

Intellectual Capital in Enterprise Success

Strategy Revisited

DR. LINDSAY MOORE AND
LESLEY CRAIG, ESQ.



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ADDITIONAL PRAISE FOR *STRATEGIC INTELLECTUAL CAPITAL*

“Lesley Craig and Lindsay Moore have significantly elevated the critical role which intellectual capital plays—or should play—in corporate strategy. The relatively new discipline of intellectual asset management is expertly presented as required knowledge for any company’s ability to maximize its potential growth and productivity.”

—Alexander E. Bracken, former President of the
University of Colorado, and the Executive
Director of the Bard Center for Entrepreneurship

“If you are leading any size organization and responsible to leverage its assets and create new wealth—this book is for you. Moore and Craig provide leaders with new ways to strategically think about how to extract value and manage important intangible assets, the true wealth generator for the 21st. century.”

—Courtney Price, PhD, President, VentureQuest, Ltd

“With the courts and markets favoring active commercialization over patent licensing, this book should be required reading for strategists, investors, and financial managers. The authors make the elusive concepts of intangible assets and intellectual capital immediately actionable.”

—Abram E. Hoffman, DBA, IP Valuation Consultant

“Having a great advertising program to support your brand is no longer enough. Today, enterprises need innovative technology and imaginative intellectual property to achieve differentiation in today’s markets.”

—Patrick Edson, VP Marketing & Innovation,
Coors Brewing Company

“Today, there is no business entity, public or private, that doesn’t have to be concerned about leveraging all of its assets—tangible and intangible alike. When this book talks about ‘enterprise success’ it speaks to entrepreneurs, corporations, nonprofit organizations, and even civic and governmental organizations about how to leverage and benefit from their often unnoticed intellectual capital.”

—Bob Foster, Mayor of Long Beach, California

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*To all the many clients, associates, family members,
and friends who have provided the crucible
for our research and stood by us through
the years of our work.*

—the Authors



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About the Authors

Dr. Lindsay Moore (Boulder, CO) is the founder and CEO of KLM, Inc., a management consultation firm that specializes in strategy, planning, branding, marketing, knowledge management, and the management of intellectual capital assets such as brands, intellectual property, and knowledge. She has published many articles and has served as a keynote speaker at numerous national and international conferences. She is currently a Professor of Law at George Washington University Law School where she teaches Intellectual Asset Management.

Lesley Craig, Esq. (Denver, CO) is one of Colorado's most well respected intellectual property attorneys. She has practiced Law on both coast and in Colorado where she earned both the "Best of the Bar" and the "Outstanding Women in Business" awards from the *Denver Business Journal*. During her two part tenure at Townsend and Townsend and Crew, and her other practices, including litigation, IP-based transactions, trademarks, and copyrights—all with a broad international focus. In January 2005, Mrs. Craig retired from the private practice of law to teach Intellectual Asset Management at George Washington University Law School and at the University of Denver, Sturm School, with her long-time friend and colleague Dr. Lindsay Moore. She continues to lecture and write on innovation and intellectual asset management and to consult for a limited number of long-time clients under her company Gold Minds, LLC.



Acknowledgments

We inadvertently began this book over 25 years ago when Dr. Moore was responsible for the intellectual assets of Celestial Seasonings, Inc. and Prof. Craig was the company's outside intellectual property counsel. For years, monthly attorney-client meetings were followed by lunches or dinners at which we each really hungered for more and more understanding of the other's knowledge and perspective on the matters of the day. Much later, and with more deliberation, we began to appear together on panels at various business and legal forums and then to coauthor articles, most notably in the *Intellectual Asset Management (IAM)* Magazine.¹ There and elsewhere, we gave words to the theory and practice of using intellectual capital assets that are grounded in the law to fulfill strategic enterprise objectives, and we have put forth many of the principles and practices articulated in this book.

Much of the practical material for this book grew out of the authors' individual practices with clients and the "Intellectual Asset Management" course we teach for law school J.D. and LLM candidates seeking another advanced degree or more specialized knowledge in intellectual property practices at George Washington University Law School (GWU) in Washington, D.C.

The course emerged out of the relationship between Lesley Craig and her law school alma mater, GWU. With its renowned Intellectual Property (IP) program, GWU was receptive to an idea that emerged from her 35-year law practice—teaching intellectual property attorneys more about the business and enterprise context within which they practice intellectual property law, and how to think strategically about the IP they work with for corporate clients. In fact, the idea for business school type courses and

case studies was already in the minds of GWU's leadership, and in particular those of the Director of Intellectual Property, Robert Brauneis, and both the prior Dean, Michael Young, and the then acting Dean, Roger Trangsrud. They recognized the idea as an implementation of a recently formulated curriculum objective for the Law School—to make “intellectual asset management” a field of study in the School. In line with a commitment to the best of academic curricula in Intellectual Property, they were also thinking of the subject matter as an example of the changing roles and new knowledge that were becoming critical in modern corporations and enterprise.

Our practices—and the learning from years of counsel and consultation with big and small clients as well as executives and attorneys engaged in the day-to-day struggle to build their businesses or protect their rights or valuable intellectual capital—provided not only a unique body of experience, but also taught us many of the lessons in this book. Many organizations and individuals have contributed to our work. To them we would like give our recognition.

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Note

1. *Intellectual Asset Management/IAM Magazine*, a professional journal published in London, England.



Introduction

THE BRIEF HISTORY OF INTELLECTUAL CAPITAL STRATEGY

Intellectual capital is the sum of everything everybody in a company knows that gives it a competitive edge.

—THOMAS STEWART

This book is about the strategic deployment of intangible, intellectual capital assets for enterprise purposes. As such, it is a book about strategy at the highest levels.

It is also a book about the law, and in particular intellectual property law, and, because so many intellectual capital assets are created by the law, it is about the critical new role that intellectual property law is playing in shaping modern corporate and enterprise strategy.

Finally, it is also a book about the new synthetic discipline of “intellectual asset management” that has emerged since the 1990s within the worlds of corporate strategy, brand management, finance, economics, and intellectual property law.

As an up-and-coming discipline, much of the early thinking has been so new and proprietary that it is still often only in the hands of elite consultants working with large corporate clients. As a result, only a small portion of what is available speaks to small or mid-sized enterprises or to nontechnology-based industries. Most entrepreneurs and companies have had little or no access to this important body of knowledge and the knowledge management techniques and strategies that are producing so much competitive advantage and wealth in industry.

With its brief history, those who have published on the topic of intellectual capital strategy in its many forms have been either providing commentary on a particular promising development, such as patent licensing, or locating the subject matter with regard to individual established disciplines, such as traditional intellectual property law or corporate strategy. The few that have espoused methodologies or techniques of management rarely give any theory that could be applied in other situations. During the early years of intellectual asset management, these approaches, based on the unique circumstance of each enterprise, were inevitable and necessary. However, as the management of intellectual assets becomes more central to all enterprise strategy, an updated approach is necessary to advance and establish a theoretical basis for the discipline, and to articulate the practical know-how that permits some or all of the theory to be put into practice.

This book endeavors to provide an updated approach to the entire theme of enterprise strategy. It redefines the scope of the subject matter to include an expanded range of intellectual assets and to move well beyond the early focus that has been limited to patents and technology, thus providing a more balanced approach. It provides strategic know-how for corporate executives, brand managers, general counsels, and IP attorneys in both large and small companies, and across an entire range of industries.

The book's material emerges from the overlapping worlds of strategy, finance, economics, and law to provide a high-level introduction to intellectual capital assets, their strategic deployment for enterprise purposes, and their increasingly central relevance to decision-makers and professionals.

Fundamentally, this book is based on the premise that, in enterprise, the future belongs to those who are most adept at leveraging intangible, intellectual capital assets as the new means of economic production – and that this new knowledge needs to become broadly understood and widely practiced by executives and managers in business, attorneys, and perhaps intellectual property lawyers, in particular.

THE IDEA OF THE BOOK

Writers are really people who write books not because they are poor, but because they are dissatisfied with the books which they could buy but do not like.

—WALTER BENJAMIN

The role of intellectual capital in driving the market capitalization of public companies and creating vast, often exponential wealth, in the global economy has become increasingly clear since the early 1990s.

Simultaneously, the topic of intellectual capital has become more central in strategic planning discussions throughout the world of enterprise, often eclipsing discussions on traditional assets such as natural resources, real property, and labor. Strategy always concerns itself with maximizing benefits from the assets with the greatest potential. Today, those assets are rapidly changing from the traditional physical assets to the intangible, intellectual capital assets such as brands and the technological advances embodied in intellectual property.

In the last thirty years, the asset base of capital markets in the U.S. and Western Europe has increasingly shifted from the predominantly tangible assets that have characterized the value of companies since the beginning of the Industrial Revolution, to intangible assets. With this shift, many companies have discovered that they have enormous value and investment in intellectual capital assets, such as their patented technologies and famous brands, and that these assets can be used to deliver strategic advantages. Accordingly, intellectual assets have emerged to become a major factor in the development of enterprise strategy and the high-dollar valuation of modern companies.

Despite this shift in the asset base, and while most executives and professionals understand the need to manage their traditional physical and financial assets, the same is not true for all companies when it comes to intangible assets. Thus, understanding these intangible, intellectual capital assets, their dynamics, the strategies by which they are leveraged, and their role in our increasingly knowledge-based global economy, has become a critical success factor for corporations, the executives and strategists who lead them, professionals, and the attorneys that represent them.

To rise to this challenge and successfully manage these assets, executives and board members, general counsels and intellectual property attorneys, managers, financial analysts, and investors must master the new role of intellectual capital in corporate strategy and, importantly, because so many of these assets *are creatures of the law*, the new centrality of the law in formulating and executing most intellectual asset deployments.

Hence, this book is intended to present the increasingly exciting and important world of intangible intellectual capital assets, provide historical background, much needed theory, and a practical approach to managing

these intellectual assets within the contemporary strategic landscape of business and enterprise. While much has been written since the early 1990s about the discovery and promise of intellectual capital assets, little attention has been paid to laying solid theoretical foundations, identifying important causal relations, and establishing the basic principles for the management of this new valuable class of intangible assets in their many forms and combinations.

The mission of this publication is to enable strategic thinking with such assets by providing a fundamental view of intellectual asset management, inclusive of: (i) a more simplistic orchestration and presentation of its theory and practice, (ii) comparison and contrast of the differing practices that are already in use in the management of either the traditional or the new intellectual capital assets, (iii) actionable know-how with recent examples that can be applied in other situations, (iv) a multidisciplinary approach to the subject matter with recent thinking from economics, management, finance, strategy, and law, (v) a vision of the necessary relationship between intellectual property law and corporate strategy, and (vi) explication of the innovative new strategies that are being used successfully by many companies to deliver competitive advantage and create wealth with intellectual capital assets.

By and large, this book surveys the entire range of intellectual assets and reveals important principles about their nature and relationships. At the same time, it advances new economic theory about the shifting paradigm of the new knowledge economy and relating it to the development of business strategy with intangible, intellectual capital. The book delineates and contrasts the important differences between traditional physical assets and intellectual assets, with their unique dynamics, and suggests their impact on corporate financial statements and market capitalization.

Moreover, while mapping a vast range of strategic opportunity for strategists and entrepreneurs, these new intellectual capital assets are fraught with often unrecognized ethics issues. The authors of this book introduce *countervailing public policy analysis* as a tool for unpacking the ethical issues surrounding the strategic deployment of intangible, intellectual capital assets. While disagreements about the morality of markets, business activities, and strategies will no doubt continue, the authors submit that the espoused use of the countervailing public policy analysis of intellectual asset management strategies provides a reasoned technique for framing arguments about intellectual assets and arriving at moral judgments.

And finally, this work advances important thinking about the future of intellectual capital and identifies the need to revisit strategic thinking *per se* to remake it as a daily reality in our world. When considered against the backdrop of progress realized during the Industrial Revolution when tangible assets were optimized through invention and manufacture to generate vast wealth, one can barely imagine at this stage what accomplishments an era of intellectual capital could bring. Yet, one can imagine that as strategists begin to deploy the new intellectual capital asset base, its present nascent ability to create new wealth will achieve a greater scale than previously thought possible.

As we go forward, we will explore the many faces of intellectual asset management, the diversity of activities that fall within its realm, and the diverse persons and tasks that, whether we all realize it today, are a part of intellectual capital strategy. With a reading of this work, one can hopefully and profitably apply the tools available to aid in the practice of intellectual asset management. Significantly, and for the future, this treatise on modern strategy moves beyond many previous publications to introduce the new partnership between knowledge workers and information in innovation-based enterprises, between strategy and the law, and between corporate executives and attorneys, and, further, to demonstrate why that relationship is so critical in capturing and effectively deploying intellectual capital assets. In this respect, the authors hope that it will be of assistance to all knowledge workers in understanding their role, to corporate executives in understanding how to productively use their legal counsel at the highest levels of strategic planning, and equally essential to attorneys and intellectual property advisors in setting the stage for bridging insights that are necessary for them to play a new role in strategic thinking and enterprise success.

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PART ONE

The New Field of Play



The Rise of Intellectual Capital and the New Economy

THE CHANGING ECONOMIC LANDSCAPE

Tis not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change.

—CHARLES DARWIN

Since the beginning of the 1990s, there has been a tremendous increase in economic activity in the United States, Western Europe, Asia and other parts of the world. Mergers and acquisitions, the Internet, globalization, and complex new financial vehicles emerged and forever changed the economic landscape and the course of enterprise. In retrospect, we can see that this confluence of factors worked together, and on each other, to shift our entire worldview and socioeconomic paradigm, and consequentially, created a new economic climate.

Prior to that, toward the end of the 1980s, growth had become more difficult to achieve within many industries. The traditional strategies of scale and scope that had fueled consumption and ensured new levels of market penetration from the previous decades were losing their luster and ability to drive expanding revenues. To deliver earnings, many corporations had to focus on delivering bottom line improvements through efficiency and cost-reduction approaches. In the absence of revenue growth, profitability and bottom-line growth became the targets of the day for strategic thinking. Downsizing, right-sizing, cost-reduction, operational management, quality control, and operational effectiveness strategies became *du jour*.

Many markets began to show the first signs of topping out and, by that last decade of the twentieth century, consumption began declining and became unsustainable in some traditional growth markets, such as consumer products and automobiles. For early pundits, it was the beginning of the end of the “industrial paradigm” as some businesses with declining performance struggled to make their quarterly earnings release “numbers” for Wall Street. Fortunately, there was time and opportunity for growth in filling out and maximizing distribution or in developing new products, but an end was in sight. Throughout the decade, many markets slowed, consolidated, declined, and even disappeared along with the companies that served them.

It wasn’t that economies of scale were no longer relevant—they just lost their competitive advantage as they were easily copied by competitors. In hindsight, it was time for new ideas and new strategies. For the corporate world and the financial markets, the objective of growth remained—what changed forever was how it would be achieved. Industry, the corporate world, and public companies found it hard to achieve the continual growth required of their enterprises by Wall Street in what was increasingly becoming saturated and exploited markets.

