FOCUS

INTELLECTUAL PROPERTY STRATEGY

Maximising value and minimising risk

All companies own intangible assets, and they now account for over 70% of enterprise value. Intellectual property (IP) rights are a significant part of these intangible assets. The importance of IP to business strategy has increased dramatically in recent years. However, it is only very recently that IP has started to take its place as a boardroom issue. Companies that do not have a strategy for managing IP are unlikely to maximise the value, and minimise the risks, associated with this rapidly evolving asset class.

IP strategy

The evolution of IP

It is only recently that IP has been recognised as an asset class. The reasons for this include:

- The complexity and diversity of IP, for example, patents, trade marks and copyright are all very different from each other.
- The absence of global harmonisation, for example, passing off in the UK is not the same as unfair competition in Germany or trade dress protection in the US.
- The absence of liquidity associated with IP, meaning that no functional market has developed to enable normal trading, lending or insurance conditions to emerge.

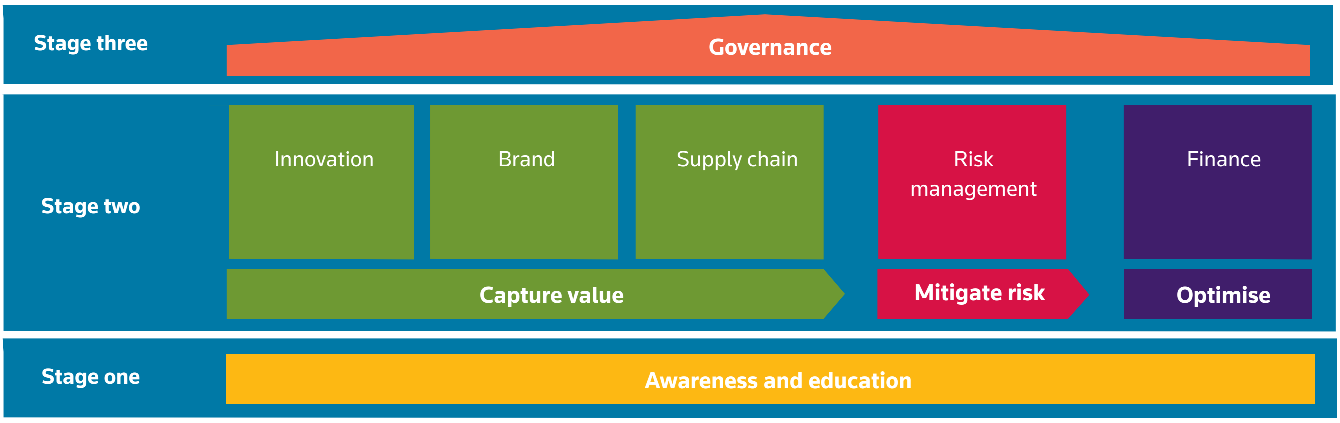
IP has evolved significantly over the last ten years. Changes in the nature of the economy and associated environmental conditions have played a large part. The most striking of these is what is generally referred to as the digital age. We are now in an era where the importance of fixed assets has declined, to be overtaken by the reality that it is intangible assets which are central to future growth.

However, these changes have yet to be fully appreciated or reflected by the financial markets, as illustrated by accounting rules that do not begin to represent the value of intangibles on the balance sheet. Even where accounting rules do exist (for example, where there is an acquisition of IP), the valuation is typically calculated after the deal is concluded, and therefore cannot fairly be said to reflect the market value of the acquired asset.

Evidence of the evolution of IP is abundant, for example:

- Liquidity has increased, as demonstrated by a range of headline patent sales, such as: Nortel ($4.5 billion); Kodak ($525 million); MIPS ($350 million); and the many thousands of other deals over the last few years where patents have been the focal point of the transaction. The Nortel saga is possibly the best known. Nortel, a major Canadian telecoms company, went into administration in 2009 and the operating business was sold to Avaya. The patents were retained and sold separately to Rockstar (a consortium including Apple, Microsoft and others) for $4.5 billion. Google missed out, and this is said to be one of the drivers for its acquisition of Motorola Mobility in 2011 for $12.5 billion. This was followed by the sale of the operating company to Lenovo for $2.9 billion in 2014, excluding the patents.

The three stages of IP strategy



- The increase in the number and severity of IP litigations. This has been dramatic in the US, driven by the growth in litigation by non-practising entities (NPEs, also known as patent trolls). The rise of the NPE has altered the nature and characterisation of IP. Gone are the days where patent litigation reflected a genuine dispute between competitors, with the primary objective of excluding an infringer from the relevant market. NPEs recognise patents as a mispriced asset and leverage this position by acquiring patents and then asserting them for financial gain. While this suggests some liquidity in the market, the litigation system (especially in the US) is a blunt, crude and highly inefficient mechanism for achieving it.

- The intense focus on the valuation and recognition of IP across a range of lending transactions. This was the subject of extensive review in the Intellectual Property Office's November 2013 report on the role of IP in business finance (*www.gov.uk/government/publications/banking-on-ip*). This interest has led to the emergence of a range of innovative business models. One example is that of Fortress Investment Group, which lends to patent-rich companies with a security package targeted at the current and future value of intangible assets.

