

To maximise IP value a company needs the right culture

*It is not enough to decide that a company needs to manage and commercialise its IP assets more effectively. Senior management also has to understand that it has a key role to play if any plan is to be a success. **Kristopher Boushie and Christopher Spadea***

Most companies and Wall Street analysts agree in principle that commercialising a company's intellectual property is an important process in maximising overall shareholder value. However, when one puts aside that abstract concept and looks to the reality of the marketplace, it is clear that implementing an IP management programme is not a standard process and these programmes are not viewed as having the same benefits and risks by each company. The first question asked by many companies is whether to create such a programme. The second, but equally important, question is how does a company go about doing it?

To answer either of these questions, a company's senior management must know what intellectual property it owns. This includes not only its patents, trademarks and copyrights, but also all forms of intellectual property such as its trade secrets, customer lists, and other intangibles – things your company knows that give it a competitive advantage. Unfortunately, many companies never get past this initial step.

Understanding what you own and why you own it

There are many legitimate variations to IP management and commercialisation strategies. Unfortunately, many companies create IP only to have it sit on a shelf until it is needed for defensive purposes. These companies never take the time to understand how the IP they own relates to the market at any time other than the day they first applied for the patent. Many companies believe that removing their patents and other IP from the safety of their filing cabinets and sending it out into the world to be licensed, sold, or

donated will cause more harm than good. A company may desire to hold IP (primarily patents) for defensive purposes. This protection from being sued by competitors or others gives the company a certain amount of operational freedom. A company may believe that IP is most valuable as a defensive tool and should be kept locked away until the day the company needs it to ward off a hostile competitor or to negotiate a cross-licence.

Some companies fear that actively pursuing licensing or litigation could lead to nothing more than a portfolio with a diminished defensive value or, even worse, could start patent battles that would not have occurred if the company had just let sleeping dogs lie. However, a great many companies holding IP are doing so for the wrong reason – they just do not know what to do with it and have no strategy at all. Sadly the let-sleeping-dogs-lie strategy often does not work well because not all competitors play nice and companies are often sued by businesses or individuals with whom they do not compete. Further, it is difficult to negotiate a cross-licence with a competitor when you are not quite sure of the value (or extent) of your own holdings. Passively managing (ie, not managing) IP is tantamount to minimising shareholder value. The business community has begun to realise that doing less does not create more value, just the opposite.

For this article we have assumed that you have already come to the realisation that, like it or not, you need to establish an IP management and commercialisation programme. One of the first hurdles that must be overcome in order to achieve success is to show senior management that the risks

associated with such a programme can be minimised, while the potential gains can be substantial. Buy-in from senior management is absolutely essential because to have a successful intellectual property management/commercialisation programme a company's entire corporate culture must be supportive of the end goal.

In evaluating the importance of a company's culture on a successful IP programme, we have looked at two companies with very strong, supportive IP cultures: Texas Instruments and Proctor & Gamble.

Why Texas reworked its IP strategy

Texas Instruments Incorporated (TI) is a good example of the positive impact corporate culture can have on the success of an IP management programme. TI was not always the licensing powerhouse it is now known to be – with IP generating a significant portion of TI's profits. As explained by Kevin Rivette and David Kline in their book *Rembrandts in the Attic*: "Texas Instruments...was reportedly saved from bankruptcy in the mid-1980s by an all-out patent licensing and litigation effort. In 1992 alone, TI earned \$391 million from patent licences – 43 percent more than its \$274 million in operating income for that year. Its current licensing revenues are thought to be about \$800 million a year. All told, analysts estimate that TI has earned more than \$4 billion in royalties since it began enforcing its patents in the mid-1980s."

Richard Donaldson witnessed the evolution of TI's culture first hand. As TI's retired Senior Vice President and General Patent Counsel, he was employed by the company for 31 years as a patent attorney. While at TI, Donaldson was responsible for all aspects of protecting and enforcing IP for TI worldwide.

From the beginning, IP was important to TI. However, early on TI did not do anything with its IP. As Donaldson states, TI's IP strategy was defensive only – it allowed for operational freedom from competitors' lawsuits.

"Operational freedom is not a bad strategy in an orderly market where you don't want to be blocked from the next generation of technology," he says. In addition, there were general corporate issues. "TI had so many patents that no one wanted to look at them," Donaldson says.