At this time, an important new growth strategy emerged and had the effect of consolidating markets and providing growth. With its promise of new growth, it became the darling of CEOs. The thinking was: If growth through new or expanded consumption was becoming harder to deliver, why not own a greater share of any respective market by acquiring competitive or related players? Even though the market was not growing at a dynamic rate, an enterprise could deliver vibrant growth to investors by owning more of the market.

Simultaneously, a new financial vehicle arose to drive the new strategy. The idea of “stock-driven” acquisitions emerged, allowing acquisitions to be financed with cash and with the appreciated stock value of the acquiring organization. Suddenly, it was possible for a company to grow by leveraging its appreciated market capitalization or public stock value to acquire another company.

As the consequent tide of acquisitions rose, the concept quickly evolved to allow even “noncash” acquisitions to occur through a “pooling of the assets” of the acquirer and the acquired company. This made acquisitions

even easier to conceive, and hence, the history of the modern acquisition began.

THE NEED TO VALUE A NEW ASSET CLASS

—*Whose wealth, arithmetic cannot number.*

—PHILIP MASSINGER

Since the beginning of modern business during the Industrial Revolution, the primary measures of enterprise wealth were based upon traditional, tangible assets such as cash, financial capital, property, plant, equipment, inventory, and the like—the “physical and financial assets” of an enterprise. Unexpectedly, during the early 1990s, a subtle shift in this ruling oligarchy of traditional assets became evident.

The rise in mergers and acquisitions brought new problems in reaching company valuations, setting acquisition prices, and accounting for the surrounding transactions. “Book value,” broadly the combined worth of tangible assets in an organization, and “market capitalization,” book value plus the value of intangible assets, were suddenly often widely variant numbers. Acquirers were putting up the value of their public stock to acquire companies, and acquired companies were asserting the value of their intangible assets to set the value of their company for acquisition. Unexpectedly, traditional approaches to valuing enterprises in mergers and acquisitions proved to be inadequate in addressing the new value and importance in acquisition candidate companies. This was attributed to “intangible assets” and previously underrecognized and unmonetized entities like “brands” and “intellectual property.”

As the decade gained momentum, these “intangible assets” that were not on balance sheets but were *de facto* recognized in the newly appreciated stock values that were driving acquisitions, swiftly emerged as primary sources of value and wealth in both the values of acquiring and acquired companies. Moreover, in the need to account for price paid and assets acquired, these newly accepted “intangible assets” began to be formalized variously as “intangible assets,” “intellectual assets,” “knowledge assets,” “knowledge-based assets,” and eventually, to encompass their

overlapping definitions, *intellectual capital* in juxtaposition to the tangible, physical assets of the balance sheet.

THE EARLY TERMINOLOGY OF INTELLECTUAL CAPITAL

When I use a word, it means just what I choose it to mean – *neither more nor less*.

—LEWIS CARROLL, *ALICE IN WONDERLAND*

When defining “intellectual capital,” one must articulate it with regard to a set of terms and phraseologies that are often confusingly similar, with each describing a dimension of intellectual capital as seen from a particular moment in history and from the perspective of a particular profession and its body of knowledge (see Exhibit 1.1).

“Intangible assets,” “intellectual property,” “intellectual assets,” and “knowledge-based assets” are discipline-specific terms that are often used interchangeably and synonymously to refer to what at its most articulate has become intellectual capital.

“Intangible assets,” also often known as “nonfinancial assets,” are accounting and financial terminology that predates the 21st century understanding of intellectual capital. Such terms are used by accountants and financial professionals to refer to the entities or factors of financial analysis that couldn’t be captured and reported in the traditional documents of financial reporting, such as balance sheets and profit and loss statements. Originally lacking the ability to be formalized within the traditional financial concepts, such “intangible” entities were often subsumed, if they were attended to at all—for accounting purposes under the term “goodwill” and placed on the balance sheet as such. Thus, until the turn of the 21st century, any monetary value attributed to brands and intellectual property was chiefly captured as goodwill.

“Intellectual property” has long been recognized in modern law as those ideas, inventions, processes, names, and creations that could be protected and asserted under the law as patents, trademarks, copyrights, and trade secrets. Since the European Renaissance, the economic and political significance of ideas and inventions has been acknowledged in some form or other, initially as business monopolies or commercial grants that were bestowed

by a monarch or nobility, and later, under the U.S. Constitution and legislation as patents, copyrights, and trademarks.

Near the end of the 20th century, it became clearer that intellectual property was a business asset as it had both economic and strategic significance. At that time, lawyers and managers referred to it in its strategic deployment as “intellectual assets.” Soon after, a new discipline referred to as “intellectual asset management” emerged. During the 21st century, intellectual asset management sufficiently formalized and became the topic of numerous scholarly publications, journals, seminars, conferences, and job positions in various corporations and enterprises.

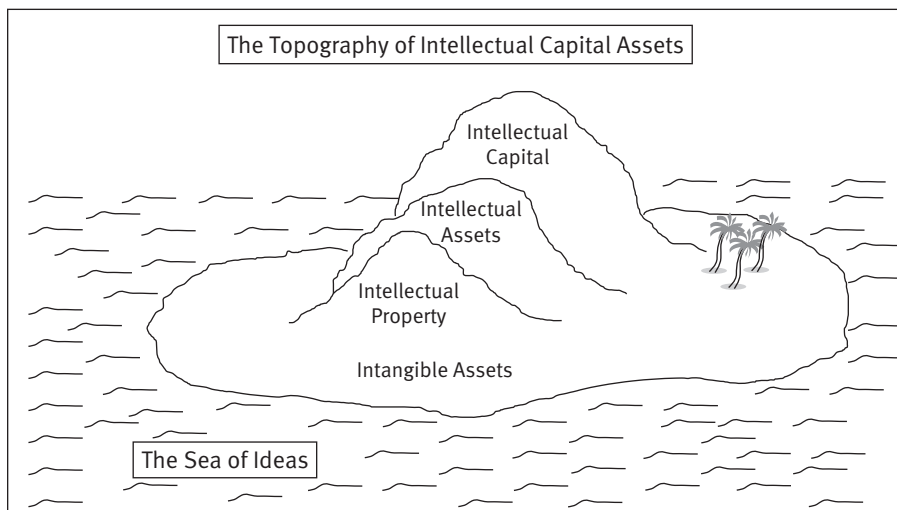
Simultaneously, economics and the emerging knowledge management and informational technology disciplines referred to intellectual assets as “knowledge-based assets.” As the production process for creating intellectual assets became increasingly codified, data was collected and turned into information, and then finally to knowledge, and thus “knowledge-based assets” became the operational term for increasingly sophisticated intellectual assets.

Strategically, and at the senior and executive levels within corporations, “intellectual capital” became *de rigueur* as the synthetic terminology used to refer to all the intangible, intellectual, knowledge-based assets that were being formalized for business deployment within society and that could be protected under the law. As a result, the “intellectual material” under study and to be identified, captured, formalized, and managed became known as “intellectual capital.”

Suddenly, *intellectual capital*,¹ a concept latent in the accounting language of “intangible assets” and “goodwill,” became broadly recognized as merger and acquisition (M&A) candidates negotiated final valuations and set their purchase or sale prices during the M&A boom that began in the early 1990s.

Prior to this time, the traditional measures of valuation had always been “book value” and some multiple of “times revenues” to reflect the likely immediate sales projections and the ongoing business of a company. However, companies facing acquisition increasingly negotiated enhanced valuations by asserting the worth of their “intangible assets.” Entities like

EXHIBIT 1.1

THE EMERGENCE OF INTELLECTUAL
CAPITAL ASSETS

brands, patents, intellectual property portfolios, and even knowledge and management talent were to be factored into purchase prices, especially if you were selling. In some sense the recognition and assertion of value for “intangibles” was an ordained response to the idea of purchasing another company with appreciated stock. The values tendered were circular, because both the appreciated stock to be used to finance an acquisition, and the appreciated value of the company to be acquired, were driven by the same capital market forces that were monetizing all intellectual capital assets.

Accordingly, as these assets soared in value, it became increasingly necessary to value this emergent class of intellectual capital assets in a formal and traditional accounting sense. Early methods to quantify these assets focused on financial approaches that set asset values through net present value calculations on future revenues, or approaches that, following the model of valuing tangible assets like real estate, tried to appraise the value of a respective asset. “The brand” was the first such widely valued intangible asset. The brand was generally seen as the symbol of the combined goodwill or intangible value of an enterprise, and the most immediate proxy for the amalgamated intangible value of an enterprise. Later, and in some

accountings of relatively brandless organizations, intellectual property assets often replaced the brand as the index of intangible asset value and of all knowledge-based assets *per se*.

By the mid-1990s, as brand valuations advanced under the early valuation models, it became clear that these assets possessed surprising levels of value, often values significantly greater than the physical and financial assets of the enterprise under study. What's more, in the aggregate, across the economy, they constituted an astounding proportion of the value of the greater economy.

THE SHIFTING ASSET BASE AND THE RISE OF THE NEW ECONOMY

Wealth is the product of man's capacity to think.

—AYN RAND

As the 1990s progressed, it became clear that intangible, intellectual capital assets were more important than originally thought, and in fact, were driving a stealth-like sea change in the U.S. economy that was not immediately perceptible.

From 1978 to 2004, the asset base of the Standard and Poors (S&P) 500 Index, regarded as a broad measure of the U.S. economy, shifted radically from 95% tangible assets to 85% intangible assets. The tangible and intangible asset bases flip-flopped from an economy based almost entirely upon tangible assets to an economy based progressively upon intangible assets. As this base shifted, intangible assets became worth, conservatively, two to three times the value of the traditional, tangible physical and financial assets.

This momentous shift in the asset base of the economy drove the emergence of a *new economy* that is based on intangible, knowledge-based, nonfinancial intellectual capital assets. This shift has a number of profound implications for business that will be discussed in this chapter and throughout this book. Foremost among them are:

- 1) The recognition that these new assets differ in kind, nature, and dynamics from the traditional assets.

- 2) That because these intellectual capital assets differ in kind, they are deployed under different economic principles.
- 3) That because these assets behave differently and find their optimization under different economic principles, they require new strategic thinking for their full deployment.

The simplest way to unpack these implications is by turning to the shift in economic principles and by looking at the primary differences between the two classes of assets. We can identify these contrasting differences with the following table that broadly displays the shifting economic principles by asset class and type:

Shifting Economic Principles	
Tangible Assets	Intangible Assets
1) Scarcity drives value	Adoption drives value
2) Wasting assets	Nondepleting assets
3) Nonvolatile	Highly volatile
4) Empirical knowability/control	Unknowability/incomplete control
5) Arithmetic growth	Exponential growth

With these characterizations, we can begin to understand why the management of intellectual capital assets is of such great concern in modern business and enterprise, and why strategy, as the rudder for all enterprises, must be *revisited*.

Assets and Wealth Creation

The primary distinction between tangible and intangible assets lies in their differing ways of creating value.

The value of tangible assets has largely been set in accordance with the assets' abundance or scarcity and their consumption or depletion. Under the traditional economy, the bases for wealth creation are a company's hard or physical assets such as raw materials, equipment, energy, and labor. These physical assets are finite in size and application. For example, diamonds and precious stones are considered to be of great value mainly because of their scarcity relative to other commodities such as wheat or

bananas. With tangible assets, scarcity drives value relative to consumption; that is, the more there is of a respective tangible asset that is desired, the less its value. Consequently, in traditional commodity markets, an overabundance of food crops generally results in a reduced value per any respective market quantity. For instance, if diamonds should ever be as abundant as dirt, we would have to assume that their value would drop to that of dirt.

However, the value of intangible assets is driven by their adoption and use, and because they are nondepleting, they can be used again and again without being consumed. Thus, where intangibles, such as know-how and information, are used to create wealth, these assets can be shared without being depleted and in fact increase in value the more they are used. Software, or a body of knowledge, can be deployed over and over and have their useful life subject only to being superseded by a superior knowledge-based asset or innovation.

Accordingly, the Microsoft Windows Operating System has become more valuable than any other computer operating system because of its broad, universal adoption. It would be worthless if only a few people used it, but almost everyone uses it. The more it is used, the more valuable it becomes. In this sense, intangible assets enhance their value by a mechanism that is opposite to that of tangible assets. Their value is increased through adoption, not scarcity, and the more abundant or in-use they are, the greater their value.

All enterprises create and hold such intangible assets, ranging from their trade name and valuable brands, to their patents, the secret know-how of their core competencies, or their strategic plans.

Leveraging Assets

Secondarily, each *class* of assets is leveraged in its own respective way.

With tangible assets, the primary economic leverage is in driving *consumption*; and it is in their being used-up that their economic value is realized. Whether it is coal or cars, tangible assets are “depleting” or “wasting away” and they are consumed in their economic deployment. You can only burn coal once.

Alternatively, intangible assets are neither consumed nor used-up through their use. They can be used over and over again, and are thus “nondepleting”

assets. While coal and cars decline in value from the moment of their creation, computer operating systems become more valuable with their abundant availability and ongoing use. In this case, use does not consume, but increases asset net worth.

Under the new economy of intangible assets, increasing the returns on investment is accomplished by sharing, partnering, collaborating, and forming alliances that has replaced the unequivocal silo-based competition of the traditional economy. Making proprietary software code available for the creation of expanded software libraries by third parties would have been 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 others like Apple Computer.

Analogously, 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 intangible, intellectual assets, adoption drives value, and prices can fall while profitability increases with market penetration. In some cases, such as Internet access or cell phones, providers have offered their product or service at low or zero cost to the customer to gain adoption, achieve critical mass, and to sell related services or supplies. Further, the rise of brands taught manufactures that market differentiation drove demand and that even commodities, like water, could be sold at a premium if they were tied to the right intangible assets (e.g., a powerful brand like PepsiCo's Aquafina bottled water).

Manageability

Importantly, tangible and intangible assets differ in their volatility.

Tangible assets are relatively “fixed” and certain. We know how many items we have in inventory. We can count them. We can see them. And with the partial exception of perishable tangibles, such as bread or fresh fruit, we wouldn't say that tangibles like books or cars are volatile. But intangible assets are extremely volatile. The value of the brand of a major company can plummet millions of dollars in a day based upon a negative news report that damages the company's reputation. And while news of a war can have a big effect upon global oil prices, it is because supply is affected and not because the underlying asset value has changed.

While tangible assets lack volatility, intangible assets can be extremely volatile and their differing volatilities directly link to their ability to drive varied magnitudes of value. Tangible assets are characterized as being capable of incremental or arithmetic growth, while intangible assets are characterized as being capable of exponential growth or decline. Hence, this volatility can be a mixed blessing.

