They claim that they have modified the BSC specifically for the unique non-profit environment (Kaplan and Norton, 2004). This paper, however, argues that the modified BSC does not resolve the problems discussed above. The modified BSC becomes even more confusing. The confusion starts with the financial perspective being replaced in the modified model by a fiduciary perspective, which reflects the objectives of other constituents such as donors and taxpayers.

Kaplan and Norton (2004) claim that both financial and customer stakeholders needed to be satisfied concurrently. Therefore, both customer and fiduciary perspectives are located on the same level, which, however, does not fit in the original cause-and-effect relationship principle. The two perspectives (fiduciary and customer) are not connected. As a result, there may be a misconception that service recipients are not important to donors and taxpayers or that the latter are not concerned with the needs of the service recipients. However, both donors and service recipients are, in fact, closely linked together and their needs and expectations from the two sides do not necessary have to be in the same direction. Therefore, meeting the needs of both the financial and customer stakeholders simultaneously is not just difficult, sometimes it is impossible.

Although the BSC model has witnessed a big step in the strategic management development in terms of visualising their knowledge and skills in NPOs, the model itself is not compatible to the unique non-profit environment in the knowledge economy. As Backman *et al.* (2000, p.4) argue:

> [a]lthough elements of the current [strategic management] models make sense at a general level, they are not sufficiently nuanced and sensitive to the unique environments of non-profits … [and thus,] … there [is] a *large conceptual gap* between the strategy models available to organisations in the non-profit and for-profit sectors … the non-profit strategy models do not, as yet, offer a conceptually robust frame for widespread *adoption* by practitioners [*emphasis added*].

The main reason for the conceptual gap, as identified by Backman *et al*. (2000), is that strategic management concepts utilised in NPOs do not address the social dimension and/or distinctive nature of competitive and collaboration in non-profit settings. In contrast to the situation in for-profit organisations, a major part of a non-profit leader's responsibility is to consider the effect of strategy on a charitable or mission rather than simply on financial performance (Alexander, 1999; Guy and Hitchcock, 2000; Ryan, 1999). A strategy that sacrifices mission for greater margin will eventually become untenable as it likely alienates stakeholders such as service recipients and the general public in the non-profit sector (Alexander, 2000; Courtney, 2002). In this sense, there is little connection between contemporary strategic management concepts and the social missions pursued by NPOs (Chetkovich and Frumkin, 2003). Accordingly, the effectiveness of the contemporary strategic management concepts in the sector is greatly reduced (Alexander, 2000; Crouch, 2003; Lyons, 2001).

In short, the development of strategic management in the non-profit context has been equally dramatic as it is in the for-profit sector, if not more. Figure 1 briefly illustrates the development of strategic management in the social service non-profit context as discussed in this section.

Take in Figure 1

The need for a competent non-profit strategy

The urgency of developing a new, more complex strategy management technique which reflects the challenges and messy realities non-profit leaders face everyday is increasingly pressing (Backman *et al.*, 2000; Salamon *et al.*, 1999; Stone *et al.*, 1999). This new and complex non-profit strategic management framework not only should help NPOs to improve their performance, but also preserves and regains their cherished qualities. As Salamon *et al*. (1999, p.37) suggest:

> … [NPOs] need to be able to demonstrate the worth of what they do, and to operate both efficiently and effectively in the public interest. *This will require something more than traditional management training, or the wholesale adoption of management techniques imported from the business or government sector. Rather, continued effort must be made to forge a distinctive mode of non-profit management training that takes account of the distinctive values and ethos of this sector while ensuring the effectiveness of what it does* [*emphasis added*].

The distinctive mode of non-profit management training as described above can be interpreted as a competent strategic management technique that can be utilised to assist NPOs achieving effective performance and, at the same time, sustaining the distinctive values and ethos of the non-profit sector. Light (2002, p.19) argues that '[NPOs] are not corporations, small businesses, governments, faith-based organisations, or firms, even if they behave like all of the above from time to time. They are non-profits and must become more non-profit like if they are to choose their future'. Therefore, NPOs must develop a special kind of strategy that can assist them to achieve high performance (Letts *et al.*, 1999); that is, to achieve social purposes under the current turbulent changes and, at the same time, emphasise the cherish qualities of the organisations (Frumkin and Andre-Clark, 2000; Moore, 2000). Such a strategy not only is about what an organisation intends to do but also is concerned with what the organisation decides not to do (Kaplan, 2001). This is important to NPOs since these organisations today live a 'hand-to-mouth existence' under the public sector reform movement (Lyons, 2001).

Although highly supportive of the notion that NPOs need to be managed strategically, this paper takes a step further by arguing that the organisations must place the social dimension at the centre of their strategy since the social dimension is often the raison d'être of NPOs' existence in the society. This paper argues that, unlike other for-profit strategic management concepts, the concept of intellectual capital (IC) can be utilised as a competent strategic management conceptual framework in the non-profit sector, in particular in today's knowledge economy.

