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Key licensing issues for senior executives

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Linking licensing with corporate strategy

By **Peter Spours**, ThinkFire

Corporate strategists plot their company's future in terms of products, prices and markets. The marketing team translates this into tactical plans to develop products, drive into new markets or grow existing ones. But where does IP strategy fit into this picture? Is it a compass to guide decisions? This chapter explores the essential link between corporate and IP strategy, and provides advice on creating synergy and valuable commercial opportunities.

In the most successful companies, IP strategy and assets inform decisions, protect markets and provide IP currency for strategic transactions. At the other end of the spectrum, IP assets are little more than a shadow of past R&D programmes. The best companies understand the IP landscape in which they operate, have a clear view of risk and an ability to predict and respond to IP actions by competitors. At the other extreme are companies where IP is always a problem. They are always on the back foot and somehow their IP is not quite good enough to provide commercial freedoms. What makes the difference? How does the board ensure that it understands the IP risks and the company's IP supports the corporate strategy? The simple answer is that this profound difference does not come about by accident. It comes from meticulous analysis and planning to develop and maintain an IP portfolio that is relevant, cost effective and capable of evolving with corporate ambitions. This powerful combination comes from alignment of IP strategy with corporate goals.

Patents and products

Patents are business tools that provide a measure of commercial control over products that use the inventions claimed in the patents. The vital relationship is that between the patent claims and the relevant products. For that reason, the first step to align corporate and IP strategy is to understand the company's patent portfolio in terms of the relationship between patents and products. This may sound obvious but experience has shown that few companies have this knowledge because they use technology to classify their patents. This is the way the patent offices work and the form that patent agents and researchers prefer. However, this classification is of little value to business executives who think in terms of markets and products. If the portfolio is to be useful in guiding and informing decisions, it must be organised and presented in a form that reflects the corporate strategic plans and is understood by decision makers.

All applications of patents arise as a result of the relationship between the monopoly claimed within the patents and the products produced or sold. The primary purpose of patents is to defend marketing activity and deter others from copying. To understand this defensive position, a match is needed between each patent and the products that use the invention. Often this is a one patent to many products matrix and requires considerable skill to create, because the creator needs a sound knowledge of the patents and the company's products. This matrix can be very revealing. It shows which products and markets have good defensive cover and which are exposed. In addition, it may also show parts of the patent portfolio that are no longer relevant.

A patent/product matrix is key

A patent/product matrix informs executives and creates a link between corporate ambitions and the patents held. This will show the areas of strength and where good patent cover exists – this is the key to an effective licensing programme and provides IP currency for business development transactions. Areas of weakness show where the product portfolio is vulnerable to attack by others. This may indicate an area where R&D is less strong and where active patenting or patent acquisition needed.

The next step is to create a similar matrix illustrating the match between the company's patents and its competitor's products, and finally their patents and the company's products. It is not necessary or appropriate to carry out a detailed analysis on a claim by claim basis but a considered view of skilled engineers versed in patents is required.

Collating all this information will identify the strengths and weaknesses of the IP portfolio and those of the competitors. Firstly, the creation of such an IP landscape demonstrates the degrees of business freedom because it will clearly show which patents relate to particular products in the company's and competitors' portfolios. Secondly, the patent analysis becomes a powerful marketing tool because it enables the company to understand the following:

- The balance of 'IP power' between the company and competitor.
- Its own strengths and vulnerabilities.
- Its competitors' patent weaknesses in products and geographic terms.
- The patent/product relationship.

For some companies, the result of this mapping is a revelation. A powerful example is a FTSE 250 company certain that their new licensing programme would reap rewards to counter retail margin pressure. They had selected target companies, but had wrongly assessed the balance of power. This was because they had used a technology classification to plan licensing rather than focusing on the relative sales revenues of products that the patents potentially affected. Their first patent assertion resulted in a forceful rebuttal and counter-assertion that set alarm bells ringing. If they had continued, the result would have been a programme that would have cost the company money in royalty out-payments and, potentially, risked an injunction by alerting a competitor. They then completed a product based patent analysis and created a new licensing programme. This focused on licensing in a different market sector and using cross licences to preserve patent peace within the company's own market sector.

Creating a link

Having created an IP/product matrix, how do we use it? How does it help to align IP activity with corporate or marketing strategy?

Firstly, it allows an assessment of freedom of action. This is the ability to sell products or services in a chosen market, knowing that if patent infringement allegations are made, the company's own patent arsenal will be strong enough to negotiate a resolution and preserve the right to pursue corporate aspirations. Patenting plans can be tuned to provide patents in areas where the portfolio need strengthening. Further, in vulnerable areas where there is a short term need, patents may be bought.

Secondly, it provides a clear view of the parts of the IP portfolio with in depth patent coverage and its relationship to competitors' products. Now real commercial choices can be made in full alignment with corporate strategy and the areas of strength provide support for those ambitions with 'IP currency' for transactions.