A corollary to this point is the observation by economists and financial analysts that intangible assets offer the greatest opportunity to drive the creation of wealth in the modern world. Broadly, this is considered to be true because most tangible assets have been and are being fully optimized or highly exploited, while the exploitation of intangible assets has yet to fully begin. Strategies of operational effectiveness, scale and scope, have been in practice in the industrialized nations for decades unto centuries. Hence, in many cases, only finite levels of further optimization can be eked out of tangible assets. However, intangible assets are a recent discovery, and with their increasing formalization, the strategies that optimize their potential in many cases have yet to be discovered and are far from being fully exploited. A well articulated brand or a brilliant invention can be, exponentially, worth billions of dollars with successful commercialization, but each barrel of oil, even when it is highly inflated, still operates within an arithmetic and relatively narrow range of value fluctuation.

Further, this volatility or nonvolatility affects the ability to manage the respective intangible and tangible assets. Volatility impedes the ability to gain complete or full control of a respective intangible asset. Intangibles tend to shift under us when they are managed, and they always remain partially indefinable in our knowledge or deployment of them—they lack set limits.

However, we shouldn't imagine that there is a total schism between the two economies and their respective asset classes. Most companies will continue to have a lot invested in both kinds of assets, and will thus require the skills necessary to manage both kinds of assets for the foreseeable future.

Nevertheless, as the ratio of assets shifts toward intangible assets, new strategies and understandings are needed to build value and leverage the most valuable enterprise assets to provide sustainable competitive advantages and deliver new levels of enterprise value.

In many cases, this need for new, intangible asset-based strategies will be problematic because many managers and executives within today's organizations were taught during their careers to deliver growth and create value through the exclusive use of factories, working capital, products, and the specific traditional assets quantified on the balance sheet. Under the paradigms of industrialization and manufacturing that ruled in corporations throughout most of the twentieth century, strategic thinking was concerned with orchestrating functional disciplines,² developing process-based competencies, achieving economies of scale and scope, managing costs, perfecting vertical integration, and instituting ongoing incremental optimizations. Until the 1990s, such strategies of "operational effectiveness" ruled the corporate world and dictated the careers of managers and executives.

The strategic deployment of intangible assets is fairly new in the history of strategic thought, and, at this stage, often difficult to actually apply. Many of the individuals who built their careers within the traditional approaches to tangible assets lack the experience, understanding, and vision necessary to effectively shift into the era of intellectual capital assets. While they may be experienced at trimming one-tenth of one percent off the cost of goods sold in a manufacturing plant, they are often unclear on how to build brand equity, how to bundle and unbundle copyrighted media content, or how to enhance the strategic positioning of the enterprise in its markets and to drive market capitalization by utilizing patents in creative ways.

While the operational effectiveness strategies of the manufacturing era are still important and relevant to their respective tangible assets, individuals schooled within the manufacturing era often find it hard to develop strategic thinking that leads to the exploitation or leveraging of intangible assets. As a result, many managerial competencies are paradigm-specific, and the tangible asset paradigm does not easily embrace the intangible asset vision without a leap in thought, a shift in the perceptual gestalt, and the development of appropriate new managerial and leadership competencies.

Today's best strategic thinkers are those who are strategically "bilingual"—able to think in terms of strategies that ensure the optimal, effective leveraging of the traditional tangible assets, and simultaneously the highly differentiated strategic deployment of the new intangible intellectual capital assets.

HOW TO START MANAGING
INTANGIBLE ASSETS

Whether you believe that leaders are born or made, any enterprise and anyone in an enterprise can begin to better align their thinking and activities with the concepts expressed in this chapter. Here's how to begin:

1. Assess whether executive leadership is thinking strategically about intangible assets or if they are operating only under the traditional asset paradigm.
2. Take stock of where you are. Look at the current organizational structure and see if the brand or IP, and their respective functions, are integrated into strategic planning.
3. Encourage everyone to read and become more educated in the new ways of thinking that equally understand both tangible and intangible assets, and leverage each to achieve corporate goals.
4. Keep alert for opportunities to make intangible, intellectual capital assets a part of strategic thinking in your organization.

Concurrent with the above-mentioned manufacturing paradigm, there is also a theory of corporate organization that often locates responsibility for what are now beginning to be recognized as intellectual assets within separate functional discipline silos.

Within corporations or large organizations, assets are assigned to levels of leadership and responsibility according to their value and strategic significance, with the strategic direction of the most valuable enterprise assets being trusted to the executive levels of management that form overall corporate strategy. Therefore, as intellectual capital emerges, functional disciplines, such as the marketing and legal departments that have traditionally held responsibility for the brand and intellectual property, find their roles changing to reflect the new, greatly increased value and strategic significance of their assets.

However, functional disciplines often lack the strategic orientation that is appropriate to the management of valuable intangible assets. Such functional disciplines, often originally defined during the manufacturing era, are regularly unable to rise to the level of responsibility required for the

executive management of intangible assets. Therefore, under the emerging intellectual capital paradigm, these assets that are actually or potentially the most valuable assets of the organization, are becoming the responsibility of executive management, the material of strategic planning, and the new *means of production* that even replaces traditional manufacturing.

For example, in the past, an asset that is today as valuable as a brand, was once the sole responsibility of the marketing department and was treated as a mere tool of the marketing “discipline” and an instrument of a specific marketing strategy. Today, with brands in very large companies valued at billions of dollars,³ “the brand” has become the responsibility of the CEO, the newly titled C-suite “Chief Marketing Officer,” and often the entire executive leadership team.

Another example is that of patents. In most technology-based companies, the intellectual property portfolio consists of technologies, trade secrets, know-how, and patents. In the past, these holdings were viewed as matters of law and title, and thus safely administered within the legal department which played a “strategic” role in the business only when there were significant matters of infringement, wrongdoing, or contractual arrangements, such as licenses or joint venture agreements.

Today, traditional intellectual property management departments often experience an identity crisis as the objects of their administrative activities become the substance of the new intellectual capital strategic thinking. As the focus at the levels of strategy formation shifts from tangible to intangible assets, General Counsels, Vice Presidents of Intellectual Property, and Chief Intellectual Property Officers are often called to play new strategic roles within their organizations that go beyond their normal functional role competencies of filing, prosecuting, maintaining, protecting, litigating, and reporting on intellectual property.

As a brand or intellectual property portfolio (as portrayed in Exhibit 1.2) is deployed anew as intellectual capital, and under the leadership of top corporate executives and for strategic purposes, we see the materialization of a new discipline of *intellectual asset management* (IAM) emerge cross-functionally among the executives and practitioners atop all of traditional functional areas and professions. This new body of thinking assumes the burden to straddle both the worlds of the root functional disciplines (e.g., marketing, IT, R&D, and law) and the strategic world of executive responsibility.

Because corporate strategy is not formed at the level of functional area management, this is where the matter of vision and leadership comes into the

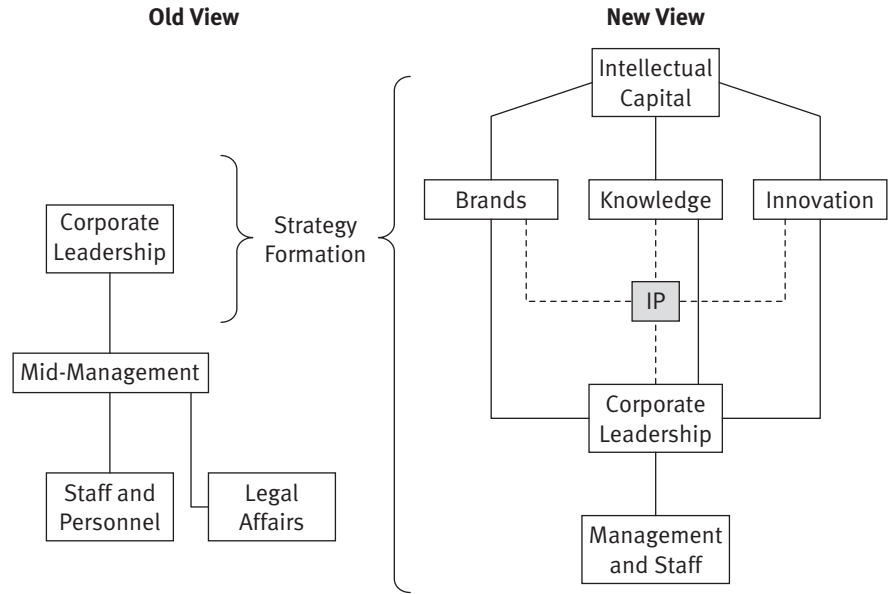


EXHIBIT 1.2

THE NEW STRATEGY PICTURE

successful strategic positioning of intangible assets within an organization. Intangible assets are rarely handled in a strategic manner by mid-management or personnel within a company. Intangible assets are strategically positioned only in the persons of the CEO, the Chief Marketing Officer, the Chief Intellectual Property Officer, and the like, and only when they realize the strategic connections between the respective assets and the planned results for the company. It is only in the hands of individuals at this level that intangible asset matters are on the table as strategic assets, and the expertise is present to form the appropriate enterprise strategy. Thus, the adoption of intangible asset strategies at the top of an organization is less a function of the theory or practice of functional disciplines *per se*, and is more the direct result of the ability of those persons who have a seat at the strategy table to think strategically within the new paradigm of intellectual capital and to deliver on key corporate objectives.

We may marvel at the purported degree of market capitalization that is now driven by intangibles in the public markets. We may agree that these intellectual capital assets are of the greatest significance and strategic importance to an enterprise. But in the end, it is those persons that have

the vision and the responsibility to embrace the new paradigm (e.g., to build a lifestyle brand, to leverage a patent to create a new revenue stream, to gain adoption for a new technology, or to create a merger around copyrighted content and to form the strategies), that will turn intangible assets into competitive advantage and profitability.

Thus, the strategic positioning of intangible assets depends upon both the knowledge of how to leverage intangible assets, and, of equal importance, upon intangible asset leadership at the executive level.

We may hear of the savvy CEO who makes intangible assets a plank in their strategic platform, or of executives who know what the intellectual asset manager knows and bring it to the strategy table, but on the whole, the thousands of organizations in the world will begin to create and leverage their intangible assets only when those with the vision of the new paradigm have assumed the responsibility to lead at the top and form those strategies that successfully leverage intangible assets, turning them into intellectual capital.

BECOMING AN INTANGIBLE ASSET LEADER

The intangible asset leader does the following:

1. Studies the history of strategy, understands, and can articulate the differences between industrial/manufacturing era strategies and intangible intellectual capital asset strategies.
2. Thinks strategically about the central problems of the enterprise.
3. Advances and defends strategically sound strategies that use intellectual assets when they offer a superior solution.
4. Gets involved in strategic planning and joins the strategic conversations within the company.
5. Grows out of functional discipline management into executive leadership.

Today, driving enterprise value, market capitalization, or stock price means both fully optimizing tangible assets and “strategically” leveraging

intangible assets. Hence, assuming that the tangible assets in most successful organization are already highly optimized and being effectively managed, the greatest strategic and financial impact can be accomplished by leveraging the intellectual capital assets of the organization.

THE SIGNIFICANCE OF INTELLECTUAL CAPITAL

The industrial laws of gravity are being supplanted by rules dictated by knowledge . . . old value chains will break or become obsolete.

—LEIF EDVINSSON

As suggested earlier in this chapter, “the brand” was just the first among an ever broadening range of intellectual capital assets that have emerged since 1991 to drive the development of business and to provide economic growth. Early, in the recent history of managing intellectual capital assets, the problem was to identify, capture, and make such assets operational in business activities. By the turn of the 21st century, it had become clear that all intangible, intellectual, knowledge-based assets were intellectual capital assets, and the challenge was to deploy such assets effectively against strategic ends.

Ultimately, the driving factors in the discovery of intellectual capital assets were twofold: the need to drive consumption in saturated markets and the need to derive new sources of competitive advantage in increasingly homogenized markets. But, as the new assets were discovered and put to work, a new horizon of potential wealth beyond that developed with physical assets appeared. It became clear that the new class of intellectual assets was but the beginning of a shifting paradigm and a previously unimagined new world. While physical asset wealth and markets were becoming saturated, the promise of new wealth made possible by intellectual assets suggested new possibilities beyond consumption *per se* and the traditional scale and scope models of competition. To many, it seemed that the rules of the economy and the principles of how an economy works were being turned on their heads. Under industrialization, physical assets and the ownership of the means of production determined who had or did not have wealth, but with intellectual capital assets, the main social

and economic distinctions for enterprises and individuals were becoming the distinction between those who possessed know-how and those who did not.

Of course, in the end, the real significance of intellectual capital is that it is the discovery of *a whole new class of assets* that can create value and immense wealth. The emergence, recognition, and ability to manage intellectual capital have repositioned the strategic significance of all the intangible assets included within this new concept of intellectual capital. Intellectual capital has reframed the value and opportunity for brands, knowledge, and intellectual property to drive innovation, provide competitive advantage, and to create equity while delivering shareholder value. In this sense, the rise of intellectual capital has also shifted the focus of strategy in all business and enterprises going forward.



Notes

1. An intangible asset that cannot be physically touched that provides a competitive advantage or confers enterprise value, such as a strong brand, enterprise reputation, intellectual property, or employee know-how.
2. “Functional disciplines” is a human resource term that is used in corporate management to refer to the various functional specializations, such as “marketing,” “finance,” and “operations,” that are necessary for the operation of a business or company.
3. Coca-Cola, the most valuable brand in the world, was recently valued for *Business Week* magazine at \$65.324 billion in 2007.



The Theory of Intellectual Capital

WHAT IS INTELLECTUAL CAPITAL?

The importance of intangible assets is magnified by the fact that they (are) dominant in every well-run enterprise across virtually all business sectors and in every major industrial country.

—BARUCK LEV

Tom Stewart, in an early article in *Fortune* magazine that explored the appearance of intellectual capital assets, defined the new concept with reference to the then “new economy” as:

. . . The new economy is about the growing value of knowledge as an input and output, making it the most important ingredient of what people buy and sell; it is about the rise in the relative weight of intellectual capital vis-à-vis real estate, plant, and equipment, and financial capital; and it is about the development of new techniques and technologies to manage and measure knowledge materials and assets more effectively.¹

This early definition defines “intellectual capital” as “knowledge.” We all know, at least implicitly, what knowledge is. Many will think of “scientific knowledge” or even “information technology” and their outputs such as pharmaceuticals or software. Operationally, and for its strategic deployments, intellectual capital can be thought of as falling within the following specific categories:

- 1) The Brand, being a significance and an identity conveying the values and meanings of an enterprise, its products and services, and ultimately its role with the customer, consumer, and society.

- 2) Intellectual Property, including trademarks, copyrights, patents, trade secrets, licenses, and intellectual property strategies.
- 3) Corporate Intellect, the intelligence, energy, and creativity of the organization, including knowledge, know-how, trade secrets, information, and data.
- 4) Corporate Culture, the organization's way of doing business, its rituals, its practices, its history, "corporate memory," and its social and cultural capital.
- 5) Human Capital, the people, with their education, ethical character, abilities, talents, and relationships.
- 6) Innovation, the work product of knowledge workers, and the ability to invent and take products and services to market.
- 7) Goodwill, the residual intangible, intellectual value in an enterprise that hasn't found its proper classification as either a tangible or specific intangible asset.