Intellectual Capital (IC)

The IC concept and its components

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 (1997, p.44) as 'the possession of knowledge, applied experience, organisational technology, customer relationships and professional skills that provide … a competitive edge in the market'. Following the work of a number of scholars in the field of IC, IC encompasses three primary interrelated non-financial components: human capital, structural capital and relational capital (Bontis, 1998; Roos *et al.*, 1997; Stewart, 1997).

Human capital (HC) includes various human resource elements, including attitude, competencies, experience and skills, tacit knowledge and the innovativeness and talents of people (Choo and Bontis, 2002; Guerrero, 2003; Roos and Jacobsen, 1999). It represents the tacit knowledge embedded in the minds of people in organisations (Bontis, 1999; Bontis *et al.*, 2002). HC is important to organisations as a source of innovation and strategic renewal (Bontis, 2002; Bontis *et al.*, 2000; Webster, 2000). A higher level of HC is often associated with greater productivity and higher incomes or compensation (Wilson and Larson, 2002). It is therefore in the interests of human resource managers to recruit and develop the best and brightest employees as a means of achieving competitive advantage (Bontis *et al.*, 2002).

Structural capital (SC) refers to the learning and knowledge enacted in day-to-day activities. The pool of knowledge that remains in an organisation at the end of the day after individuals within the organisation have left represents the fundamental core of SC (Grasenick and Low, 2004; Roos *et al.*, 1997). SC becomes the supportive infrastructure for HC. It includes all of the non-human storehouses of knowledge in organisations such as databases, process manuals, strategies, routines, organisational culture, publications, and copyrights which creates value for organisations, thus adding to the organisations' material value (Bontis *et al.*, 2000; Ordóñez de Pablos, 2004).

Relational capital (RC) characterise an organisation's formal and informal relations with its external stakeholders and the perceptions that they hold about the organisation, as well as the exchange of knowledge between the organisation and its external stakeholders (Bontis, 1998; Fletcher *et al.*, 2003; Grasenick and Low, 2004). RC is important to an organisation because it acts as a multiplying element creating value for the organisation by connecting HC and SC with other external stakeholders (Ordóñez de Pablos, 2004).

The three IC components are inter-dependent (Subramaniam and Youndt, 2005; Youndt *et al.*, 2004). Through the combination, utilisation, interaction, alignment, and balancing of the three types of IC and as well as managing the knowledge flow between the three components, IC renders the best possible value to organisations in the knowledge economy.

As what constitutes the IC components for one organisation may not be the same for another organisation (Roos *et al.*, 2001; Roos and Jacobsen, 1999; Snyder and Pierce, 2002), such a unique characteristic is compatible with RBV's four attributes of firm resources: rare, valuable, costly to imitable, and non-substitutable. Accordingly, IC is considered context-specific (Bontis *et al.*, 1999; Roos and Jacobsen, 1999) and investments in IC are likely to be different depending on the type of organisations (Subramaniam and Youndt, 2005). The practical applications and the pragmatic approach of the early IC research provide a basis for practical managerial tools and methodologies. Therefore an IC perspective helps to bridge the gap between the conceptual thinking of RBV and a practical approach necessary for the adoption of the framework by managers (Peppard and Rylander, 2001a).

IC becomes the main differentiating factor that provides a competitive market position to an organisation (Kaplan and Norton, 2001; Teece, 2002). It gives rise to income in a knowledge-based economy as compared to an industrial-based economy (Bettis and Hitt, 1995; OECD, 1996). In other words, the IC literature has its roots firmly grounded not only in RBV, but also in aspects of KBV of the firm (Peppard and Rylander, 2001b).

A number of researchers assert that the concept of IC can be employed for strategic analysis, which can drive organisational strategy (Fletcher *et al.*, 2003; Roos *et al.*, 2001; Sveiby, 2001). IC focuses on processes rather than financial results (Edvinsson and Malone, 1997). It stresses competence-enhancement but not cash flow improvement (Mouritsen, 1998; Roos *et al.*, 1997). It concentrates intangible resources, rather than tangible ones (Klein, 1998) and it promotes the creativity possessed by all organisational members to underpin the future non-financial prospects of an organisation (Mouritsen, 1998; Roos *et al.*, 1997; Stewart, 1997). In sum, IC is about attempting to balance the transferring and converting of knowledge external and internal to an organisation.

Although the IC perspective was first developed as a framework to analyse the contribution of intellectual resources in for-profit organisations, as argued in this paper, the concept of IC is equally relevant to NPOs (Kong, 2003). The next section outlines the importance of IC in the non-profit context.

Importance of IC in the non-profit context

IC is capable of adapting to the challenges posed by the non-profit environment in the knowledge economy because some of the theoretical roots of IC come from the internal focus associated with core competence theory (Mouritsen *et al.*, 2005). IC helps to shift NPOs' strategic focus to intellectual resources including knowledge, skills and experience. This is important to NPOs because strategic activities and changes that are brought to the organisations will be mainly driven by internal initiatives by paid employees and volunteers rather than external forces such as government agencies. Therefore, resistance to those strategic activities and changes by volunteers and employees is likely to be lowered.

