The strategic edge

Tactical deployment of intellectual assets may bring short-term benefits, but sustainable success depends on thinking and acting strategically

By **Dr Lindsay Moore** and **Lesley S Craig**

It is said that tactics win battles, while strategy wins the war. This distinction between strategy and tactics is as old as the science of strategy itself, dating back at least to the ancient Greeks and the writings of Aristotle.

Originally, strategy referred to the difference between the plans of the general, the statesman or a leader endowed with greater perspective, and the acts of the soldier or a follower on the ground as he negotiated the actual terrain and operated without the benefit of a fuller perspective.

It is common to liken business to war when talking about strategy, as the aim of both is to win. In most businesses, the job of winning falls to the executives; thus they are the authors of strategy. The tactics and execution are then delegated to the functional disciplines (marketing, finance, operations) within each organisation. In this way, strategy is still the domain of generals and executives, just as tactics are the tools of those charged with execution.

The growing field of intellectual asset management is all about the need to leverage intellectual property and other intangible assets. Since the 1990s we have seen these assets rise in importance with little distinction being drawn between the merits of a strategic or a tactical deployment. Of course, in some sense, any asset deployment is certainly better than no deployment. But thinking as a strategist it is critical to assess our deployment of intellectual assets and to differentiate between those uses which turn intangible assets to fulfil corporate strategies and those that deploy the assets for operational advantage.

Many practitioners easily overlook this subtle distinction, jumping to promote merely tactical activities, such as patent mining, because of the free cash flow they can bring to the bottom line. They fail to recognise that just making money does not necessarily deliver a long-term competitive advantage to their company. Many companies today have billions of dollars of cash, but no real plans to allocate their capital to truly strategic initiatives.

Targeting this failure to deliver true shareholder value, innumerable articles in the *Wall Street Journal* decry default stock buy-back programmes that are pursued for the sole purpose of increasing earnings per share to give the illusion of corporate value. The fact that money is not spent on either breakthrough innovation or strategy to drive businesses forward underscores the failure to distinguish between non-strategic deployments and those that, of course, make money, but more importantly have the ability to provide long-term competitive advantage and drive enterprise valuation.

Strategic asset management

The fundamental model for managing all assets, whether they are traditional economy tangible assets or new economy intangible knowledge-based assets, is the same: deploy them to provide an advantage.

Tangible assets, those which comprise the book value or the financial value on the balance sheet of an enterprise, are optimally leveraged with best practice activities that enhance efficiency and deliver what has come to be called operational effectiveness. Tangible assets share certain features in common: they are limited or finite in nature;

they are depleted or consumed through use; and their value is driven by scarcity.

Accordingly, tangible asset strategies leverage the traditional plant, property, equipment and cash to provide the optimal return on assets (ROA). These activities are important to any well-run operation. But because every company can use and similarly leverage the same assets in the same or similar ways, they provide no differentiation in the marketplace or any sustainable competitive advantage to an enterprise. In other words, they cannot provide the winning edge.

By way of example, most companies have learned how to maximise their tangible assets to deliver enhanced profitability and functional operational benefits. In days past, during the industrial era, companies that could run their equipment 24 hours a day or shave one-tenth of 1% off the cost of goods sold, did possess a competitive advantage through some economy of scale that allowed them to compete more effectively in the marketplace. Now, during our information age, the secrets of all such operational practices are well known to all the most successful companies in the world and they no longer bestow an appreciable competitive advantage upon their possessor.

Intangible assets, namely those which account for most of the market value of many companies, ie. the balance of value left in total market capitalisation after subtracting a company's book value, are most advantageously leveraged by corporate strategies that deliver competitive advantage and enhanced market capitalisation. In other words, strategies that win in the marketplace.

Success arises from leveraging each class of assets in the way that is appropriate to it and, assuming the optimal and efficient management of traditional assets in most enterprises, the greatest improvement to company performance is now accomplished through the strategic leveraging of intangible intellectual assets. Contrasted with tangible assets, these intangibles are plentiful, they can be easily and repeatedly shared and they are not depleted by use; crucially, adoption, rather than scarcity, drives their value.

But such strategic use is often easier said than done. Many managers and executives have built their careers working with tangible assets. They may have successfully, even brilliantly, leveraged working capital, expanded operational scope and achieved economies of scale. Nevertheless, they lack the skills necessary to be as successful with intellectual assets which respond to different principles (adoption versus consumption). Sustainable competitive advantage comes primarily to those organisations that have figured out how to capture and leverage their intangible intellectual assets; assets such as brands, innovation and the brainpower of an organisation, and how to leverage them strategically — that is, in service to some higher enterprise goal.

Extracting value and showing ROA – strategic or tactical?