Two events changed TI's perspective. First, in 1982 the Court of Appeals for the Federal Circuit (CAFC) was created in an effort to promote greater uniformity in certain areas of federal jurisdiction and relieve the pressure on the dockets of the Supreme Court and the courts of appeals for the regional circuits. The CAFC also assumed the jurisdiction of the US

Court of Customs and Patent Appeals.

It had been TI's experience (which was by no means unique) that, prior to the creation of the CAFC, most patents that were the subject of litigation were found to be invalid. This discouraged companies from trying to enforce their patent rights through the courts. Following formation of the CAFC many companies began getting more aggressive on enforcement.

The second event to cause TI's reassessment of its IP strategy was foreign dumping of products in the mid-1980s which competed directly with TI's core businesses. TI found itself competing against companies from overseas that were licensed by TI, but at greatly undervalued rates. With this foreign competition, TI was finding it difficult to make a profit on its manufacturing operations.

TI's paradigm shift was from the top down. Donaldson recalls a conversation he had with Mark Shepherd, Jr, the chairman and CEO of TI at the time. In the chairman's office, Shepherd told Donaldson that TI was shifting from holding IP for defensive purposes to a strategy of active licensing. Another very conscious shift was in TI's willingness to pursue litigation. Given market conditions in the mid-1980s, strategic management of TI's IP rights was, in Donaldson's words, "key at that time to TI remaining profitable".

The directive from TI's chairman and CEO placed critical IP management decisions in the legal department. Business managers lost their veto over whether to pursue licensing with infringement actions against TI customers.

While Donaldson acknowledges that in the mid-1980s "TI had a better [IP] portfolio than its competitors", the company was also very effective in integrating its legal, business and technical people. It was this integration of disciplines that was essential in TI identifying the IP it owned; what its competition was doing and what IP they owned; and in understanding where product groups and the industry were going. Interaction of legal, business, and technical personnel happened on a routine basis, not only in the context of litigation.

TI's strategic shift continued under Jerry Junkins, who succeeded Shepherd as chairman and CEO. Donaldson credits Junkins with recognising that TI might not always be able to maintain a positive gap in patent portfolios with its competitors and that competitive advantage could be lost in next generation products. TI saw more long-term value in greater co-operation with licensing competitors. The business managers were still kept out of the licensing process to better

maintain their relationships with customers (they could blame legal for any woes since they were not directly involved).

Donaldson credits TI's success in licensing and IP management to several factors. First, senior management consistently supported this long-term strategic shift of focus. Second, TI legal had central control of all licensing. "It can't be a contest between different business interests," he says. Third, TI had excellent lines of communications between people in different disciplines.

Conversely, Donaldson attributes the failure of many companies in achieving more strategic use of IP to lack of culture or commitment. "IP management is not a short-term strategy. A single patent infringement case can take years to bring to resolution. You need to have the stomach for it," he explains.

Rights management the Procter & Gamble way

Are the experiences of TI unique? Does a company have to be an incubator of high-technology inventions to pursue TI's comprehensive strategy for exploiting intellectual property? The answer is that there are benefits from pursuing a comprehensive IP management programme for firms in all industries. We spoke with Dr Jacobus (Koos) Rasser about this issue.

Rasser spent the majority of his professional career at Procter & Gamble (P&G). After spending several years at P&G as a chemist, he moved into the legal division. He spent his last eight years at the company as its Vice-President and General Counsel for Patents where he was responsible for all of P&G's patent work. Currently Rasser is the managing partner of the law firm Howrey Simon Arnold & White's London office.

According to Rasser, P&G's culture has always supported a strong IP management programme. However, P&G's approach to IP has also evolved over time. Years ago, when P&G's product line was dominated by household cleaning products, competitors generally respected each others' patents. This changed as P&G got into other product lines such as hair care, nappies (diapers), and other personal care products. "In these other areas, features are more noticeable by consumers," says Rasser, who gives the example of elasticised leg openings on nappies. Consumers began purchasing based on specific, noticeable features, not strictly brand recognition. If companies wanted to maintain or gain market share they had to offer the same noticeable feature. "Because of this, there were more incentives for others to infringe," Rasser explains.

As P&G's business evolved during the mid-1980s, so did senior management's focus on the importance of IP. "It shifted from the sandbox of the R&D scientists and patent attorneys to high-level managers," says Rasser. This shift also coincided with the creation of the CAFC – which Rasser also credits for increasing the importance of IP through increased enforcement of IP rights, making patent infringement lawsuits a genuine threat.

