The transforming world of licensing

Licensing Consulting Group's **Rand Brenner** examines the changing role of IP in today's business environment

Today the economy is going through a transformation. The term 'knowledge economy' is the recognition that knowledge is the driver of innovation and the creation of IP. IP is an enormous value driver for today's companies, and it's a value that is just now being recognised.

One of the biggest assets of most companies (public and private) is IP. In the 1970s, IP was not recognised as any kind of "asset." Traditional assets such as plants, equipment, products, and inventory – tangible assets – comprised the lions' share of a typical company's assets. Today, these tangible assets represent less than 20%, and intangible assets – including IP – represent 80% of the balance sheet assets. Yet, the tremendous value of IP is often overlooked. It is viewed as an afterthought – something a company gets to protect its rights and not recognised as a value creator. However, that is quickly changing as stakeholders, investors and shareholders are now recognising that companies with IP can indeed be very valuable.

The market for IP is huge and growing. According to a recent study by Deloitte & Touche, licensing in the US has grown to about a $500bn industry from just $15bn 25 years ago. The US Patent and Trademark Office estimates the value of IP in the US is worth over $5trn.

Countries around the world, such as China and India, that a mere 10 and 15 years ago had weak protection and enforcement of IP rights, now recognise the importance of IP to the growth of their economies in the 21st Century. This recognition is borne out by the ongoing negotiations between countries focused on the harmonisation of IP laws around the world.

This realisation of IP as the most valuable company asset is creating a dramatic shift in the way investors value companies. CEO's and business owners are starting to understand that commercialising their IP requires actually doing more than just selling products and services. Many large public companies are now unlocking the value of their IP holdings through aggressive IP management strategies - examples include Motorola Mobility, Nokia and AOL. Investors are getting higher returns over the last few years from the performance of some 'pure play' (ie, licensing) IP companies such as Acacia and VirnetX. Read any financial publication today and you'll find news about intellectual property every day.

IP is an income producing asset. When combined with the right management and well executed licensing programme, IP will return higher gross margins and profits (or lower costs). It is now at the forefront of company value creation and it's reflected in the stock performance of many public companies. The Ocean Tomo (OT) 300 Patent Index tracks IP rich companies. Between 2007 and 2012, the OT 300 index consistently outperformed the Standard & Poor's 500. These companies have a proactive licensing programme, are generating high revenues and they are securing their IP rights through aggressive legal protection.

Monetising the value of IP through licensing is a low-cost, high-return model. Unlike producing and selling a product, which requires machinery, tooling and raw materials, licensing is less labour and cost intensive. It requires meetings with companies, making presentations, negotiating agreements and monitoring contract compliance. Revenues from licensing go right to a company's bottom line and increase company and shareholder value.

The licensing business model is creating a new type of emerging company on Wall Street – the PIPCO's or Public Intellectual Property Companies. These companies have large IP portfolios and use the licensing model to commercialise their IP. They focus on extracting the maximum value from their IP, which is often much higher than the manufacturing and sales model. Rather than use it as a competitive advantage to keep others out, PIPCO's license their IP into new markets, applications and competitive products. They recognise that the core IP (ie, patents, technologies and brands) bundled with the surrounding proprietary know-how and trade secrets can be more valuable than the underlying products or technologies.

PIPCO business models vary from the pure non practising entity (NPE) - to the 'hybrid NPE'. Many of the largest NPEs are public companies with multi-billion dollar market capitalisations, such as Acacia Research and Interdigital. These companies own or control large portfolios of IP. While some are controversial in their operating methods (otherwise known as 'patent trolls'), many offer smaller businesses the resources and heavy lifting to protect and monetise their IP.

Many companies are emerging into hybrids, that both use their IP to produce and sell products (or technology), and license out their IP. Some examples include IBM, which generates over a billion dollars a year from licensing out a large portion of their technologies to multiple industries around the world. Another example is Proctor & Gamble, who licenses out its core IP (ie, brands), in addition to their proprietary know-how and trade secrets in such areas as manufacturing technology, marketing systems, and customer research. These companies capture far more value (and revenue) licensing out their IP then using it as a proprietary asset.

