The truth about licensing

Not every company is in a position to practise classical carrot and stick style licensing. But that does not mean that licensing is not an option for every business, regardless of the intangible assets they own. By ***Lesley Craig, Esq*** *and* ***Dr Lindsay Moore***

No one doubts the allure of intellectual asset management. More and more intellectual property managers in today's enterprises have heard the call and want to understand and apply this emerging art to join the ranks of strategic thinkers, enhance corporate earnings and to advance their careers.

For many, intellectual asset management seems to presuppose a large patent portfolio and means enhancing revenues with a programme of patent enforcement through licensing. Thus licensing, or at least what many may think of as classic licensing, involves finding infringers and forcing them to pay royalties or to purchase your patented invention. To non-technology-based companies with famous brands in consumer goods, it may mean collecting royalties from someone who wants to use your brand on their own products or perhaps to indicate that they use your branded product as an ingredient or component under a co-branding arrangement. For purposes of this article, either definition will do.

No doubt licensing is nearly as old as intellectual property itself. The grant of a patent, for example, gives the patent holder the right to exclude all others from making, using or selling the patented invention: as such, to license means to permit, or to refrain from exercising a right to enjoin, such practices. Anyone practising the patented invention without permission of the owner is an infringer. However, a patent holder can license an otherwise infringing practice of the invention explicitly by entering into a written agreement, implicitly through an oral agreement or de facto by failing to exercise its right to enjoin the unlicensed use. In the same way, traditional trademark rights are also rights to exclude others from using the same or confusingly similar trademarks on the identical or related goods. Failing to enforce unauthorised use of trademarks over time has the added disadvantage of eroding or destroying the underlying right.

Those with any knowledge of the realities involved in extracting money from infringers through stick licensing know that it is hardly a simple matter. It has evolved in many instances into an art, almost always involving the strategic acumen and financial wherewithal required to threaten litigation successfully (hopefully without the need to see the matter through to trial and perhaps an appeal). In such dealings, especially with regard to patents, countersuits and/or years of negotiation are frequent occurrences. In fact, in the semi-conductor industry, the art has developed into a sophisticated mating dance with choreographed and well-practised steps involving preparing a strong and articulate case for infringement, presenting it to the potential licensee, the possible licensee countering with a cross-presentation of patents allegedly infringed by the would be licensor and a series of civilised and politely scheduled negotiating meetings over the course of a year or two, normally culminating in mutual cross-licensing arrangements and perhaps some payment to the party with the stronger portfolio.

With such practices hardly uncommon, it is easy to understand how the science of collecting money from infringers could easily eclipse a basic business and why, for some, it has become the primary business, either de facto or by design through the creation of special holding companies or licensing entities.

More recently, companies have been urged to mine patent holdings for opportunities that

are unrelated to their core businesses and to seek out those who might beneficially utilise such intellectual property, for a price of course. Notwithstanding the attractive win-win sales pitch that can be formulated by the would-be carrot licensor, finding the right party, then persuading them that you have something not invented there and that they should pay what you deem it is worth is simply not that easy either. Similar models, albeit often for pre-commercialised technologies, are the primary business of most university tech transfer offices. Again, the time, effort and staffing required to succeed in such activities belies any suggestion that simply owning a technology equates with a quick and easy new source of revenue through licensing.

The truth about licensing, or at least classic stick and carrot licensing, is that it is not a viable option for most enterprises. Only a small proportion of companies have the deep pockets to support litigation, or the vast patent portfolios to mine. Even if a company can identify the patents it owns and businesses that either infringe or might benefit from a licence, few have the organisation or clout simply to pick up the phone or send a letter and find that a new revenue stream is on line.

So does that mean that intellectual asset management is not a worthwhile option for most companies or at least not for companies where patents are not de rigueur? Could it be that books like Rembrandts in the Attic and Edison in the Boardroom grabbed centre stage with an exciting story but that their promise of new revenue streams really speaks only to large technology based companies? Or, could it be that all the recent hoopla about the value of intangibles in the newly arrived knowledge-based economy might apply only to those same companies or to those few additional companies with famous brands, like Coca-Cola? If intellectual asset management is not so limited in its application, then why is so much written about classical licensing and so little about avenues more easily adopted by any enterprise?