Even though the sandbox now included high-level managers at P&G, the underlying culture of P&G already existed to exploit the new high-level focus. Internal IP attorneys were already aligned and co-located with P&G's R&D community. Each of P&G's R&D centres had IP attorneys working next to research scientists. "It led to high-quality patent applications by attorneys who really knew the technology," Rasser explains. P&G's attorneys and R&D scientists also understood the competition.

Each R&D centre was directly funded by a business unit. Rasser says that R&D was expected to be close to competitive activity so legal and R&D people were specifically assigned to track this. These people knew what the competition was doing and how this affected the intellectual property position of P&G.

Additional integration among the R&D scientists occurred at the corporate level with occasional internal seminars where the scientists would discuss R&D efforts. Rasser says that corporate integration was "sometimes easier within the legal department". In fact, longevity with a particular R&D centre and business unit made the IP lawyers a valuable knowledge resource. "Many of the senior IP attorneys had greater corporate knowledge of current and past R&D efforts than the scientists," Rasser says. This knowledge was shared within P&G's legal department.

Rasser says that in most competitive situations "P&G had little interest in one-way licensing". In many cases, P&G would prefer to use its patents to maintain its own market position. Cross-licensing, on a case-by-case basis, became a way to avoid litigation and for each company to get some value in return. P&G often did pursue one-way licensing in areas where it did not directly compete. "As P&G became more global, patent protection became more expensive. P&G looked at abandoning patents where it had no commercial interest but the R&D community did not want to abandon these patents. This led to outside licensing," he explains.

Financial credit for licensing at P&G was and is shared by legal, R&D and the business unit. The reason for this lies in the needs of the licensee. "Most prospective licensees wanted more than just a licence, they wanted technical support," says Rasser of the time he was with the company. Money flowing in was allocated to legal, R&D and the business unit based on a distribution key. There were good incentives for all areas of the company to co-operate.

Understanding a company's IP is part of new accounting rules

In addition to the benefits described above, a detailed understanding of IP is now required for public companies in the United States as part of GAAP. Public companies are now required to obtain such an understanding through the imposition of FASB Statement nos. 141 and 142. FASB Statement no. 141, Accounting for Business Combinations, and Statement no. 142, Accounting for Goodwill and Other Intangible Assets, have been in effect since June 2001.

Under these new rules, companies can no longer combine goodwill with other intangible assets, such as IP, on their balance sheets. Instead they must report goodwill and intangibles separately, must disclose intangible asset classes – such as patents and trademarks – and provide the estimated useful lives of such intangible assets in financial statement footnotes. The anticipated effect of these rule changes is to allow the public a greater understanding of the intangibles' affect on the books and records of the acquiring entity and allow for a more transparent accounting of each class of intangibles on the books of a corporation.

In order to comply with these new accounting rules, companies will be forced to perform a complete analysis of the IP they own in order to determine the value of that IP. In addition, the value of these intangibles must be tested each year to determine if there has been a diminution in the value of those assets which would warrant a write-down. The key message here, even for the most risk averse IP manager, is that if you are forced to spend the time and money to understand your IP for accounting purposes, why not take the next steps to fully realising that value?

Much of the initial time, effort and expense required to begin an IP management and commercialisation programme are now mandated for public companies under these accounting rules. Using this initial work as a jumping off point to an effective income-producing programme would seem to be efficient and reasonable for any IP manager.

Five areas of focus for a successful IP management programme

Assuming that senior management has now been convinced that an IP management programme is required both from a fiduciary and an SEC accounting regulation perspective, it must focus on actively managing the company's IP – to generate revenue, protect the company's current market position, gain future market share, report value to shareholders and, ultimately, to maximise shareholder value. How does senior management change corporate culture and develop the level of buy-in needed?

- Education – everyone in the company must learn to recognise what falls within the definition of IP. This also increases the likelihood that employees will recognise when the company's IP rights might be infringed by others or *vice versa*.
- Communication – to be successful in IP management, a company must utilise a wide range of employee talent: business (marketing and finance), legal and R&D personnel. In addition, there needs to be some ongoing forum where these different disciplines can interact and can learn about company innovation and competitive challenges. No effective IP decisions can be made without understanding the entire dynamic which includes the technology, the market demand and business issues and the legal landscape.
- Documentation – to support legal challenges and facilitate licensing negotiations, companies must educate their employees on records required to pursue or defend IP actions. While this could be an entire article itself, a company's record retention and documentation policies must be appropriately aligned with its IP strategy.
- Incentivisation – properly aligning investments and payoffs (risks and rewards) can have a major impact on the success of an IP management programme. Consider which areas of the company fund the initial R&D, maintain ongoing R&D, fund litigation and conduct licensing. Do not penalise profit centres or divisions from pursuing litigation by saddling them with all the cost and limiting their recovery (as seen in a real-world example where a patent-holding division was required to fund a multi-million dollar lawsuit against the company's major competitor, but only received reimbursement of its costs, despite a settlement in excess of \$100 million). On a more basic level, companies must incentivise their people to invent in the correct areas. These