While each of these categories enjoys high levels of strategic significance in the modern enterprise, the primary intellectual capital drivers, across all companies that can be immediately accessed and managed strategically, are the brand and intellectual property. We will address the nature of the brand in the following pages, and the nature of intellectual property in the following chapters.

THE POTENTIAL PRIMACY OF THE BRAND

The word makes a thing what it is in its naming.

—ATTRIBUTED TO MARTIN HEIDEGGER

The brand can be viewed as the primary point of leverage for both enterprises and intangible assets because it offers the greatest possible degree of leverage and orchestration for other individual intangible assets.

Specifically, the brand can act to organize the individual meanings of various intellectual assets, orchestrating them into a meaningful whole, giving them recognizable significance, and can act as the ultimate end for all of the intellectual assets in an enterprise by leveraging them most highly. By themselves, individual intellectual assets, can be, for example,

licensed or sold to others, but in the world of business, they are procured to be part of a product or service that is most successfully taken to the market under a brand. The brand, among all intangible assets, has this unique, synthesizing ability.

Exhibit 2.1 portrays the brand as the *ultimate intellectual capital asset*, and also the ultimate *raison d'être* for all of the other forms of intellectual capital. From this perspective, each form of intellectual capital, such as a patent or an innovation, may exist unto itself, but only when it is organized toward the end purpose of a brand does the individual asset become optimally leveraged and commercialized.

Thus, for example, the intellectual property that comprises a technology could be leveraged by being out-licensed to another company for that company's business purposes, netting a royalty stream. It would, however, be most highly leveraged comparatively, by the company that takes it to market under its brand.

The brand, when well articulated and strategically positioned in its market as a complex identity replete with multiple meanings, acts through its dynamic to assemble and leverage the intellectual content within a particular company. It does this by *distilling* the individual intellectual assets within an organization into what the enterprise stands for in its

The brand is an end in itself. It is the ultimate intellectual capital asset and the reason for being for all other forms of intellectual capital.

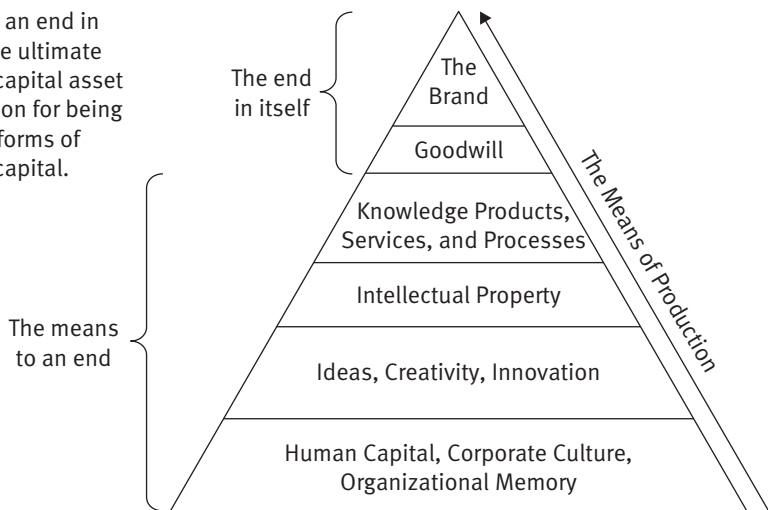


EXHIBIT 2.1

THE BRAND AND INTELLECTUAL CAPITAL

world and into that which makes the company different and so confers the greatest competitive advantage upon the enterprise. The brand may therefore be seen as an end in itself while all other intellectual assets are merely means to that end.

Nevertheless, because well-managed brands are constantly developing and adjusting to their times and changing market opportunities, it is important to recognize that they are always distilling new meanings and articulating new significances for their respective enterprise. Periodically, they may reach the peak of what they can say or do for an enterprise and can appear to be fixed in time. But at the same time that a brand *distills*, the brand may also be seen as a *distillate* of all the intellectual content of an enterprise. However, because strategically managed brands are constantly changing, it may be most helpful to imagine brands as always *becoming* and constantly distilling intellectual content. Thus when the brand is viewed as the *raison d'être* for all other forms of intellectual capital, its dynamic provides the fundamental theory for achieving a highly leveraged state of affairs with intangible intellectual capital assets.

THE NEW FINANCE OF INTELLECTUAL CAPITAL

None of us really understands what's going on with all these numbers. . . .

—DAVID STOCKMAN

Historically, and by the end of the 20th century, viewing “the brand” as the primary intangible asset was just the recognition of an ever-broadening range of intangible, knowledge-based intellectual capital assets. At the same time, the financial prospects for these assets began to take shape in the minds of those who saw how these assets could be exploited to drive enterprise valuation and performance.

As intangible assets became progressively more formalized for strategic purposes, the basic theory of business valuation changed to incorporate the new class of assets and to reflect that the financial value of an enterprise is composed of *both* (i) its traditional physical and financial assets (commonly reported on the balance sheet), and (ii) its intangible assets (rarely, or only

The Identity Theorem

$$\text{Corporate Valuation} = \text{Market Capitalization} \left\{ \begin{array}{l} \text{Intangible Assets} \\ + \\ \text{Book Value} \end{array} \right.$$

EXHIBIT 2.2**THE BASIC THEORY**

partially reported anywhere), and that the two result in the market value of a company as tracked on the various financial exchanges. This combined financial value is stated by the market as the “market capitalization” of a company. (See Exhibit 2.2)

Importantly, with the rise of a new class of intellectual assets to be leveraged comes the realization that each asset class would be best leveraged in its own way. Traditional physical and financial assets are leveraged according to a kind of pre-Einsteinian “financial physics” that is appropriately driven by the fundamentally mechanical nature of the means of production as developed and optimized during the industrial revolution. Under the new economy, the “physics” of assets change as they become knowledge-based assets, and some of the long-standing rules turn on their heads. Instead of scarcity driving the value of Microsoft’s Office software as it does De Beers diamonds, omnipresence drives its value. The economic principle of the “less there is the more valuable it is” that drives tangible assets becomes “the more there is the more valuable it is” for knowledge-based assets where *adoption drives value*.

Chief executives, financial officers, and strategists alike are all awakening to the hitherto untapped opportunity to create and leverage intangible assets for the most strategic business purposes. While there are many objectives at various times in all enterprises, the most strategic consideration is the “strategic positioning” of the enterprise to ensure success in its endeavors and its perpetuation. For most enterprises, that comes down to enhancing competitive advantage and positively driving market capitalization or enterprise valuation with the assets of the undertaking. For our purposes, these are considered “the highest objectives” of any company or enterprise.

Financially, and in all cases, there are tangible and intangible assets. Each has its fundamental principles that dictate its dynamic and rule how it can be leveraged. Primarily, tangible assets are leveraged under the rule of *efficiency*, and thus their highest leverage is that of total efficiency or perfect economy. A company runs the plant twenty-four hours a day and thus fully leverages the physical assets of plant, property, and equipment. Even an operations executive *extraordinaire* couldn't get any more out of the plant than twenty-four hours in a day.

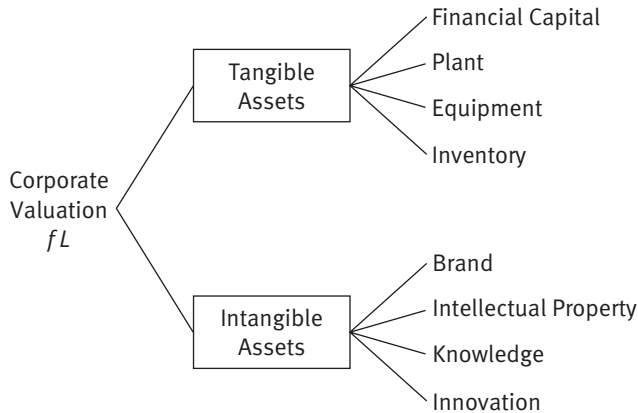
Intangible assets, leveraged under the rule of *adoption*, achieve their highest leverage through *use*, or to use a technological euphemism from the early days of broadband—to be “always on.” Google, for instance, makes its search engine's software available to all comers for free and successfully sells search-related advertising because it has the greatest usage. Its free adoption is leveraged *higher* than other search engine players, making it the industry leader.

Thinking strategically with these new assets requires a new logic and presents challenges for decision-makers at all levels. As tangible assets on the balance sheet are optimized, they offer less opportunity for growth. At the same time, intangible assets are largely underleveraged and present abundant opportunity for deployment. Therefore, the logical, strategic thing to do from the perspective of finance is to spell out each intangible asset, benchmark the respective asset, set its performance metrics, and ensure that each asset is highly leveraged. Doing just that with the tangible assets is how finance gave us our modern day economic success.

Yet, many corporate executives find it a challenge to spend their time learning how to create new value for their organization, build equity, and deliver growth and value for investors with these new intellectual assets. Of course, ultimately, driving market capitalization and increasing stock valuations means optimizing and leveraging *both* tangible and intangible assets, but the focus of opportunity today is with the intangibles.

Exhibit 2.3 presents an exploded view of the primary traditional tangible and intangible assets and thereby suggests the primary opportunities for enhancing leverage.

Most modern successful enterprises have barely begun to leverage their intangible assets to drive their valuation. Thus, we have both the opportunity and the problem of gaining expertise with this new class of assets. Assuming high leverage for all tangible assets, we focus upon the segmented


EXHIBIT 2.3 LEVERAGING ASSETS

map of the intangible assets. All intellectual assets are not equally developed; to date, brands and intellectual property have received the greatest attention and acclaim.

THE NEW ECONOMY AND THE SHIFTING PARADIGM

Knowledge is power.

—FRANCIS BACON, *MEDITATIONES SACRAE*, 1597

The “New Economy” is an expression that refers to the shift from the economy based upon industrial manufacturing and material assets, to one based upon knowledge and intangible assets.

During the 1950s and 1960s, Peter Drucker, the twentieth-century founder of the science of management, legendarily defined the new economy as an “. . . economy within which people work with their brains instead of their hands, and *knowledge workers* are paid to think.” Thus the phrase “knowledge workers” entered our lexicon to describe the then emerging new kind of worker Drucker was discovering in the most advanced corporations.

Importantly, as the economy changed to favor companies that leveraged the power of ideas and innovation to create new value, “the means of

production” shifted to intangible assets and operated under new economic principles. To reiterate, these new assets differed in important ways from the traditional assets. Their nondepleting nature meant widespread use drove value. This alone opened the doors to a new understanding of competition. The traditional economy was characterized by “silos” between businesses and between the functional disciplines within businesses. The new economy, while no less competitive, embraces cooperation and even alliances among “competitors” and the leveling of silos between functional disciplines. Now, once unorthodox arrangements such as standards groups have been transformed into a form of beneficial competition through the counterintuitive alchemy of “*adoption, not scarcity, drives value.*” Under the shifting paradigm, once siloed competitors find it more profitable to share patented technologies through “cross-licensing” for collective use, as opposed to excluding use by others as done in the traditional use of patents. The following chart portrays the dynamics of three key factors that arise with the new economy in virtue of the differing natures of tangible and intangible assets. Considering the contrasts between the two economies, and the tangible and the intangible assets that lie behind their performance, we can quickly see how the shifting paradigm accounts for the need to *revisit* strategy.

The Shifting Paradigm		
Economic Factors	Traditional	
	Economy	New Economy
Wealth Creation	Capital intensive tools, materials, energy, labor Traditional assets with arithmetic growth	Knowledge, technology, and its management Intellectual capital and exponential growth
Competitive Advantage	Invention, capital investment, industry	Ideas, innovation, creativity
Economic Ethos	Competition, silos	Cooperation, alliances

Taking each of the economic factors one at a time:

Wealth Creation Wealth creation under the traditional economy implies the investment of structural capital into frequently substantial capital-intensive tools. These tools take the form of property, plant, and equipment

and necessitate the deployment of materials, energy, and labor to manufacture products or services. If successful, these products or services accumulate wealth in an arithmetic fashion driven by their units.

Under the new economy, wealth creation requires that capital be invested in “brain power” or human capital, and in the use of technology to allow networking, calculation, collaboration for innovation, and rapid work product generation. If successful, these knowledge products and services, driven by their usage, accumulate wealth in a frequently geometric fashion.

Each asset base delivers a substantially dissimilar level of wealth accumulation, as Exhibit 2.4 demonstrates. It portrays the exponential explosion on intangible asset valuation that gained notable momentum at the beginning of the 1990s. The “market premium” layer that is displayed in the chart may be understood as an index for the awakening awareness of intangibles and their appreciating value by Wall Street and investors, at least in the U.S.

Viewed from the perspective of wealth creation, *the brand* provides a classic demonstration of how, when it comes to intangible assets, *adoption drives value*. In contradistinction to the traditional law of supply and demand, where *more is less*, brands increase in value as positive brand awareness develops around them. Famous, highly regarded, and broadly adopted brands command premium pricings for their products and services. These brands create demand among consumers who want to buy

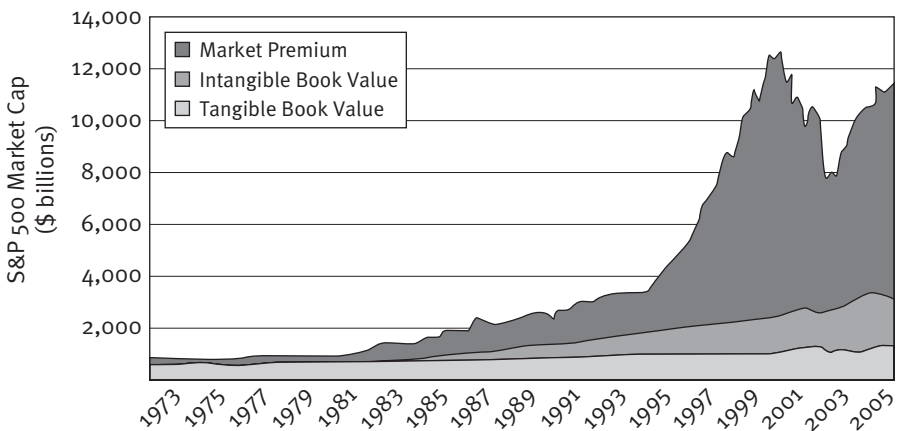


EXHIBIT 2.4

COMPONENTS OF MARKET CAPITALIZATION²

the offering, thus acting to “pull” branded products or services through the market, thereby delivering enhanced gross margins.