Perhaps it is just that the pioneering activities occurred in companies with the most to gain from classic licensing and that was the method they could capitalise on to grab the low hanging fruit under the new theories of intellectual asset management. Perhaps if we look at the underlying theories applicable to the new paradigm of creating wealth with intangible assets other strategies can be seen. Perhaps even more advantageously, the tools to create new strategies will become apparent.

The changing economic paradigm

The chart opposite, entitled Comparative economic models, compares basic economic concepts under both the traditional economy, which has evolved since the beginning of the industrial age, and the new economy, which is evolving under the influence of intangible assets. The chart presents significant areas of change within four areas of economic activity and is suggestive of influences that impact the development of business strategy.

The chart is not intended to suggest that there is a total schism or dichotomy between the old and new economies. Many companies will continue to have enormous amounts of money invested in hard assets and the traditional skills used in managing those assets will continue to be of great importance. But the ratio of tangible to intangible assets within the world's wealth is changing dramatically, signalling a need for new strategic thinking in most cases. Within the US, and across the Fortune 500 companies, the market-to-book ratios between intangible and tangible assets have shifted dramatically during the last 10 to 15 years, forever changing the mix of the combined asset base. Today, on average, intangible assets are two to three times the value of the traditional physical assets such as property, plant and equipment. This means that for every dollar of market capitalisation, intangibles are conservatively contributing 50% to 60% of value.

Of course, creating wealth by leveraging intangible assets is not entirely new. After all, educators, professionals and consultants have been sharing their knowledge and expertise (non-depleting intangible assets) over and over again for decades. But today, with the rapidly increasing preponderance of intangible assets in the asset mix of organisations, their importance and role in driving enterprise strategy is rising in significance.

By looking at each of the economics factors covered in the chart, we can see how the deployment of assets has changed with the shift in the asset base.

Assets and wealth creation

Under the traditional economy, the bases for

Comparative economic models

Economic factors	Traditional economy	New economy
Asset base	Tangible/physical assets	Intangible, knowledge-based intellectual assets
Wealth creation	Materials, energy, labour	Knowledge and its management
Economic ethos	Competition/silos	Cooperation/alliances
Product pricing	The law of supply and demand. *Diminishing returns: the more there is, the less its value.*	Adoption drives value. *Increasing returns: the more there is, the greater its value.*
Distribution and market scope	Linear/point-to-point	Global networks
	Regional/national/multinational	

wealth creation were a company's hard or physical assets, such as raw materials, equipment, energy and their labour force. These physical assets and traditional energy sources like coal and oil are depleted through their use, and of course labour forces are finite in size and application.

Conversely, where intangibles, namely, knowledge and information, are used to create wealth, these assets can be used and shared without being depleted. A patent or a body of knowledge can be deployed over and over and will have its useful life subject only to being superseded by a superior knowledge-based asset.

All enterprises create and hold such intangible assets, ranging from their trade name to the secret details of future products and strategic plans. By way of example, no one doubts that branding acumen is a core competency that Proctor & Gamble applies to its consumer products businesses, and in recent announcements, P&G has been described as contributing that core competency as part of its ante into joint ventures.

The economic ethos

Within the traditional economy, limited resources and the law of supply and demand created management and operating silos within organisations that drove competition for these resources throughout economic and business systems. Patents and copyrights were collected and stockpiled and used primarily to maintain monopolies and to exclude others from their practise. Licensing was more the exception than the rule, ideas and information were hoarded, and competitors were just that. Within this mindset, new technologies, like VHS and Betamax, competed until there was a winner in the market.

Under the new economy of intangible assets, where assets are not depleted by their use, increasing return on investment is accomplished by sharing, partnering, collaborating and forming alliances that replace the unequivocal competition of the traditional economy. In this situation, use does not consume but increases asset net worth. Making proprietary software code available for the creation of expanded software libraries by third parties would be inconceivable under the traditional business model, while just such an approach has driven the success of Microsoft and the PC platform to the detriment of companies such as Apple Computers.

Pricing for profit

Pricing within the traditional economy was driven by the availability of raw materials and the scarcity of products within a market – the rarer the product or its materials, the higher its price.

With intellectual assets, adoption drives demand and prices can fall while profitability increases with market penetration. In some cases, such as internet access or cell phones, providers have given their product or service away to gain adoption to sell related services. Further, the rise of brands has taught manufactures that market differentiation drives demand and that even commodities, like water, can be sold at a premium if they are tied to the right intangible assets, eg, a powerful brand.