From the perspective of corporate strategy, not all intellectual asset management practices or activities are strategic. Many are undertaken under the traditional operational effectiveness model that has long ruled corporate management and are thus concerned with extracting value from the asset, delivering a return (ROA) or optimising the asset in some respect.

Patent mining is tactical, for example. With patent mining, a portfolio undergoes analysis to find patents (typically not directed to the company's core technology and products) that are being infringed. The goal of the mining is to force infringers to license and enhance bottom-line revenues through royalty payments for the third party's use of these otherwise under-utilised assets. Traditionally, management buys in to a proposed project to mine patents based on the assumption that nothing related to core business – ie, nothing of value to direct competitors – will be licensed to them. In the optimum situation, the otherwise unused assets produce an income stream that is unburdened with cost of goods sold and largely falls to the bottom line to enhance profitability.

On the other hand, cross-licensing, undertaken to obtain a competitive advantage in the marketplace, is strategic. However, cross-licensing between competitors in settlement of litigation or in standards-setting may only be tactical, depending on whether the licence itself ultimately puts you in an equal rather than superior position to any other player. Such tactical action is something that any company could do given the resources and inclination, while strategic action contributes to the differentiation of the enterprise in the marketplace in some unique way not easily copied by another enterprise. Both actions fulfil a company goal, with tactics optimising the assets of the company for leveraging and the strategies using the assets of the company to provide growth, competitive advantage or to drive market capitalisation.

Strategic drift

How does this work out in practice? While not definitive, the following analyses identify three primary activities that can lead the strategist astray.

Leveraging assets for tactical purposes

Intellectual asset management loses its strategic edge by failing to distinguish between enhancing effectiveness and giving the enterprise a differentiated strategic position in the market or creating a competitive advantage.

The classic case is mining patent portfolios. This, of course, is good, but it may not have established a real link to delivering on corporate strategic goals. Even the much-admired IBM patent portfolio deployment initiated in the 1990s, while creating new revenue streams totalling billions of dollars and leveraging unleveraged intellectual property, did not seem to contribute directly to the overall strategies of the corporation or moving the business as a whole forward. That, apparently, was left to the now well-known consulting arm of IBM, which reinvented the strategic significance of Big Blue around the world, expanding its brand to stand for all things information technology and transforming the company from a computer manufacturer to the services and consulting company that it is today.

At IBM, the patent licensing programme was the undertaking of a functional discipline (the IP department) at a time when IBM was in financial trouble, having posted a US$5 billion loss and so in need of income to offset its failing fortunes. In this respect, the patent licensing programme, by boosting the return on R&D investment and creating substantial new free cash flow, primarily enhanced the operational effectiveness of the company. Operational effectiveness is always good, but in strategic thinking circles it is carefully distinguished from strategic activities that provide or directly support competitive advantage.

How so? Achieving operational effectiveness in creating and managing intellectual property is of great value, especially in larger companies that possess substantial portfolios; but it does not necessarily deliver a competitive advantage because arguably any company that has an IP portfolio and the necessary support resources available could also establish and operate a licensing programme. By their very nature, licensing programmes are not the concern of the strategic thinkers at the top of the organisation because they won't advance the company in the marketplace.

Licensing-in technology, on the other hand, would primarily be a strategic activity insofar as it procured new technology, not otherwise available on a timely basis, necessary to the development of new or improved products or services. In such a case, the activity would be undertaken for the technology itself and not for the IP *per se*. Similarly, creating a patent thicket could often also be strategic in preserving or advancing a competitive advantage.

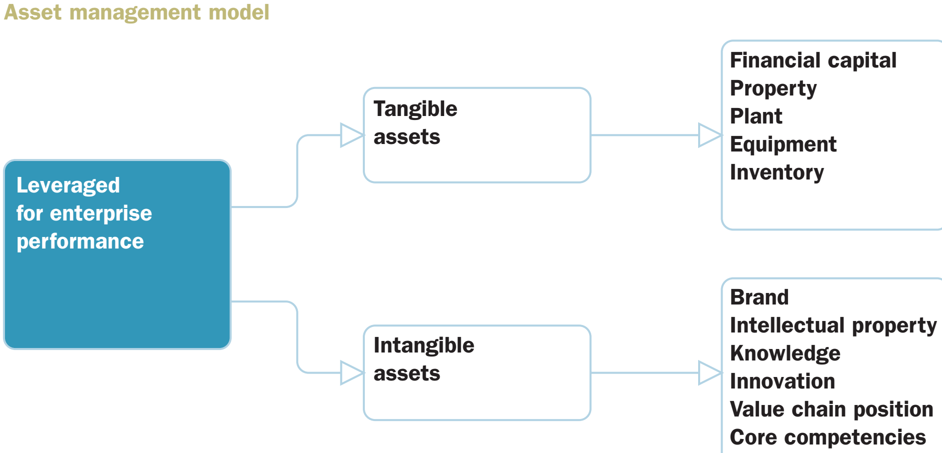
The strategic thinking is not accomplished unless, in the end, a use is found for given assets that deepens the strategic differentiation of the company.