The spate of partner and ingredient identification programs that have proliferated in technology and the food and beverage sectors speak to the value that 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” or special ingredients be identified by original equipment manufacturers (OEMs) and product manufacturers, creating vast amounts of added wealth for both licensees and brand owners.³

The concept of identifying components to the consumers of end-products has revolutionized sales within many industries, creating *pull* for components or ingredients and driving sales in a way probably not possible with the “push marketing” strategies largely employed by OEMs. Traditionally, OEM products are “pushed” through the market with deals and discounts to encourage consumption when there is no market demand from consumers. However, strong brands such as Intel Inside, create demand or “pull” for OEM products into which they are incorporated.

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

Economic Ethos The economic ethos has also shifted with the emergence of the new economy.

Within the traditional economy, limited resources and the law of supply and demand created management and operating silos within organizations as well as exclusionary practices between competitors that drove competition for scarce resources and customers in both business and economic systems. Patents and copyrights were collected and stockpiled and used primarily to maintain monopolies and to exclude others from their practice. Licensing core technology to competitors was the exception rather than the rule and ideas and information were hoarded.

Within the new economy, players within industries have increasingly set aside basic competitive instincts to pool knowledge and intellectual property and to form consortia intended to create industry standards that ensure mutual benefit and overall industry growth. The battle between Betamax and VHS for the “industry standard” during the 1970s taught

many players that when it came to intangible assets, the competitive model of the traditional economy could mean that even winners (VHS) could be 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 unable to realize their growth potential. Under the new economy, whenever intangibles are significantly involved, cooperation between competitors allows them to compete more effectively.

Competitive Advantage Viewed from the perspective of competitive advantage, the worldview shift from old to new marks the distance between strategies of “invention” and the old tools of “access to capital” and “capital-intensive investment.” These tools conferred the achievements of *scale and scope* during the manufacturing era. In the new technology-based era of continuous invention or “innovation,” it is creativity, and ideas that can provide the marketplace excitement of “the new.” and hence the competitive advantage of “differentiation” in the marketplace.

Classically, “invention,” as supported by exclusionary intellectual property protection, coupled with the capital necessary to support business *scale and scope*, provided organizations with substantial balance sheet assets and their competitive advantage. Scale generally meant a large manufacturing capacity, and scope meant breadth of business undertaking or that the enterprise was multidivisional. To be an industry leader and to have a large portfolio of business undertaking was to fulfill the ideal.

Under the new economy, “innovation” replaces “invention,” and competitive advantage is achieved through *differentiation*. As the competition is for knowledge, competitive advantage is provided by having and leveraging knowledge as the new means of production.

The same is true for each of the classical topics of competitive advantage. There is a whole selling paradigm that equally accompanies each economy. The paradigm for traditional assets has emerged through the twentieth century tracking a path from “price” as the determiner of economic success, and then to “quality” as determinate with international competition, and most recently to “service,” or the personal connection to the customer. Each of these selling paradigms has provided or contributed to the competitive advantage of an enterprise during its time.

Today, under the new economy where time seems to move faster, it is about being at the front of the knowledge base, or providing “the new,” and building excitement to gain adoption.

Of course, product or service pricing is a very important factor. Under the law of supply and demand, the more there is the less it is worth, and volume creates diminishing returns. But under the *law of adoption drives value*, use drives value. Innovation requires a constant stream of new ideas, new products, and new services to remain competitive. “The new” and attendant innovation replace and frequently trump the selling “price-quality-service” progression of the traditional economy. Pricing, which within the traditional economy was driven by the availability of raw materials and the scarcity of products within a market, is replaced with intangible, intellectual assets where market penetration at any price drives profitability.

In the traditional economy, distribution and scope of business growth were fairly linear. Because tangible assets are physical and must be moved from one place to another, distribution channels typify the mode of market penetration for tangible assets. As goods needing physical transportation for their distribution, markets extend from point to point across a geography as they achieve regional, national, and occasionally multinational distribution.

In contradistinction, intangibles, lacking physical form, create markets at a global level across the Internet, instantaneously opening an exponentially larger economic opportunity. With the new economy, knowledge-based assets travel over networks speedily and the Internet enables enterprises to enter wherever a demand exists in the global arena and to provide the physical distribution of products and services across new distribution channels ranging from e-mail to courier services.

Amazon and eBay, employing the Internet and its global distribution network, entered their respective markets to create landmark businesses with instantly international scope. Both online companies extended their markets step by step beyond their original entry to service each new need that could fit within their business model. Simultaneously, they challenged and then co-opted the existing worldwide carrier services to ensure the delivery of their goods to wherever demand existed.

Amazon, which originally became the largest bookstore in the world, is today one of the world’s biggest purveyor of everything from books, music, videos, DVDs, and consumer electronics to toys, tools, home furnishing, apparel, and a multitude of ancillary services. Amazon, with

annual revenues in 2003 of over \$5.2 billion, created the archetypal internet business model and has become one of the most global businesses in existence.

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. With annual sales of over \$2.1 billion in 2004, eBay sells over 45,000 categories of merchandise to a registered user base of over 95 million individuals in 36 countries.

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

By looking at each of the economic factors listed in “The Shifting Paradigm” chart, we can see how the strategic deployment of assets has changed with the shift in the asset base requiring new strategy. Of course, many aspects of business remain traditional and unchanged, with enterprises securely continuing to operate within the paradigmatic strategies of the traditional economy. However, businesses increasingly require new strategic thinking to meet the challenges and opportunity of the new economy. 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 competition) could be beneficial, that “adoption drives value,” and that markets need not be limited to geographic contiguity.



Notes

1. *Fortune* magazine, “Knowledge, the Appreciating Commodity,” by Tom Stewart, pp 199–200, October 12, 1998.
2. “The Power of Intangible Assets: An Analysis of the S&P 500,” by Keith Cardoza, Justin Basara, Liddy Cooper, and Rick Conroy, published in *les Nouvelles*, March 2006. “Components of S&P 500 Market Capitalization” chart used with permission of Ocean Tomo, LLC.
3. For more on alliances where two brands are involved, cf. “*Co-Branding-The science of Alliance*,” Tom Blackett and Bob Boad, (1999. Macmillan Press, Ltd.)



The New Role of the Law in Enterprise Strategy

THE “WHY” AND “WHAT” OF INTELLECTUAL ASSETS

It is completely unimportant. That is why it is so interesting.

—AGATHA CHRISTIE

Business is transacted against the backdrops of a formal legal system. In the realm of business strategy the law has had a relatively minor role. After all, strategists could only choose along a spectrum of legal to illegal as traditional dealings involving tangible assets. Today, with the ever-increasing importance of intellectual assets, the law plays a much larger role.

It is a general premise of this book that all enterprises possess intellectual assets and that they ought to be managed, at least, to the same extent as the real or tangible property and financial assets of the enterprise. However, not all intellectual assets are worthy of the time, effort, and money it may take to manage them. For example, proprietary software is of far greater value to a software company than to a shoe manufacturer who happens to own or license proprietary software for tracking its accounts receivable. Thus, discerning the relative importance of intellectual assets within a given context is perhaps the first step to strategic *intellectual asset management* (IAM).

Intellectual assets that are familiar to most people are the subset of the entire class of intellectual capital assets commonly referred to as “intellectual property.” Intellectual property comes in various forms, including patents, trademarks, copyrights, and trade secrets.

Definitions of what is and is not within the definition of intellectual property abound. Irrespectively, the one unique trait of all intellectual property is that the “property” is actually a negative or exclusionary legal “right.” What this translates to is that the only thing the property owner truly possesses is the ability to keep others from using or “enjoying” that property without permission.

Before making the decision as to which intellectual property asset(s) to manage, it may be useful to specify “why” such intangible negative rights are desirable. It must be the case that these “exclusionary rights” provide some important competitive advantage. In light of the discussions in Chapters 1 and 2, perhaps those charged with shepherding the enterprise resources should see intangible assets as intellectual capital, and perceive that the assets enhance the company’s value, just like money in a bank account enhances book value. Alternatively, the corporate strategy may view intangible assets as a source of future income or competitive advantage. Whatever the purpose within the corporate strategy, successful management of intellectual assets requires understanding that purpose as the first step in identifying the intellectual assets most worth managing and strategically deploying. In other words, the intellectual asset management plan, and the “intellectual property strategy” (which is typically a part of it) can and should align with and serve the overall enterprise strategy.

Intellectual asset management is a developing art and science that is practiced by lawyers and nonlawyers alike. Clearly, those with an understanding of both the business strategy and the legal underpinnings of intellectual assets will be best situated to effect this alignment. Understanding the nature of intellectual assets is perhaps the threshold step for any IAM practitioner because property and assets that are *intangible* differ greatly from normal personal and real property. As such, any presumptions derived from common experience with real or personal property are likely to be false when it comes to dealing with intellectual assets. Nevertheless, if one acquires an understanding as to the nature of intangible property, one can return to the value proposition for any particular intellectual asset and ask why the asset is desirable for a given enterprise in a particular industry. Having the purpose or end result for the intellectual asset in mind then sets the parameters for a winning management strategy—be it at the stage of creating the asset, maintaining it, or leveraging it to create growth or wealth.

The concept of potential value for an intellectual asset derives from the answers to the following questions: What advantage will its owner

have compared to its competition by virtue of having the asset? Will there be competitive advantage by virtue of having a management strategy for the asset, or must the strategy be better executed or more cleverly conceived than that of competitors to be of value? Valuation of a particular intellectual asset that was realized through a transaction or perceived through public stock prices, or the like, looks at these answers by necessity, and may take into consideration numerous other factors.

However, little is as simple as it seems. Gaining an understanding of intangible property as intellectual assets requires experiencing several forms of uncertainty. Despite the more precise definitions offered in Chapter 1, the terms “intangible asset,” “intellectual asset,” “intangible property,” and “intellectual property” are often used interchangeably in legal writings. Thus, for purposes of this chapter, they are frequently interchangeable, with “intellectual property” being the term for the subset of intellectual capital that traditionally has been recognized under the law.

What is central to the discussion on the role of the law in enterprise strategy is that assets that are intangible, such as intellectual property differ from tangible and financial assets and the differences require that they be treated and managed differently. Not only do intangibles, such as intellectual property, exist only as negative rights of exclusion, but they are also constantly changing. In addition, the best practices for the management of intangibles often vary according to the asset itself, (e.g., a patent, a trade secret, or a copyright). The dissimilarities among these various types of intangible assets dictate differing management strategies. As well, and importantly, those intangibles, understood as assets that are “intellectual property,” are *creatures of the law*. Consequently, to understand them, we must understand the law that influences their existence. However, our understanding is often incomplete, and in many instances the only interpreters of the uncertainties are attorneys with particular points of view and biases. Nevertheless, it is possible to navigate through this myriad of uncertainty to successfully manage intangible intellectual assets.

THE NATURE OF THE BEAST

*Alice: I didn't know that Cheshire cats always grinned; in fact,
I didn't know that cats could grin.*

The Duchess: You don't know much; and that's a fact.

—LEWIS CARROLL

Intellectual property has some unique aspects that directly affect the nature of any strategy in which it plays a part. The laws of nature define an apple, what it is and how it will behave. Notwithstanding the debates of philosophers, the laws of nature arguably permit us to readily understand not only the apple's existence, but how to maintain it and use it, and who can own or possess it. We understand how it depreciates over time (rots) and we can manage it with that knowledge. The apple, as an asset, is predictable.

When it comes to *creations of the law* like intellectual property, we may have valuable assets but there are few laws of man that provide any firm definitions of the metes and bounds of each such asset. These assets change. New properties can be recognized; for instance, copyright protection for semiconductor masks and patents for methods of doing business are recent additions to the law. What will and will not be a part of the asset can change, (e.g., by legal decisions interpreting claims), by the standard of distinctiveness required for trade dress or the adherence to the "moral rights"¹ requirement in copyright. All the worse for intellectual asset strategists, as not only can the definitions, and thus the intangibles themselves, change, but the typical business person charged with such responsibility usually has only his lawyer as an interpreter. This is hardly the stuff that instills confidence in banks that are asked to lend against intellectual assets or on Wall Street when it seeks to value companies whose assets are more and more of the intangible kind.

This chapter requires delving into what has heretofore primarily been the purview of intellectual property lawyers. Why? Because intellectual asset management is no longer reasonably delegated solely to lawyers and because IAM is already in practice, by necessity, with the CEOs and CFOs, brand managers and IT managers, general counsels, and in HR departments. IAM is now a key duty of upper management who must grasp these concepts with an understanding and perspective that may differ from that of their traditional attorneys. Executives now need to ask and receive answers to the right questions and process the legal opinions in the light of business strategy. For all of the reasons and propositions set forth in Chapters 1 and 2, everyone who does or desires to participate in the business of management for growth and the creation of wealth must be able to formulate the right questions and ensure that the answers received are directed toward the business purpose. With regard to

intellectual property, it is no longer sufficient to understand or receive information about it in the context of legal activities or potential litigation. This is a shift in the universe of discourse from the concerns of functional disciplines to that of enterprise strategy.

Knowing how the law views intellectual assets may, in fact, allow IAM practitioners to leverage such assets to their maximum advantage. After all, to manage a class of assets, we should be able to identify and know something about its nature or essence—if one wanted to herd cats rather than sheep, it would be useful to understand the *nature of the beast* so to speak. The same is true should we want to increase their number (breed) or value or simply maintain them in good health.

Unlike most tangible property, the nature of a particular genus of intellectual property may dictate strategy. A case in point involves the U.S. laws of copyright. With copyright, unfettered infringement by a dozen third parties may result in a loss of revenue, but the owner is free to seek a remedy and stop or enjoin the 13th infringer. The existence of the copyright as an asset is not affected by the first twelve decisions not to police or prevent unauthorized use of the copyright.

Conversely, trademarks have a different nature. Unfettered infringement by a dozen third parties may preclude enforcement against the 13th. In other words, the failure on the part of the trademark owner to take action might result in a total loss of a trademark right “to exclude others.” Thus from a “management” point of view, a trademark requires different activity than a copyright just to keep the intellectual asset in existence.

Today, it is a necessity to understand much more of what has heretofore been the purview of intellectual property attorneys. Without such understanding, there can be no proper business or strategy evaluation of the legal advice proffered. Even just asking the right question of *your* attorneys for the purpose of understanding background, expertise, and educational bias, can effectively assist you in challenging or validating any legal opinions that seem to run counter to sound business strategy.

The high cost of obtaining and maintaining intellectual property can often be the primary force in determining IP strategy, especially in small enterprises. Many CEOs have been advised to sue (with estimated costs in the hundreds of thousands of dollars) in order to “protect” a trademark

when the infringer is neither an actual nor potential competitor—even when the infringing activities may have no impact on the CEOs bottom line. We want to suggest that the CEO be given a rational way to tie this recommendation and its associated cost to return on investment (ROI) or diminished trademark value.

Similarly, the average enterprise needs to better understand what the value of any one patent could be. After all, the cost to file and prosecute a single patent exceeds \$10,000 and can reach \$250,000 – 1,000,000 or more to protect and maintain protection worldwide over the patent’s 20-year life. Determining a *strategy* behind acquiring any item as expensive as a patent is crucial for every enterprise contemplating such acquisitions. For CEOs relying directly on outside patent counsel, too often the only clearly understandable basis for the decision turns out to be cost. Even in large organizations with in-house general counsel, the decision more often than not comes down to budget.