Ten steps to a comprehensive IP strategy

1. Make sure you understand IP

Think of IP as anything your company knows that gives it a competitive advantage. Anything that you would (a) want to keep a secret from your competitors; or (b) if that's not possible, you would like to prevent them from copying, falls within this definition of IP.

2. Make sure you know what IP you own

This requires a thorough analysis of your business. The sheer magnitude of the exercise requires a considerable investment of time and monies. But it will pay off handsomely in dramatically improving your ability to capitalise on the IP you own. It will also do wonders for your organisation's IP awareness, important for step three.

3. Make sure new IP is recognised and protected

Any organisation creates new IP on a continuous basis. The personnel creating the new IP should know how to prevent its destruction (that is, refrain from broadcasting it to the world), and flag it to the right people so steps can be taken to protect it.

4. Analyse your IP portfolio for an optimum fit with your business plan

If the creation of IP in your company is a more or less random process, as is frequently the case, chances are that your IP portfolio does not match your business needs. There will be IP you don't need, and there will be IP you do need but don't have. This leads to steps five and six.

5. Engage in cost-effective portfolio management

It is costly to hang on to IP that is of no use to you. Prune it from your portfolio (by stopping the payment of maintenance fees), or find a way to use it for revenue generation (licensing!).

6. Target your IP investment

Now that you know where your IP portfolio is weak you are able to improve your position by shoring it up where needed. This can be done with a highly targeted R&D project or by finding technology elsewhere that is available for licensing. The same can be done in other areas of IP for example, by developing a more distinctive bottle for your product, improving brand recognition through advertising, etc.

7. Leverage your IP portfolio into revenue

There are many ways in which this can be done, the most obvious one being licensing. Other examples include cross-branding, as Harley Davidson is so successfully doing.

8. Set up an active licensing programme

Licensing is such a powerful tool that it deserves a separate mention. If you're new to licensing, expect a long learning curve. But there truly can be a pot of gold at the other end, as IBM and TI have convincingly demonstrated.

9. Enforce your IP rights

As your IP portfolio becomes more valuable the probability of infringement goes up as well. It's the curse of success. IP infringement is the highest form of flattery. The cost of lack of vigilance is deep embarrassment, as BT found out when it discovered that it owned a patent that covers hyperlinks (or so they said), but had allowed it to expire in Europe before realising they owned it.

10. Tell the world you have an IP strategy

We are finding that financial analysts consider IP strategies very important in their investment decisions. By going through steps one through nine you have created a sound, solid IP strategy. All there is left to do is explain to the world what you have created.

Koos Rasser, managing partner, Howrey Simon Arnold & White, London. Formerly chief patent counsel at Procter & Gamble

incentives should be both remunerative and non-remunerative.

- Consolidation – IP strategy should rest in the legal department. The company's lawyers need to be extremely knowledgeable about the company's products, technology and competition. IP strategy should not be constantly revised and thwarted by individual business managers protecting turf or desired future turf. It is impossible to have a successful and effective IP strategy when too many people with too divergent interests have veto authority over the process. This is where the leadership of senior management is truly put to the test.

Some common points on a unique process

A uniform senior management-led effort is the basis for any effective IP management programme. All patents are unique. There is no one-strategy-fits-all approach to IP management that maximises shareholder value. Focused management support is needed for an effective strategy which will reflect the unique business considerations of any company and thus lead to a customised process specifically tailored to maximise the value (including market position) of the business.

While each company faces its own unique business considerations, some standard rules apply to all companies. The most basic rule is that in order for a company to maximise the value of its IP it must first determine what IP it owns and what the value of that IP is in the marketplace. Once this is determined, alternatives – tailored for the IP being evaluated – such as keeping IP for defensive purposes rather than more proactive strategies, can be compared and educated decisions can be made regarding which alternative to pursue. In light of new accounting rules, public companies must now spend the time, effort, and money to understand the entirety of their IP and its value. If a company does not have a comprehensive IP management programme, it should consider the new accounting rules as an opportunity to begin such a programme. ■

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