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There are many ways that IP can be monetised. Producing and selling products is one option. But to maximise the return on the IP investment, a business needs to use several strategies. Licensing out rights to generate revenues from non-competitive products or markets is a second option. A third option is licensing in or acquiring IP rights to enhance the company's core IP, product sales or market recognition. Cross licensing is a strategy to settle or avoid litigation disputes (and costs) by sharing rights to your company IP in return for rights to your partners IP. Enforcing IP rights is often an overlooked strategy, yet it's one of the most important, since it directly impacts all other licensing strategies.

Often times the competitive advantage can be found by licensing a company's IP out to competing companies or industries. Why would a business use this strategy? To create a level competitive playing field and give it a better competitive advantage. For example, your business created a better retail packaging design for your (proprietary) laundry detergent. You now have a competitive advantage on two fronts - the formula and packaging. Rather than competing on both, license the packaging technology to your competitors and level the playing field on retail shelves. Compete on your detergent formula quality and get paid every time a competitor sells their product. You'll find this licensing strategy in many industries including computers, cell phones, video games and electronics.

Financing is a growing opportunity for intellectual property. Royalty financing and debt collateral are two financing options available to IP owners. The biggest challenge to the financing community is the understanding of IP value and risks associated with commercialising it. I've had conversations with investment firms looking for licensing deals to finance. Their investors, such as big pension funds and insurance companies, are looking for new places to park their money and get steady returns over five or 10 years. Licensees with double and triple A debt rating are the criteria for a good investment risk. However, bankers and Wall Street still need a lot of education on what IP is and how it works.

Key issues

There are a number of key issues and challenges for companies today as it relates to IP.

The first one is building an IP oriented business. This means shifting the management focus from a tangible business operating plants and equipment, to focusing on how to maximise the value of the company's core business assets - IP. Unlike a tangible product, IP is very fluid and can be used in new ways or in different product formats. Examples include inventions and formulations created for one purpose that were more valuable for different applications.

The second point is in understanding that IP is more than just the core IP, such as a patented product or technology. Often times, the brands, know-how and trade secrets can be more valuable than the core IP. It includes the manufacturing knowledge, marketing know-how and proprietary information that are captured as part of the IP value.

The third issue is how a company values its IP. It's a challenging question for businesses and companies of all sizes. As a core business asset, the value of a company's IP must be reflected on the balance sheet. It can significantly impact the bottom line by increasing company valuation and stock prices, reducing taxes and securing favourable financing options. I recently spoke with one IP valuation firm who told me they get at least 20 calls a week from companies wanting a valuation for tax purposes or financing.

The fourth issue is mitigating the litigation risk. IP law is very fluid and it never seems to stay still. As a result, litigation is an issue, especially for companies with patents and technology. The increasing pace of innovation is also bringing an increase in IP litigation. Companies have to understand the litigation risk of commercialising their IP, and develop a plan to manage it. For example, IP insurance has been around for about 20 years, but its existence is relatively unknown. IP insurance is now available to IP owners and businesses of all sizes. It helps control an IP owners litigation risks by ensuring that there are funds available to pay the associated legal expenses.

In today's economy, businesses must rethink how they view themselves and their core IP assets. IP is no longer just a means of protecting innovation – it's also a potent business asset and a means of capturing value. IP rights are the most important form of competitive power that any company can own. They are the foundation for a company's market dominance and continuing profitability. Monetising IP creates recurring revenues that enhance the bottom line and increase company value. It's important for executive management to understand the extent of their IP rights and what they can do with them. It requires IP expertise paired with effective management. It requires identifying all the trade secrets and know-how behind the core IP assets of trademarks, patents or technologies. And it requires an understanding that management of a company's IP rights can be challenging, fast-moving and, often unpredictable.

Author

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