This, however, is not to say that everyone needs to go to law school. What is needed for strategic management is a general knowledge of the law, a grasp of the basics, and an understanding of the boundaries of what attorneys can do. This includes a rational assessment of otherwise lawful actions that are available and not totally constrained by the legal precedents of the day. Strategic attorneys look at what the client (internal or external) requires for competitive advantage rather than at the law in terms of what can or cannot be protected. Businesspersons who have already found “strategic lawyers” are getting interpretations of the law that are useful for IAM. The purpose of this chapter is to urge those who have not found such “strategic” attorneys to have at least the information necessary to challenge the attorneys they have. All that is required is to take the time to gain some basic knowledge of the *nature* of intellectual property and other intangibles.

The table on the next page is intended as the most rudimentary guide to the basic nature of various intellectual property assets.

Many existing intellectual assets defy being pigeonholed according to this grid and rightfully claim to have features or aspects recognized under more than one category. Some may claim protection, and thus exist under laws yet to be enacted or theories of law and balancing public policy considerations yet to be tested. These are the types of changes that must be accounted for by sound IAM strategy and practices.

Summary of the Various Types of Intellectual Property Protection

Feature/Type	Patent	Trademark	Copyright	Trade Secret
Intangible Asset	Machine, manufacture, process, or composition of matter; business method; software	Brand — identity, source, logos, good reputation; trade dress	Original and creative works made up of words, sounds and pictures; software programs	Anything that is kept secret and provides a business advantage
Fundamental Nature	Structure and function	Source-indicating function	Expression	Confidential relationship
Basic Metes and Bounds of the Exclusionary (Negative) Right	Make, use, sell, or import by self; inducing another	Use source indicator that is identical or confusingly similar	Copy, publish, distribute, display work, create derivative works	Use and unauthorized disclosure
Threshold Requirements:	Useful, new, nonobvious, and described properly	Distinctive enough to indicate a single source and used as such	Original with a modicum of creativity	Relatively confidential; useful; duty/relationship
Mechanism for Creation:	Grant of U.S. and foreign patents	Use of the mark in U.S. and some countries; by grant of registration in most of the world	Creation of an original work in almost every country	Body of laws of each different country

THE TROUBLE WITH LAWYERS

The first thing we do, let's kill all the lawyers.

—SHAKESPEARE, *HENRY VI*, PART IV, II, 86

An intangible asset only *exists* as a function of the law that creates or recognizes it as a private property right. However, since the “right” has no tangible substance, intangible property is traditionally described as a “negative right.” Whatever it is that the law recognizes, the owner “owns” the right to prevent others from using it, destroying it, or otherwise interfering with his or her “enjoyment” of that right.

As negative rights, there are special rules that apply to intangibles. Intellectual property attorneys specialize in knowing those rules and uniquely view intangibles from that perspective. In many countries, these intellectual specialists are agents rather than attorneys, and are not required to be learned in those countries’ law beyond what relates to the particular type of intellectual property. Trademark and patent agents, respectively, must know the rules and law regarding trademarks and patents. They need not be schooled in the law of anything else.

The concept of the “right” as a piece of property, let alone one to be valued or monetized as an asset, can be far afield for patent agents (outside the traditional realm of assignment and licensing). Conversely, even attorneys trained in most general areas of the law are often not particularly trained or experienced in the laws of intellectual property. In fact, most attorneys are typically unfamiliar with the fine points of the distinguishing features and nature of intellectual assets and can thus be handicapped in the maintenance and protection of intellectual property (outside the traditional procedural realm of legal enforcement and litigation).

One result of all of this is that the answer to the question, “Can I own something ‘intangible’ as an intellectual asset?” or “Can I prevent someone from using, ‘enjoying,’ or damaging my ‘enjoyment of it?’” can vary depending on the perspective of the lawyer answering the question.

The path, in greater detail, to a useful “understanding” of the answer received is to (i) know the limits of the expertise of the opiner; (ii) understand any natural biases; (iii) independently assess the advice given; and (iv) challenge any conclusions that suggest valuable business assets are

not protected under the law or that the business strategy you want to implement cannot be accomplished within the laws pertaining to intangible assets. This can be accomplished with the basic understanding of the difference in *intangibles*.

Historically, lawyers have been viewed as contentious by nature and rigid in their interpretation of the law. Lawyers (and judges) are learned in the law. They look to case law as a primary source for defining what is and is not an intangible asset. Such interpreters do not comport well with the changing economic paradigm where more and more of an enterprise's value resides in intangibles and the need to reliably attribute value to them. Relying on case law (or worse yet, your attorney's personal interpretation of the case law) creates an unusual set of "uncertainties," none of which aid in the quest to understand intangibles as a source of wealth and also in managing, valuing, and then monetizing and commercializing them.

Written judicial opinions are the result of disputes significant enough (at least to the parties) to have been fully litigated, before a judge or jury. In addition to be reasonably relied upon, the initial decision also to being the subject of an appeal. They are very *fact-specific*, (i.e., a very small change in circumstance may make them inapplicable to the next situation). The result is a paucity of truly useful information relative to the ever-growing need to understand and assess the value of any particular intangible asset.

Forgetting for the moment the horrific cost of litigation in the U.S., there are few businesspersons who when faced with business litigation have ever really been satisfied with an attorney's response to the reasonable question "Will we win?" As we all know, from life or television, litigation is always unpredictable, even in the strongest of cases. For better or worse, traditional attorneys can do their best, but none can be an honest guarantor of the outcome in litigation. More to the point, good business strategy most often results in having no litigations. Accepting what may or may not be the outcome if one litigated over the assets is not always the right measure for determining a win in strategy or negotiation involving the asset. To a lawyer, the interpretation of the case law and application to a business situation can be black and white, particularly in view of the legal ethics that are constraints on an attorney's hyperbole about an asset and his ability to claim more than what he is sure exists.

But in business, and, in particular, where value may be what the market says it is, or where one's junk may be another's gem, grey may always be the real color.

Make no mistake; attorneys who can interpret the business as well as the legal landscape exist. A recent *ABA Journal*² has dubbed them "strategic lawyers." If you have one, great, if you don't, simply beware of the language that your attorney is speaking and be able to interpret it for yourself.

In large technology-based companies, such as Dow Chemical, with enormous pre-existing patent portfolios, or Cisco Systems with its declared strategy to quickly grow its patent portfolio, there is an obvious need and role for patent attorneys, and in particular, those who are highly skilled in the nuances of specific technologies and patents. Traditionally, patent or intellectual property attorneys were involved in the creation of patents and the registrations for copyrights and trademarks, and thereafter in the policing or enforcement of these rights against infringers. However, IAM, today, is not always directed toward maintaining exclusive use in the owner. Today IAM is more broadly viewed from the perspective of creating wealth through a myriad of alternatives.

Organizations that are large enough to have internal patent counsel may fare no better if the patent counsel is unskilled in the newest "science" of intellectual asset management—the places to learn strategic thinking, though increasing, are themselves few and far between. The science of IAM is relatively new and those most experienced or knowledgeable in it are privately employed or have left the law for the more lucrative consultancy field.³ This book is intended to provide some basic understanding for a do-it-yourself approach as well as for those who can and would advantageously employ consultants.

This is a time for all business attorneys to reflect on their perspective on intellectual property as they know it. When they look to the law for definition of an intellectual asset, do they perceive that the law may be in flux with respect to the particular asset of interest or do they look at the facts at hand in light of the current law? You, as well as the attorneys, must simply recast their thinking from the traditional role of attorneys. Normally, intellectual property attorneys apply the current law to a stated set of facts and predict the outcome of a legal dispute brought at that time over those facts. Now more than ever, attorneys must also look to see what the law should reasonably be and assess if there is movement in

that direction in the U.S. or abroad. And foremost, they must understand why they are being asked to create or protect a particular asset.

THE WINDS OF CHANGE

If you see footsteps, across the entire minefield, follow them.

—ANONYMOUS

Any uncertainty created by who answers the questions posed by companies is compounded by the very nature of the law that can itself change over time. Legal decisions defining intellectual property and other intangible assets change. Case law applies the law at the time of the decision to the facts of the case. Not that all such assets are grounded in quicksand—in all events, change can work to your benefit or detriment and a good strategy looks ahead to where the winds of change may be blowing.

Laws are grounded in public policy, often as a balance between countervailing policies. Public policies themselves shift and change. Laws can also be based on the economics or the science of the day and these too can change. Strategies may include lobbying to influence policy, but good intellectual asset managers understand the policies and countervailing policies and, at least, anticipate what changes may evolve that affect the intangible of interest.

Judicially created “case law” evolves to change the limits of what is protected—sometimes expanding and sometimes contracting those limits. In some instances, case law expands existing statutory schemes, like that for copyright, an example that we will look at more fully, to embrace innovation that has found business value ahead of legal protection for that value.

Also, legislative bodies can act to create, expand, or contract protection for intangibles. They can do so outright through new legislation, but most of the time, they act after courts create the need for them to act, through case law, (i.e., by deciding what the limits of protection are or that no protection exists). Frequently, initially enacted laws, fail to anticipate technological advances. This creates the opportunity to influence or, at least anticipate, which intangibles will be the subject of new or enhanced protection.

In the periods when there is no clearly applicable law to protect “new” or newly valuable intangible assets, they have often been characterized and sometimes protected under existing laws. At such times, creative attorneys with a clear understanding of public policies for and against protection of intangible property have successfully strategized to gain status as assets and protection for the previously unprotected intangibles. Their clients have had significant competitive advantage and their actions have been a major “win” in the field of intellectual asset management.

The key is to be educated as to the nature of intellectual assets and to keep an open and inquisitive mind in addressing the challenge of “creating value” or keeping a “competitive advantage” when the intangible assets that are of value to an enterprise are not fully recognized or protected under U.S. law.

To summarize, the law can be seen as a moving target, providing varying protection at different times, for different people and in different places. Varying protection can be highly significant in the context of managing intellectual assets. Because such assets are creatures of the law, *changes in the law are changes to the assets themselves*. Think about valuing or creating assets for their expected value when the law that defines their existence, their metes and bounds, and how well they can be protected (in essence, how valuable they are), can and, often, does change.

Courts continually interpret existing statutes for infringement of intellectual property. We suggest here that those interpretations are sometimes intended to be in support of the public policy for or against monopolies, and in furtherance of the needs of business. In other words, it is possible to drive legal changes to further the need to protect intangibles of value or the need to limit the scope of such assets. This is particularly true when the intangibles are newly recognized as *assets* to an enterprise and have yet to be defined or recognized by the law as something of value.

In the U.S., Congress can act to create protection for intangibles even if courts decide that none exist. In the U.S., it has always seemed that the law lags changing societal and business needs. But in many countries, case law has at times evolved to change the limits of what is protected – sometimes expanding and sometimes contracting those limits.

The European Union has addressed many similar issues to bring some unity to the treatment of intellectual assets among its 27 member countries. For example, it has created protection for database collections and the designs of functional articles beyond what is now available under U.S. law.

SOME BASICS ABOUT THE LAW OF INTELLECTUAL PROPERTY

Curiouser and curiouser!

—LEWIS CARROLL, *ALICE'S ADVENTURES IN WONDERLAND*

We now turn briefly to a closer examination of the current framework, legal or otherwise, that surrounds the creation and maintenance of intellectual property and the forms of intangible property most widely recognized throughout the world.

Intellectual property, as indicated above, primarily includes patents, trademarks, and copyrights. We start with them and, for our purposes, also include corporate and trade names, service marks, domain names, and trade secrets. All of those intangible assets exist because of the various laws that protect the owner against unlawful use of them by others. Think of real property. If you see someone picnicking or otherwise trespassing on your property, you have the option of taking no action. You don't have to exercise that right.

This right to take action is optional with private property—you are not required to exercise your right to kick trespassers off your property. The government does not care whether you exercise your right or not, but if you want to stop that picnicker, or any other trespassers, the laws, that is, the courts, are there to help you enforce your right.⁴ Through the courts, you can obtain an injunction against whomever was trespassing and you might also be entitled to receive money from the trespasser, assuming you could prove to the court that in trespassing, you were somehow damaged in a manner provable to the court's satisfaction. Consider the example of trespass to private land. Suppose that someone stayed on that land on a day when the owner was going to rent it. The owner had a contract to rent the land for \$500 for a given day and the owner lost out on that specific \$500 because of the trespass on that day. The \$500 would be specific in amount and not speculative. Saying that one might have rented the property on that day or that the land is worth about \$500/day for rent is likely to be deemed uncertain or speculative.

So, a first trait that all intangible property has in common under the law is that of a “negative” right. As to intellectual property, the second trait is that intellectual property assets are “creatures of the law.” In a

sense, they cannot exist *but for* the law that recognizes the right. In other words, it is the law that defines the metes and bounds of intellectual property. Unlike real property where the metes and bounds of the property are defined by physical measurement, it is only the application and interpretation of the law as to what can and cannot be copyrighted or what the scope of a patent claim is that determines the asset's dimensions, (i.e., what can be owned to the exclusion of others). One result is that unlike the physical measurements of real property that should not change from survey to survey, intellectual property assets can change with changes in the law. The law changes through judicial interpretation, repeal of old laws, and the enactment of new laws. As the law changes, so does the definition and perhaps the value of the intellectual property. Also, the law changes from jurisdiction to jurisdiction, (i.e., from state to state, country to country, and even courtroom to courtroom).⁵ It is the ever-changing law, coupled with a reliance on the law to exist, that creates a unique opportunity and challenge to those who would tackle the intellectual asset management of today's enterprises and, to generally create value and wealth from intangibles.

So here we are, trying to define property that cannot exist without legal recognition and that are themselves constantly changing over time and from place to place. Think of applying the law to intellectual asset management as a new application of Heisenberg's "uncertainty principle." Rather than a correlation of location and velocity, for us, the dilemma is that the more one "knows" whether something is or isn't patentable, or is or isn't protected under the copyright statute, the less one may be able to think outside the box and creatively achieve the goal of IAM—namely to align a future strategy for the intangibles assets with a sound business strategy. Going forward, we will try to define intellectual property and the types of intellectual assets already recognized under the law. We say "try to define" because we intend to explore some classic examples of how "the law" is changeable. And perhaps, the vagaries and variability in the laws may prove to be reason *not* to let "the law" dictate all strategy.

Intellectual property represents legally sanctioned monopolies in an otherwise free market and anti-monopoly society. Unlike personal property, intellectual property rights exist and are maintained and transferred in ways that are not always obvious. A primary public policy in free market society is against the very existence of the intellectual assets we seek

to value most. An economic principle in free markets is that markets, not monopolies, should determine prices, and that competition is always good for the market. The idea that competition is “good” for society is a basis for the general bias against monopoly in free market economies, while the most valuable intellectual property assets are legally sanctioned “monopolistic” and exclusive rights.