Distribution and market scope

In the traditional economy, distribution and scope of business growth were fairly linear. Goods needed traditional transportation for their distribution and markets expanded from point to point across a geographical area as they achieved regional, national and occasionally multinational distribution.

Within the new economy, knowledge-based assets travel over networks almost instantaneously and the internet enables any enterprise to enter the global arena wherever a demand exists and to provide the distribution of products and services across new channels ranging from e-mail to air express.

New intangible asset strategies

Many aspects of business remain unchanged, with enterprises securely continuing to operate within the paradigmatic strategies of the traditional economy. However, increasingly businesses require new strategic thinking to meet the challenges and opportunity of the new economy. New strategies are necessary to leverage this new asset base of intangible assets and to provide competitive advantage. And because not all intangible assets are within the legally protectable class of intellectual property, more and more new strategies are being created to leverage intangibles. What are some of these new strategies and in particular those that move beyond the classic licensing of patents or brands?

At the dawn of the information age, early adopters of the opportunities offered by the new economy made vast fortunes by understanding that knowledge was an asset, that partnerships (even with their own competitors) could be beneficial, that adoption drives value and that markets need not be limited to geographic contiguity. Some of the best-known examples of the deployment of intangible intellectual assets went well beyond stick licensing and patent mining.

Knowledge and its management

A number of companies emerged as the

internet reached critical mass to deploy it as a vehicle for the delivery of training and education both to large and decentralised audiences, and on a global basis. Companies like Corpedia, Docent, Eduneering and Click2Learn revolutionised corporate training and all levels of education to create a multi-million dollar knowledge management industry.

Today workforce training and management education, ranging from ethics and compliance training to management development, are delivered directly to the desks of individual employees through carefully designed online interactive training programmes. These accelerate employee learning, reduce the costs of training large workforces and make continuous education a daily reality for thousands of companies and tens of thousands of individual employees.

Training and education that was once delivered only to limited groups of individuals in classroom formats, now penetrates to deeper levels within organisations to develop a higher overall workforce IQ while driving the training and education industry from a relatively small industry segment that generated only tens of millions of dollars annually during the 1980s to an online concern that today is sized at nearly US$1 billion dollars annually.

Cooperation and alliances

Players within industries have increasingly set aside competitive considerations to come together pooling knowledge and intellectual property to form alliances and consortia intended to create industry standards that ensure mutual benefit and industry growth. Betamax and VHS taught many players that the competitive model of the traditional economy could mean that even economic winners (VHS), when it came to intangible assets, were often losers, either through the loss of superior technology (Betamax) or industry growth opportunities.

Cooperation among competitors is now increasingly the norm in technology-driven industries because without the open sharing of certain technological substratum and standards those very industries are not able to realize their growth potential. In this sense, under the new economy, and where intangibles are significantly involved, cooperation between competitors allows them to compete more effectively. The sharing of technology and know-how within such consortia of competitors, and the creation of industry standards, has allowed such entities to be successful.

Adoption drives value

The brand provides the classic demonstration of how, when it comes to intangible assets, adoption drives value. Recognised by some, as perhaps the most valuable and omnipresent of intangible assets, the brand is also the ultimate strategic tool.

In contrast to the traditional law of supply and demand, where more is less, brands increase in value as positive brand awareness develops. The spate of partner and ingredient identification programmes that have proliferated speak to the value which can be gained. Two of the most successful have been "Intel Inside" and "NutraSweet". Both trademark owners have encouraged, if not demanded, that their component parts be identified by original equipment manufacturers (OEMs), creating vast amounts of added wealth for both licensees and brand owners.

Famous, well-known, highly regarded and broadly adopted brands command premium pricings for their products and services, and thereby deliver enhanced gross margins. The concept of identifying components to the consumers of end-products has revolutionised sales within many industries, creating pull for components or ingredients and driving sales in a way probably not possible with the traditional push marketing strategies largely

How Sony leveraged its marketing savvy to remain competitive

Sony presents an interesting example of how one enterprise recognised the value of intangible assets and leveraged them into a joint-venture with a competitor that provided both parties with advantages that they needed to remain competitive in a changing marketplace.

Long recognised as the leader in consumer electronics and the top seller of televisions worldwide, a strategic miscalculation left Sony without a flat-screen manufacturing competency when, contrary to their expectations, consumers fell in love with flat-screen televisions.