Diluting assets to obtain growth

Trademarks can offer an interesting example of licensing which is not simply tactical, but deleterious. Indiscriminate trademark licensing, trivialising line extensions, selling on features, imitation of competition and price promotion may all be undertaken to provide incremental revenue growth in a company. However, these activities can also be instrumental in eroding brand equity, diluting and tarnishing otherwise valuable brands, and thereby even reducing market capitalisation.

The common approach among many popular consumer brands of engaging in merchandise licensing notably erodes brand equity. In such cases, revenues and income become more important than deepening the strategic positioning and differentiation of the core brand, leading to activities that rivals can imitate, thus reducing the cache of the brand. This erosion of brand equity emerges from the failure to understand the diminishing returns that eventually come

Asset management model



with market saturation and over-consumption, and the likely role of innovation as the alternative to squeezing more dollars out of an intellectual asset.

Brand licensing programmes often emerge within companies at a critical moment of forgetfulness when leveraging the assets for royalty income seems like a smart thing to do and the risks of multiple licences using the same brand recede into the background. In these cases, Coke comes out with Diet Coke and Pepsi comes out with Diet Pepsi, Pepsi enters the bottled water market and Coke enters the bottled water market, Starbucks begins offering sandwiches and McDonald's establishes an arrangement with a speciality coffee company and they all reduce their peak of differentiation and end up looking more like each other to gain growth at all costs. The assets each company possesses are diluted because short-term growth is the be-all and end-all, and none of the companies has a truly strategic plan that will deliver new growth.

Weakening competitive advantage through the failure to leverage core competencies

These brand-related examples also weakened strategic positioning by offering what rivals can easily match, rather than creating a unique product or service based upon the orchestrated core competencies of the company.

Apple, in launching the iPod during 2001, enhanced its competitive advantage exponentially. It did so by entering a lacklustre MP3 market with a unique offering that, coupled with new software, technology and characteristic Apple design, redefined MP3 as a way to manage data and deliver media, be it music, audio books, television or DVD content. Apple thus embarked upon a route that the competition could not follow because rivals did not possess the root core competencies to deliver a new direction to the marketplace. Apple worked in secret to develop a product that completely changed the rules of the game, leveraged its core competencies and the reputation for design and style inherent in its brand to create a landmark restructuring of the modern lifestyle that is only now, after all these years, being trumped by Apple itself with its carefully orchestrated new iPhone. Apple builds what only Apple, with its unique knowledge-base, can build, leaving competitors with only the opportunity to follow and copy.

If companies do not deeply engage core competencies, they are not leveraging the most fundamental sources of intellectual capital in any organisation. For Starbucks to start offering sandwiches or McDonald's to offer speciality coffee is for both to forget what built their brands and thus to under-optimise their opportunity, so levelling the playing field for everyone. We often get lost in the details and the practices, and without even noticing it, fail to align intellectual assets with corporate strategy.

Strategy v tactics

Strategic deployment of the asset	The effectiveness of the organisation
Leveraging the asset to achieve a goal	Leveraging the asset to gain a return on the asset
Using the asset to provide growth, deliver competitive advantage, drive market capitalisation	Optimising the asset (for leveraging)
Building value	Extracting value
Marketplace deployment	Operational effectiveness

The long-term edge

Talking about strategy suggests that we are in control of our destiny. It leads to the realisation that success comes from picking the right strategy while failure arises from picking the wrong strategy or no strategy at all.

To be strategic is to engage an asset in its most comprehensive and complete aspect – as a total technology and not just as a patent; or as a brand rather than a trademark – and to find its possibilities in that state and at that level of totality.

In the end, many deployments of intellectual assets are not necessarily going to be strategic. Many will be merely tactical. While not lacking merit, they will not be concerned with advancing the highest purposes of the enterprise. Lacking such relevance, the more tactical they become, the more they can be copied, so diminishing their value and thus not contributing to the strategic positioning of the company.

Long-term advantage in the marketplace arises only from the strategic deployment of intellectual assets. ■

Dr Lindsay Moore *and* ***Lesley S Craig Esq***
Dr Moore is the founder and CEO of KLM Inc, Boulder, Colorado. Ms Craig has retired from full-time practice of law, but continues to consult for selected clients through her company, GoldMinds, LLC. Ms Craig and Dr Moore co-teach intellectual asset management at The George Washington University Law School