Obviously, there are overriding countervailing policies in favor of protecting certain of these intellectual property assets. This tension for and against is the ever-present background of intellectual asset management. Understanding and remembering the tension can be essential to effective IAM. Equally essential is to remember that a monopoly holder with the right to exclude others, need not do so if the intellectual assets are best leveraged by a strategy of sharing. Take our previous example regarding Microsoft—adoption of a computer platform has been shown to drive value better than “excluding” or limiting its use by others.

And finally, intangible assets are more fragile than other assets and are more easily diminished and destroyed during the normal course of business. The qualities attributed to intangibles create a unique obligation on the part of those who would manage the intangible assets of today’s enterprises to understand, at a minimum, the rudimentary legal framework under which intangible assets can be created, controlled, and ultimately leveraged to competitive advantage.



Notes

1. “Moral rights” means certain inalienable rights of attribution and integrity that belong to authors in respect of their copyrighted works. Under the Berne Convention, these rights are expressed in Article 6b as follows:

“Independently of the author’s economic rights, and even after the transfer of the said rights, the author shall have the right to claim authorship of the work and to object to any distortion, mutilation, or other modification of, or other derogatory action in relation to, the said work, which would be prejudicial to his honor or reputation.”

2. “The Strategic Lawyer—Companies Are Placing Premiums on Advisers Who Understand Both Business and the Big Picture,” by Jill Schachner Chanen. *ANBA Journal*, July 2005. A correction has been made to this story. Because of an editor’s error, in “The Strategic Lawyer,” July 2005, page 42, professor and lawyer G. Richard Shell was not correctly identified. The Journal regrets the error.
3. One purpose behind writing this book is the authors’ experiences with smaller companies who need this information and cannot afford the best consultants. Moreover, the science of intellectual asset management was first conceived of and developed by those with enormous patent portfolios. As a result, few practitioners of IAM have extended the application beyond extracting value from patents. The current awards for patent infringement are reason enough to fuel the current climate of patent enforcement, by patent licensing companies among others.
4. For both tangible and intangible property, there may be requirements, such as timeliness, attached to your rights to exclude.
5. In the U.S., the law is also changing based on whether the federal courts allow the individual state courts to determine the law in a field or whether the federal government acts to “pre-empt” the field and require all states to apply the same law. When litigation, or the threat of litigation, is a tool in IAM strategy, vagaries among states as to the law regarding matters that are not “pre-empted” can be used to advantage when the competition is national. The same is true when the competition is global and the laws differ among countries.

The Changing Rules



The Law in Flux

THE CHALLENGE OF INTELLECTUAL ASSET MANAGEMENT

We have forty million reasons for failure, but not a single excuse.

—RUDYARD KIPLING

We have talked about the need to manage intellectual assets “strategically.” There are many well-known practices that enable enterprises to manage tangible assets “efficiently.” However, because they are well-known, everyone uses these practices and their adoption cannot be said to be “strategic.” As discussed in Chapter 2, tangible assets are leveraged under the rule of efficiency. Under the old paradigm of wealth creation, intangible assets (mainly intellectual property), like tangible assets, were managed for efficiency. There was no distinction between managing hard and soft assets. But, unlike the management of tangible or hard assets, intellectual assets management (IAM) is a new and developing idea. IAM, under the new paradigm, is about more than managing for efficiency. It affords those who practice it the opportunity to be strategic with intellectual assets and they benefit enormously through the competitive advantage that can be achieved.

No doubt, some aspects of IAM involve processes or methodology used to gain efficiencies. For example, IAM includes systems and practices to aid in “the ability to manage” the patenting process, decisions on whether and where to file patents or registrations for trademarks or copyrights, whether to maintain or abandon intellectual property for cost considerations, and decisions regarding protection and policing. Everyone who participates in those activities is an “intellectual asset manager” to some

degree. As with the practice of any science, tools can be of the greatest assistance. However, no matter how faithfully a tool is used, it cannot substitute for the strategic thinking that must necessarily precede its effective implementation. There are some aspects of IAM that are more akin to the management of tangible or hard assets. However, for our purposes, IAM is the science of going about taking intangible, intellectual assets and managing them strategically to win in the marketplace.

THE VALUE PROPOSITION FOR IAM

Our belief in any particular natural law cannot have a safer basis than our unsuccessful critical attempts to refute it.

—KARL POPPER

Reflecting on the shifting asset base of the Standard and Poor's (S&P) 500 Index as presented in Chapter 2, we can see that for most existing enterprises, large portions of their valuation are already astoundingly comprised primarily of intangible assets. Enforcing patents within such intangible asset portfolios through lawsuits for patent infringement has become an enormous business where potential for recoveries in excess of \$100 million often make the gamble worthwhile. For some, such enforcement is a matter of basic strategy for the management of patents; namely, acquire patents on your daily business and enforce them against infringers to have a monopoly position in the market. During the early 21st century, a number of patent and licensing enforcement companies (PLECs), more commonly referred to as "patent trolls," emerged. Their only business is to acquire patents and then sue infringers. However, the percentage of the millions of existing patents that can be used to obtain this kind of income is very small, and the cost of obtaining any one patent and maintaining the monopoly in even a portion of the world is very expensive. Thus, there is growing pressure to manage limited resources to produce patents that are "worthwhile."

Similarly, millions are spent in advertising to develop brand equity and strong trademark rights. Strategic management of these assets has become crucial to increasing wealth and, as with patents, there is growing pressure to leverage these assets to underwrite the cost of their creation, to obtain and enhance margins they provide, and to drive the overall market capitalization of companies.

Similar scenarios demonstrating the new awareness of value and opportunity exist for virtually every type of intellectual property and intangible asset. The result has been more recognition of the need to manage these assets. At the same time, there seems to be few sources from which to gather the knowledge and techniques of effective IAM.

THERE IS NO CASE LAW ON IAM

Toto, I've [got] . . . a feeling we're not in Kansas anymore.

—DOROTHY, IN *THE WIZARD OF OZ*

Calling upon a lawyer or an expert in intellectual property law as a resource for guidance on IAM techniques and strategies may be of little help. This is because *there is no case law* relating to the management of intellectual assets that can guide the day-to-day activities associated with IAM. Judicial case law, by definition, derives from situations where two parties have taken a dispute through the courts to a point where there is at least one written opinion deciding the issues. Leading case laws in the U.S., emanating from the Circuit Courts and/or the Supreme Court, represents an even smaller subset of those cases that have been appealed after an initial decision. These are normally published and scrutinized by attorneys because, usually, they elucidate fine points of the law. In typical intellectual property law cases, these points might include: (1) what factors should be considered in determining how the claims of a patent will be construed, (2) what “likelihood of confusion” in a trademark matter will constitute, or (3) what will amount to “substantial similarity” in a copyright issue. While the answers to such questions may be useful during IAM, they do not articulate a theory or processes for the practice of IAM.

However, the management of intellectual assets primarily deals with the business of maximizing profits and providing competitive advantage with a company’s intangible assets. In most cases, this means using litigation as a strategy or perhaps not litigating at all. In any event, there is no case law that holds or discusses whether an intellectual asset management strategy is successful in a business context, or whether it’s sound from the point of view of the enterprise. Rarely do we see a written account of the business impact of a particular legal decision, or if we do, it’s never in a legal case law book. Although lawyers learn statutes and case law,

it is neither lawyers, in general, nor intellectual property attorneys, in particular, that naturally have the keys to understanding the science of IAM. Where then does the expertise lie?

The field of intellectual asset management is a recent development with its roots in several companies with large patent portfolios. The majority of IAM expertise is in the hands of large corporations and consultants to those companies. The expertise for valuation of intellectual property, whether for quantifying damages in an infringement suit or for determining the price in the context of a merger or acquisition, is also largely in the hands of consultants.

To date, the emphasis of whatever information *is* readily available to all is on strategic management and leveraging of large patent portfolios. Books by consultants,¹ though professing to be applicable to all types of intellectual property, are geared to the expertise of the writer-consultants, namely, patents. They leave one to wonder what there is to IAM that does not ultimately relate to making money by licensing one's patents and/or suing those who infringe.

The dilemma of finding adequate knowledge about theories and practices of IAM may be characterized by the two dichotomies we have identified. Intellectual property lawyers understand the details of creating and maintaining intellectual assets and also have expertise as to the legal boundaries of the assets themselves, but there is no case law for them to read on IAM. As a result, they do not necessarily have any knowledge of the strategic options for leveraging those assets. There are also businesspeople and consultants that are potential sources of IAM expertise. They understand the overall strategies but often cannot aid in the details of all IAM because they do not understand the nuances of the laws that define the assets.

WHY LAW PLAYS A ROLE IN INTELLECTUAL ASSET MANAGEMENT

The law is a sort of hocus-pocus science.

—CHARLES MACKLIN

Are the nuances of the law really that important to the strategies and day to day activities associated with IAM? What role does the law play

that keeps the expertise of most nonlawyers incomplete? Let's take an example from the law on trademarks. Many fashion designers, as a strategy for brand development and extension, create a secondary line of clothing or other products using just part of the original brand (e.g., Yves, an old brand for cologne, was launched after development of the brand Yves Saint Laurent, as was Pucci from the Emilio Pucci brand). It seems that Michael Kors might have been thinking about Kors. However, it appears as if that plan might have run afoul of trademarks law details probably never guessed at by strategic planners. Objections to the applications to register the trademark Kors for clothing, toiletries, and luggage were filed on behalf of the brewer of Coors beer who at the time used "Coors" on a number of merchandising items (i.e., they sold t-shirts, belt buckles, sports bags, and the like bearing the Coors brand). To assess the boundary of one's "exclusionary" trademark rights, the accepted rule of trademark law is that the "sight, sound, and meaning" of two marks is to be compared when determining if one has overstepped the legal boundary of the other. Kors is identical in sound to the preexisting Coors brand. There was no formal decision in the proceedings where the objection is recorded, but for whatever reason, all efforts to register "Kors" as a single word were abandoned and there's no known use of Kors rather than Michael Kors as a brand.² One might surmise a similar surprise for investors in a hypothetical start-up whose business plan refers to patent applications filed for the company's business method. Any plan to impede competition through patent protection might go awry with the current substantial United States Patent and Trademark Office (USPTO) backlog with respect to business method patents. After all, there is no right to exclude or no risk to competitors until a patent is issued. Should that process take five to eight years, rampant competition might exist until the business methodology so patented is obsolete.

The law today defines what assets can be protected or enforced under the law. Each new judicial interpretation of the law of tomorrow may adjust the scope and hence the value of today's assets. One only needs to look at the swings in the stock prices of various companies after winning or losing a lawsuit for patent infringement to see this in action. The ability to foresee and/or advocate changes to the law is perhaps most important for strategic management of intellectual assets. After all, the continuing

expansion and growth of a business requires forward planning, an inevitable part of which is planning which assets to develop and how to capitalize on them.

INTANGIBLE ASSETS, NEGATIVE RIGHTS, AND QUASI-PROPERTY

The test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time, and still retain the ability to function.

—FRANCIS SCOTT FITZGERALD

Not all intangible assets fall within the recognizable intellectual property definitions for patents, trademarks, copyrights, and trade secrets. Nevertheless, such assets, some more akin to “core competencies” as discussed in Chapter 7, can be managed to advantage and leveraged to enhance growth or wealth. When one reads that P&G has entered into a joint venture, one can be sure that the P&G reputation for skill at brand development, which isn’t in and of itself protectable as intellectual property, has been implicitly or explicitly valued into the contribution that is attributed to each of the joint venture’s partners. Thomas Friedman, the author of the bestselling book *The World is Flat* calls out UPS as among the companies that contributed to “flattening the world” because they exemplify what he calls “Flat-tener #8—Insourcing.” UPS adds value to the goods they ship while they have custody of them. He points out that when you ship your Toshiba laptop for repairs via UPS, “UPS actually repairs the computer in its own UPS-run workshop dedicated to . . . repairs at its Louisville hub.” What were the intangible assets that UPS leveraged? In the case of UPS, the intangible asset seems to be capturing the essence of “insourcing” (i.e., being the enterprise that can manage numerous noncore functions for a global company). With the freed-up resources, the enterprise can do what it does best, focusing on its core competencies (e.g., innovating new products). The authors of this book agree with Thomas Friedman that, in this and his other examples the value was in the idea.

When we look at the leading edge of protection for valuable intangibles, especially those that cannot fall squarely within the common definitions for intellectual property, we see the courts and/or Congress

struggling to define intangibles in the context of a property or *quasi-property*³ that can be protected to the extent necessary to protect the owner's "property" interest from *detrimental misappropriation by others*. As always, the defined boundaries of the exclusionary right must be clear to decide whether someone is acting in a lawful manner with respect to that asset.

When searching for remedies for an intangible that is at issue, and it is not clearly within the definition of intellectual property or other well-defined rights, it is the evidence of the *misappropriation* (i.e. wrongful taking of that something that seems fundamentally unfair and gives rise to court decisions like that in INS discussed later).

In summary, the law affects intellectual assets in several ways. The law defines and judicial decisions refine the boundaries of the exclusionary rights in intellectual property and, sometimes, the courts and/or Congress create new intellectual assets. One example of this was a decision to include Business Methods as patentable subject matter enabling patent claims describing the business process to be granted. Prior to that, business processes like that of Dell Computer discussed in Chapter 6 were essentially unprotected. Another example is the Semiconductor Mask Protection Act. Whereas business processes were always around but not deemed worthy of protection, as the semiconductor industry grew in the late 20th century, the "masks" that were a part of this new technology became the subject of new protection.

Tangible assets exist independent of the law, are unchanged with changes in the law, and have constant metes and bounds. When we manage tangible assets in business, it seems manageable. Conversely, intellectual assets exist as defined by the law, they change with changes in the law and their metes and bounds change with the legal definition of the asset. They seem impossible to manage.

THE LAW IN FLUX

*There was a young lady named Bright, Whose speed was faster than light;
She set out one day In a relative way, And returned home the
previous night.*

—ARTHUR BULLER

Times change and so do the laws that govern us. Some changes are dictated by the fluctuations in social mores (e.g., the enactment and subsequent repeal of prohibition, restrictions on the use of child labor, and the criminalization and decriminalization of abortion). Some changes are fueled when new facts about old things come to light (e.g., secondhand smoke is a health hazard in the workplace, or a government's desire to encourage or discourage certain behavior among its citizen population through the use of taxes or tax credits). Increasingly, the changes to our laws can be traced to new discoveries. The rate of innovation in the 20th and 21st centuries continues to present issues for governing not contemplated at the time existing laws were enacted. Nowhere is this more evident than in the laws relating to intellectual property.