After years of stellar success with their crystal-clear Trinitron picture tubes, Sony hadn't anticipated the sea change that is now emerging in the television market as consumers move increasingly to purchase flat-screen models. As Sony's Trinitron sales began to fall, the company realized that because it lacked a flat-screen manufacturing facility, its global share of the television market was endangered.

Sony approached Samsung, one of the top global manufacturers of flat-screens, and created a joint venture that guaranteed Sony the screens they needed to create flat-screen televisions, while providing Samsung with a large customer for their new flat-screen manufacturing facility. The two companies agreed to share the US$2 billion expense that Samsung had undertaken to create a new LCD panel factory, and each company parlayed their intangible, knowledge-based assets into a winning combination.

Samsung contributed its senior operations management and its engineers with their flat-screen manufacturing knowledge to creating and operating the flat-screen manufacturing operation, while Sony contributed its marketing savvy. Samsung was assured of immediate and ongoing demand for its products and the opportunity for its flat-screens to gain recognition among consumers, while Sony enjoyed a supply of flat-panels and ultimately a pricing advantage driven by its expected high order quantities. There is every reason to believe that both companies, as equal partners in the joint-venture, will reap the return on investment in the flat-screen factory, and the enhanced value derived from the congruently leveraged intangible intellectual assets.

employed by OEM component suppliers.

Strategic brand management, the art and science of brand building, is an often overlooked intellectual asset management skill. But given that the brand is usually the most valuable intangible asset within an organisation, its strategic management can produce the greatest of gains.

Global networks

Amazon.com and eBay, employing the internet and its global distribution network, entered their respective markets to create landmark businesses with instantly international scope. In both cases, they step-by-step extended their markets beyond their original entry to service each new need that could fit within their business model, while simultaneously challenging the existing worldwide carrier services to ensure the delivery of their goods to wherever demand existed.

Known for parlaying its auction model into the largest single marketplace between buyers and sellers in the world, eBay draws buyers and sellers from wherever they exist to make their market. Today, with annual sales of over US$2.1 billion, eBay sells over 45,000 categories of merchandise to a registered user-base of over 95 million individuals in 36 countries.

Amazon.com, which originally became the largest bookstore in the world, today is one of the world's biggest purveyor of everything from books, music, video, DVDs and consumer electronics to toys, tools, home furnishing, apparel and a multitude of ancillary services. Amazon.com, with annual revenues in 2003 of over US$5.2 billion, created the archetypal internet business model and has become possibly the most global business in existence.

In both the cases of eBay and Amazon, it is the sharing of their extensive networks with users that has turned these enterprises into such international, global successes.

A redefinition of licensing

When one thinks of the broad categories of intangible assets, such as brands and access, in the light of the shifting economic factors we have discussed here, we begin to see that licensing, in a broader sense than that conceived under its classical meaning, may in fact be a primary strategy of intellectual asset management. Most importantly, it is a strategy that is widely available and applicable to almost every enterprise, large or small, with or without a patent portfolio. After all, in its original sense license, which comes from the Latin licens, means to allow. And in each of the examples above, the owners of intangible assets are sharing or allowing the use of those assets by others in some form of negotiated exchange, such as a royalty, a transaction, awareness or other benefit.

Whether we call it licensing, or leveraging intangibles, and whether it is in the form of intellectual property or core competencies like marketing or distribution, these intangible assets are powerful means of creating wealth that can be used by one or many users simultaneously, without depletion and for the entire life of the asset, which, with the exception of patents and copyrights, can be forever.

Mining patent portfolios and then using them as the ante for cross-licensing needed technology, entering joint ventures, strategic alliances and other partnerships should be suggestive of other equally imaginative ways to deploy intangible assets to create wealth. The principles are there for everyone to use as they manage their business and form their strategies. So perhaps the truth about licensing is that, in its broadest sense, it can be an intellectual asset management strategy for everyone. ■

Dr Lindsay Moore *and* ***Lesley S Craig, Esq***
Dr Moore is the founder and CEO of KLM Inc, a management consultation firm located in Boulder, Colorado. Ms Craig is an attorney-at-law and founder of the Denver, Colorado office of Townsend and Townsend and Crew LLP.
lmoore@klminc.com
lscraig@townsend.com