IP as currency

Modern corporate governance requires answers to tough questions about the value and use of IP, placing a sharper focus on the generation of value from corporate assets. The value of intangible assets in terms of market capitalisation has been rising for many years; from less than 40% in the 1980s to an average of 85%, for the S&P 500, today. Even leaving trademarks and reputation out of the reckoning, the remaining IP asset value is significant and its contribution to corporate goals needs explanation to the board and shareholders. While most companies are skilled at using their financial and equity assets, few treat their intellectual property with the same confidence. IP currency is a valuable commercial lever, but one that comes to its full potential when aligned with core business drivers and used as a negotiating lever.

A large patent portfolio needs active exploitation to fulfil its commercial potential. In most cases defence is not enough. Corporate strategy in most companies revolves around profit growth from new ventures, relationships, markets and products. So how can IP strategy support this and how can licensing be used to support wider initiatives?

Establishing new ventures

New ventures typically have three assets: money, IP and people. In most cases the IP and people are intrinsically linked. Both have a high value and a pivotal role in the new venture development. From a licensing perspective the parent(s) need to decide whether to assign the IP to the venture, thereby maximising its value, or license, thereby preserving the right to exploit the technology commercially by additional routes. This is a clear case where the corporate and IP strategies need to be aligned to maximise the overall benefit.

Consider the example of a European company that invested in a new generation mobile phone company in South East Asia. The Asian partners had money but lacked expertise and any relevant IP to defend the new company operations. The final deal saw all the money provided by the Asians and equity provided to the European company, in exchange for an assignment of a few key patents, licences to many others, a technology transfer and consultancy. In addition, the new company contracted its R&D to the European company for its first two years. Here is a clear example of IP currency in use. Not only had the European company received an equity stake without a financial outlay, it had also used its IP to fuel business growth in a new market.

Equity ventures involving third party funds such as venture capital or hedge funds require particular attention to resolve the inevitable tensions over IP value, financing and licensing potential. This is true for investments in both listed companies and start-ups because the correct use of IP can have a profound effect on overall profitability and share value. There are a number of well-reported cases where shareholder value has been destroyed by costly settlement of patent infringements and others where IP exploitation programmes have such value that they form a significant element of company profit.

Building corporate relationships

Licensing is a powerful tool in building long term corporate partnerships because it can create economic collaboration within a sound commercial framework. A common goal is to reduce R&D costs by sharing activity between parties, thereby allowing influence over direction and avoiding unnecessary duplication of effort. However, the terms of the background and foreground licences are the key to sustainability of such a relationship and the equitable sharing of the commercial benefits. The choice of a partner is one that is intrinsically linked with corporate strategy, but a patent/product matrix analysis will inform the choice because it enables the company to maximise its freedoms of action and address potential IP risks in selecting the most suitable R&D partners.

A low risk market entry tactic

Licensing plays a key role in many market entry strategies. While it is possible to import and sell directly, this is often a high risk option. Franchising or licensing a local manufacturer, coupled with a trademark licence, is a lower risk alternative and one which, in some jurisdictions, is more tax efficient. A high degree of quality control is required in trademark licensing; hence this option is best used where a long term strategic relationship is expected. In such circumstances, this can be an efficient way to build brand awareness in the new market.

A revenue growth and corporate expansion tool

A licensing programme can be driven by profit alone and, if R&D is seen as a sunk cost because it is needed for the current business, is highly profitable. However, the range of commercial opportunities and confidence to use IP increase dramatically when strategic alignment is made. Here the company is able to make optimum advances to appropriate parties. If the right type of licence – assertion, technology transfer, trademark or one of many other combinations – is chosen, then the most advantageous deal can be prepared, presented and closed.

There are many examples of the consequences of ignoring this simple truth: patent assertions made against potential business partners; money spent needlessly on R&D that duplicates other's work; or simply revenue opportunities missed and risks left unmitigated. In all these cases the corporate will should have prevailed, but a lack of strategic alignment compromised new business opportunities.

It is crucial to put the correct mechanisms in place to view and use IP in alignment with corporate strategy and as IP currency for wider business transactions. Only then will the IP portfolio be playing its true role in defending the business and creating wealth by offsetting cash or stock demands and generating profit.

Reducing procurement costs

Companies face difficult choices in establishing optimum relationships with suppliers because these choices have an impact on both price and competitive supply. Licensing can play an important part if aligned with the wider procurement interests of the company. When contract manufacture is replaced by licences and supply contracts, it reduces costs through competition, and provides economies of scale and a royalty stream from sales to others. Alternatively, a company's own patent portfolio can act as a lever to reduce prices as an offset for royalty. This was a tactic put to good effect by a major US computer manufacturer when it looked to reduce supply costs in the personal computer market. Its suppliers not only took licences to manufacture but also assumed some R&D costs as they developed the products to meet its customers' evolving requirements.

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ThinkFire advises and represents technology companies worldwide on business aspects of IP. It assists companies to use IP to improve business results, reduce royalty payments to others and further corporate objectives using IP as a transaction 'currency'.

Formerly, Peter directed worldwide licensing operations for BT Group plc, managed business development for its internet business and set up mobile ventures in Asia. He was a director of several mobile phone and internet companies.