These evolutionary changes have caused the green shoots of new business models to flourish. These include Open Invention Network's support of Linux, RPX Corporation's defensive patent aggregation service, and Allied Security Trust's consortium buying strategy. New solutions are continuously being developed, such as Lot Network's use of springing licences, and Patent Properties' IP strategy product for SMEs.

The world is watching

Because IP represents such a significant part of corporate value, it is now a key issue in the full range of corporate transactions and events, including acquisitions, divestments, investments, collaborations and financings. IP is no longer something to be handled by a specialist some way down the line. It will often be the deal driver and the relevant issues need to be identified early on.

The impact of this trend can be seen in recent deals where activist shareholders were motivated by mispriced IP. An example of this was the MIPS transaction in 2012, where the business was sold to Imagination Technologies for $60 million and the patents were sold to an AST consortium for $350 million. This break-up was precipitated by an activist shareholder, Starboard Value, which invested when the MIPS market capitalisation was less than $250 million.

This is just an example of market participants leveraging mispriced assets. They are able to do this because of their ability to assess corporate IP better than others. This trend is a stark reminder that companies should be prepared and, at the very least, know how others perceive their IP. This is much easier with the advance in IP analytics and business intelligence. Information that was previously either too hard or too expensive to access is now available instantaneously.

IP strategy

The evolution of IP and its increased importance in corporate transactions demonstrates the importance to a company of implementing an IP strategy. An IP strategy consists of the measures that are implemented and monitored by a company to ensure that its IP rights are developed, exploited and respected in a manner that is consistent with, and adds to, its commercial goals and objectives.

The implementation of an IP strategy requires the broad participation of management from all areas of the business. This can be a radical change for some companies, where IP has been the sole responsibility of the legal department and where the remit has been limited to obtaining trade marks and growing a patent portfolio. Our visualisation of IP strategy illustrates not only the need for cross-functional involvement, but also the need for governance (*see box "IP strategy"*). Experience suggests that general counsel, with their broad remit across the business, can play a leadership role in these initiatives.

Implementing an IP strategy

Companies typically approach IP strategy in three stages: awareness and education; implementation; and governance (*see box "The three stages of an IP strategy"*).

Stage one: awareness and education. This exercise must be inclusive, and establish the views, needs and requirements of each relevant section of the business. This is the essential first step to developing a strategy that is not only fit-for-purpose, but also the bedrock of establishing support for, and understanding of, the IP strategy. Companies that do not have an IP strategy often have different views on what IP is, what it does, and its role in delivering defined business objectives.

Stage two: implementation. The various elements of an IP strategy each have a distinct objective. Capturing value includes evaluating the importance of the innovation of IP and of branding. Supply chain issues also need to be considered, spanning suppliers, customers and the organisation's operating system more generally. Risk mitigation should involve both managing direct risks, such as litigation, and indirect risks, such as any applicable indemnities. In order to optimise its position, a business should also consider harnessing the benefit of the new business models referred to above and the increased availability of IP insurance.

Stage three: governance. Once a company has developed an IP strategy, and aligned and integrated it into its business strategy more generally, it is essential that a governance structure is established. This ensures that the IP strategy is continually managed and reported. In recent times, this has seen many companies form IP strategy groups, with participation from across the business, and the emergence of a new role, the CIPO (Chief Intellectual Property Officer).

Benefits of an IP strategy

The role and importance of IP is changing at a rate that has never been seen before. This creates huge opportunities for companies who are prepared, and equally significant risks for those are not. The current challenge is presenting strategic IP considerations in a way that is both integrated and aligned to corporate strategy, and that highlights the relationship between IP value (such as licensing) and risk (such as litigation). A good IP strategy should balance and optimise IP value and risk, not choose one over the other.

This balancing exercise is often seen in the area of patents. In the past, patents were either regarded as part of a company's defensive strategy, in order to secure its freedom to operate, or its offensive strategy, that is, to chase off competitors. Today's environment is more complex and interrelated; for example, where does patent licensing and cross-licencing, or patent acquisition and divestment, fit into such a two-dimensional view of the world?

A starting point in this area is to check how IP strategy is reported to the board, and to ensure that it is not stranded within a line item on a company's risk register. Companies that have established structured IP strategies find it easier to articulate and resolve tensions and conflicts between the often complex challenge of maximising value and minimising risk.

The future is now

There is still something of a vacuum between the importance of IP and its status as a functional asset class. The recent 12% fall in GoPro's stock price, triggered by the grant of a single patent to Apple, highlights the gap in comprehension that has to be filled. The market would have behaved differently had it known that this patent was simply one of 500 similar patents owned by Apple, in a sea of more than 15,000 patents owned by Sony, Panasonic and others. Equity analysts and the media are all striving to make sense of the complexity. With this increased scrutiny, the imperative is to be prepared.

Companies that implement and maintain integrated IP strategies will be best placed to benefit and respond to the changes that are taking place. All companies should implement an IP strategy that is both well-defined and managed. IP is no longer a specialist topic to follow in the slipstream of mainstream corporate strategy. The significant opportunity to create additional value and to avoid unnecessary risk means that IP has now earned its place in the boardroom.

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