In profit-making organisations, profits serve as a simple common language for communication, delegation and co-ordination, and as a means to measure organisational success and benchmark performance (Sawhill and Williamson, 2001; Speckbacher, 2003). NPOs, however, have no uniformity of financial goals that can be applied as a means of communication to compare goods and services that they produce (Speckbacher, 2003). Accordingly, as discussed earlier, NPOs are vulnerable under for-profit strategic management techniques which stress cost saving and value for money. Mouritsen *et al.* (2005) emphasise that IC is related to questions about identity, such as 'who you are, and what you want to be' and thus, IC is not merely an objective in relation to intellectual resources, but is an identity crafted around ability and knowledge of what an organisation can do (Mouritsen *et al.*, 2005; Roos *et al.*, 1997). As a result, the IC approach forces non-profit leaders to rethink their mission and their social raison d'être. IC becomes important to NPOs not only because it helps the organisations to avoid goal displacement and resource diffusion, but it assists them to refocus their objectives on the social dimensions, which are sometimes distorted by operating in commercial contract environments under the public sector reform movement.

Most organisational resources have either decreasing or increasing returns through their lifetime (Peppard and Rylander, 2001b). For instance, a tangible asset depreciates with usage and each single entity is usually limited to defined tasks (Webster, 2000). IC, on the other hand, does not decrease in value with usage. Peppard and Rylander (2001b) argue that IC resources can be utilised simultaneously by many users in different locations at the same time and thereby, are non-competitive in an economic sense. This is because when IC is articulated and challenged, new knowledge may be developed. Thus, IC is often characterised by 'increasing returns' (Peppard and Rylander, 2001b, p.515); that is, value generated increases per incremental unit of investment. The non-competitive characteristic of IC is important to NPOs because IC may encourage resource sharing rather than resource competition. Intensified competition encouraged by public sector reforms can be destructive to the non-profit sector as NPOs are competing to each other for resources rather than working together to solve social problems. The non-competitive characteristic of IC also encourages NPOs to take advantage of knowledge sharing in the knowledge economy.

Norreklit (2000) asserts that if a model is to be effective in an organisation, the model must be rooted in the language of the organisation's people and communicated to all parts of the organisation. This draws another important point, that if a model is to apply in NPOs, it must be kept simple and easy to use or disseminate through the whole organisation. Bontis et al. (1999) argue that IC is flexible and easy to understand because it represents the collection of intellectual resources and their flows. Accordingly, IC can serve as a simple conceptual framework for NPOs that requires relatively little interpretation.

IC is important to NPOs because it helps to create changes in people's behaviour and values. Roos (1998, p.151) argues that although IC may superficially be concerned with sales growth and value creation, it has a deeper purpose.

> The deeper purpose of an IC approach is to change people's *behaviour*, not least through changing the corporate language. The concept of IC brings with it *a whole set of new values* about what is good and what is bad management, what is the right and the wrong things [sic] to do in corporations [*emphasis added*].

Values embedded in IC are useful for NPOs particularly in times of today's non-profit environment. As public sector reforms often carries with them values consistent with 'value for money' and competition, causing threats to NPOs' traditional qualities such as fulfilling social objectives. IC becomes a valid strategic management conceptual framework within the non-profit context in the knowledge economy.

On the contrary, failing to account for IC may lead to a misallocation of intellectual resources and run the risk of making poorly informed decisions, which lead to weak strategic planning processes, high employee turnover, inadequate training and development, inexperienced top management teams, and inability to turn data into information in NPOs.

In short, as Salamon (1996) argues, in the light of contemporary realities in the non-profit sector, NPOs urgently require a ‘new settlement’ to assist them to re-examine their functions, their relationships with citizens, government, and business organisations, and the way they will operate in the years ahead. This paper argues that the concept of IC can be one of the bases for such as a new settlement which enables NPOs to utilise their knowledge effectively in the competitive non-profit environment.

Conclusion

Knowledge is critical to for-profit organisations as it is to NPOs. The highly competitive non-profit environment as a result of the public sector reform movement has forced NPOs to change the way they manage and operate their activities. NPOs are now urged to utilise their organisational resources more effectively in the knowledge economy. As argued in this paper, a competent strategic management framework is urgently needed to be developed in NPOs. As compared to some popular strategic management concepts, IC is a valid strategic management conceptual framework for NPOs. IC allows NPOs to pursue their social objectives and utilise their resources effectively; and simultaneously to sustain their cherished qualities. Further research involving specific non-profit sub-sectors and methodologies needs to be carried out to empirically test the findings in this paper.

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Figure 1 – The Development of Strategic Management in the Non-profit Context