In the 1970s, a biology degree was an insufficient technical degree for licensure before the USPTO because the science curricula of biology, like psychology still is today, was not considered as rigorous as other sciences or engineering and that little in the field of biology, not associated with other sciences (e.g., organic chemistry), would be patentable subject matter. It was thought that for patent purposes, persons with specialized or advanced biology degrees were not required. Many of the early biotechnology and genetic engineering patents were written and prosecuted by patent attorneys with chemistry or chemical engineering backgrounds (author Craig among them). The rapid advances in genetics and biotechnology have changed that. A biology degree is now considered a sufficient science background for patent licensure and many attorney practitioners in this arena have masters and doctorate degrees in biological sciences, in addition to a law degree, in order to be able to adequately understand the newest inventions in the field.

In many instances, the changes have been through judicial action (e.g., the 1980 Supreme Court decision in *Chakabarty*),⁴ extended the statutory definition of "patentable subject matter" to include genetically engineered materials. The Court maintained the proposition that naturally occurring matter cannot be patented and discovery is not invention. However, "anything made by man," such as products of genetic engineering, are patentable. Chakabarty was entitled to patent his genetically engineered bacteria because "his claim is not to a hitherto unknown natural phenomenon, but to a nonnaturally occurring manufacture or composition of matter, a product of human ingenuity."

Similar changes to the concept of patentable subject matter have followed technological advances (e.g., for computer programs and methods of doing business). It would seem that the importance and value to business of technology-based improvements using genetics engineering, computers, and the Internet brought about required changes in the laws that enabled them to be monopolized as patents and be recognized and protected as assets.

HOW AND WHY THE LAW CHANGES

Nothing is as it seems.

—LEWIS CARROLL, *Alice in Wonderland*

Sometimes, laws change to reflect changes in societal values. Often, laws that express one view of society (e.g., prohibiting voting rights to women), are found to be contrary to modern societal thinking. With respect to business practices, mores change as well. Anti-trust laws evolved to prohibit abuse of power and labor laws, such as those setting the minimum wage and the OSHA standards and oversight for safety in the workplace, to stop once accepted practices involving the labor force. With respect to the law of intangible assets, there have been and continue to be changes reflecting the constantly evolving parameters of the business world. For example, when one party owns trade secrets (i.e., proprietary information or know-how, not protected by valid patent rights), it has long been considered fair to “reverse-engineer” products and processes from whatever is in the public domain. “Reverse-engineering” is the term given to the lawful effort to obtain otherwise private information about manufactured products and business processes (in those instances when the process can be discovered from the product). Reverse-engineering is typically undertaken for competitive market purposes (i.e., to make a product compete with what is being reverse-engineered). During the age of manufacture, the practice of reverse-engineering may have seemed like a sound economical practice for society to sanction. After all, the developer or holder of the proprietary information was protected first, by the cost to the second-comer of reverse-engineering and second, by the “time” or lead-time he maintained because of the time and effort that it might take to reverse-engineer.

Today, with respect to many products, technological advances are such that both the time and cost have been significantly reduced. When reverse-engineering is cheap and fast, it seems reasonable to assume that *to the initial holder* or developer, it is “unfair” because there is no longer sufficient lead time to recoup investment and society is not well served by permitting “easy” reverse-engineering. Changing the law now to label this previously permitted activity as “unfair competition” is accomplished in several ways. One way is to pass a law simply prohibiting a particular process by which the reverse-engineering occurs. An example of this was the enactment of the Digital Millennium Copyright Act of 1998 that prohibited tampering with anticopying devices embedded in publicly distributed software to prevent access to trade secrets of the software operation. Another way is to recognize previously unprotected intangible assets as protected thereby providing the owner with a remedy in court for any unauthorized use or copying. An example of this is the Supreme Court’s definition of *quasi-property* in *International News Service v. Associated Press* that resulted in the prohibition against copying “hot news.”

There are three mechanisms that keep the laws of the United States in flux: (1) The law evolves through judicial interpretation of existing laws; (2) Congress and state legislatures enact new laws and amend or repeal old laws; and (3) On occasion the U.S. Supreme Court acts to decide whether the federal or state system of laws should control, or it strikes down laws as an abridgment of rights under the U.S. Constitution.

What are the pivotal examples from the perspective of intellectual asset management? Three important examples set the stage for the emergence of expanded intellectual asset protection: (1) *Bonita Boats v. Thunder Craft Boats*; (2) *Feist Publications v. Rural Telephone Service*; and (3) *International News Service v. Associated Press*.

CHANGING THE LAW THROUGH LEGISLATION—*BONITA BOATS* AND THE VESSEL HULL DESIGN PROTECTION ACT OF 1998

Congress shall have the power “to make all laws which shall be necessary and proper for carrying into execution . . . powers vested by this Constitution in the government of the United States.”

Not all changes are accomplished through judicial action. When Courts decline to extend protection to new areas of innovation, there remains the alternative of legislative action to create new laws. In the U.S., Congress can create almost any law so long as the new law falls within the broad constitutional limits of the “Elastic Clause.” In *Bonita Boats*⁶ and the continuing story, there was a little of each of the three mechanisms for change enumerated earlier.

In the boat hull design and manufacturing industry, there was rapid and rampant reverse-engineering of the newest designs because of a quick new method of copying through the use of molding technology. Once the boats were displayed in public or sold, the details of the newest hull design went into the wealth of public knowledge (“Public Commons”) for use by anyone. Competitors, under their right to copy or use anything in the public commons, copied each other’s designs freely. Prior to the advent of new technologies, a boat manufacturer undertook a relatively long process to replicate the mold and, in a sense, that gave the designer lead time in the market to be exclusive and recoup the costs of his design or innovation efforts. As technology progressed and fiberglass hulls became increasingly popular, there was little difficulty in simply creating a mold of the newest hulls on the market and then rapidly market competitive fiberglass boat hulls. In the first part of the story as it relates to the law in flux, the State of Florida acted to protect the boat hull designer by enacting a law prohibiting the previously permitted copying when it was specifically accomplished through molding of a hull with the new design.

The law was challenged by those claiming a right to copy from the public commons by any method. The Supreme Court decided that the Florida law was unconstitutional in view of the federal laws on patents. In a sense, what was being said was that only Congress and not an individual state could create a law extending protection if the existing intellectual property laws did not apply.⁷

In response, Congress passed a new federal law that essentially had the same purpose and effect as the precluded Florida law. However, instead of prohibiting the specific way in which the copying was accomplished, Congress added to the existing Copyright Act.⁸ What happened after the decision in *Bonita Boats* and the amendments to the Copyright Acts is a still-unfolding story of laws changing to accommodate economic interests and protect previously unprotected intangible assets.

In amending the Copyright Act to protect boat hulls and decks, Congress created a new kind of protection. The section added to the Copyright Act at the time looked suspiciously—to opponents of new design protection—like a generic “design protection” law. It was “generic” in the sense that it could easily have applied to other articles besides boat hulls and decks.

The fashion industry has recently sought to extend the existing federal law to protect fashion designs that have heretofore been unprotected under any existing laws. There is also a movement to simply create *sui generis* (original) protection for designs of all functional articles. Such a change in the law would make U.S. laws more aligned with those of other countries, and especially those of the European Union.

Past and proposed new U.S. laws to protect the design element of functional articles have taken place despite the existing statutory scheme for obtaining design patents. Anyone that secures a design patent enjoys a monopoly over the use of the design for 14 years, but the monopoly begins only after the design patent is granted by the government. But, as recited in the Legislative History of the Boat Hull Protection Act, “. . . the difficulty in meeting these extraordinarily high standards, combined with the costs and delay associated with researching prior art, dissuade many designers from pursuing this option.” In one sense, according to the boat design and manufacture industry, there was nothing available that protected the lead time they needed to underwrite and recoup the investment made in the new designs. Whether design patent protection was given a fair rap, the continuing demand by various industries for protection of design by another suggests that the system for U.S. design patents is not filling the need of those industries. Neither is that need being filled by other options for protection.

By way of some background, efforts toward a federal design protection statute other than that for design patents began in 1914. Congressional bills took one of two forms: 1) changes to U.S. copyright law; or 2) “relaxation” of the restrictions placed on design patents. Despite periodic efforts in Congress,⁹ other than for the boat hull and deck designs, to date there is still no generic design protection act after so many years.

The fundamental reason was expressed by the U.S. Supreme Court. The Court said that there were concerns that formalized design protection would possibly upset a critical balance struck in intellectual

property law, especially the law of patents, namely, that the promotion of innovation must, at some point, give way to imitation and refinement through imitation, both of which are “. . . necessary to invention itself and the very lifeblood of a competitive economy.”¹⁰

In other words, detractors of design protection schemes that have been offered fear that if comprehensive design legislation are practically applied, it *might diminish rather than stimulate net commercial activity throughout the economy*. They argue that such a system of generic protection for designs on functional articles would be too great a restriction on the “right to copy” from the “public commons” and that would mean less competition.

Another genre of reasons put forth for and against separate design protection, apart from that available through design patents, relate to the desire to keep a bold delineation between the varied intangible property classifications along the following lines—utility patents for the workings of functional articles, design patents for the ornamental look of a functional item, and copyright for the look of nonfunctional articles. The problem is that, even for those who believe that there can be clean lines between functional and nonfunctional elements in an article, today, technology, aerodynamics, ergonomics, and just the pace of innovation alone, keep creating hybrids that blur the lines.

TANGLE® TOYS AND THE NEED FOR DESIGN PROTECTION

That's why it's time for a change.

—THOMAS DEWEY

The story behind Tangle® toys offers a view of such blurred lines. Tangle® toys are the creation of Richard Zawitz. The functional aspects of the unique toys were protected through the filing and ultimate issuance of a series of utility patents. However, as with any small inventor, costs were a major limiting factor to worldwide patent protection. Nevertheless, Mr. Zawitz sought protection for design elements of these “moveable sculptures” under the laws for copyright in the U.S., and elsewhere under the Berne Convention.¹¹ Obvious benefits from this copyright protection, beyond the lack of any cost limits, might include 1) the option to

sue for copyright, rather than patent, infringement in the U.S.; 2) the potential for award of statutory damages in lieu of having to prove the existence and extent of damages through lost sales; and 3) the potential for award of attorneys fees,¹² all major factors for a small company or inventor budget.

Over the last decades, it seems as if many new innovations *and the newly increasing value of information* have driven efforts to expand copyright protection (e.g., software and video games, semiconductor masks, database collections, and even the advent of mold-injection boat hulls). Why does copyright protection seem so desirable? First, there is instant protection upon creation, unlike patents and design patents that require governmental action to create the asset. Even in the U.S. where there is a registration scheme, the registration is relatively quick and inexpensive to obtain.

A second major factor is the length of the monopoly right granted (i.e., the life of the asset is relatively much longer, especially when compared to the ease of creating it). Copyright protection lasts for a very long time: the life of the author plus 70 years, 95 years, or 120 years, depending on the circumstances. Patents and design patents are granted for 20- and 14-year terms, respectively. In addition, when it comes to IAM, if one can obtain copyright protection, applying later for design patent protection can still be an option at least for a period of time.

Copyright protection is the subject of very broad, almost worldwide international treaties. The relatively inexpensive and easy to obtain worldwide protection through copyright cries out for a global strategy when it comes to executing a competitive business strategy. The market introduction of the highly popular Crocs[®] shoes provides a recent example of such strategy. At their inception, Crocs[®] shoes were resin-based sport shoes with a design feature present on one edge of the “upper” shoe. Utility and design patent protection was filed early, but before any patent protection could be obtained, there were a spate of knock-offs in the U.S.¹³ and elsewhere. Based on the then current history of action by the U.S. Copyright Office, and given that a shoe is beyond argument a “functional” item, there could certainly be no guarantee that registrations in the U.S. would issue.

However, copyright law on the subject of designs in functional articles differs from country to country, with some more lenient and expansive than the protection given in the U.S. Thus, one possible strategy is to think

globally right from the start and to look at potential copyright infringement actions, including seizure and preliminary injunction relief in countries outside of the U.S. While this might not prevent competitive copying in the U.S., preventing sale and distribution in part of a competitor's global market might be a deterrent, given the practical difficulties of global marketing when particular products are barred from some countries.¹⁴

U. S. COPYRIGHT LAW AND THE PROTECTION OF DATUM AND COLLECTIONS OF DATA

The new electronic interdependence recreates the world in the image of a global village.

—MARSHALL McLUHAN

What about the protection of data? Jeppesen Sanderson, Inc., illustrates the classic problem with copyright protection, and provides an interesting example of intellectual asset management strategy.

The company was founded in 1934 by Elrey B. Jeppesen to make aeronautical navigation charts for pilots.¹⁵ During the early days of aviation, pilots navigated by spotting prominent landmarks on the ground. In bad weather, or when their visibility was limited and the ground couldn't be seen from the air, pilots had to land and wait for the conditions to pass. During those days there were no aeronautical navigation charts. As one of the early air mail pilots, Jeppesen began keeping handwritten notes on his flight paths. According to the company history, *The Elrey B. Jeppesen Story*, "Jepp" began to record "... field lengths, slopes, drainage patterns, and information on lights and obstacles. He also included drawings that profiled terrain and airport layouts, and noted phone numbers of local farmers who could provide weather reports." As pilots and airlines learned of his charts, and the wealth of information they contained, the early notebooks grew into a global business that thrives to this day as the publisher of the *Jeppesen Airway Manuals*.

From Jeppesen's business perspective, the system to maintain and collect data was a major expense and when a single piece of data such as the

height of the watch tower at a particular airport changed, that data was valuable. It was the kind of data that allowed the company to sell its maps as a subscription service with updates, rather than at a single sale.

The big problem was that once the revised page with the new data point was distributed, there was nothing to stop a competitor from providing the same information (which after all was publicly available for anyone to research) on its own map—but without any expense of collection. As in other similar situations, the company first looked to copyright law, the normal protection afforded maps. By way of example, it sought copyright protection for its compilation of maps, its individual maps, and each updated version of each map, even when the update differed by a single, publicly available, data point.

However, in 1991, the Supreme Court in *Feist Publications, Inc. v. Rural Tel. Service Co.*¹⁶ spoke on the issue of protecting “sweat of the brow” under the copyright laws. This was a very big event in the world of protecting information and data for those whose business, like Jeppesen, involved great effort and expense in collection. Like the situation experienced by the boat hull design and manufacturing industry, once the information became available to anyone, the data itself was in the public commons. Again, with the advent of new technology, like the telegraph and then the Internet, the ability to compete using the information so laboriously gathered by someone to almost immediately compete with them seemed *unfair* to some courts and permitted by other Courts defending the right to copy from the public commons. By the time of *Feist*, protection for this type of data well depended on which court you chose,¹⁷ making the risk of litigation even greater.

The decision in *Feist* appeared to leave Jeppesen, phone book publishers, and newspapers with no recourse to protect their investment. The Supreme Court succinctly said that “sweat of the brow” is not a proper basis for copyright protection in the absence of originality and creativity.

After the *Feist* decision by the Supreme Court, what happened to the value of databases? They certainly did not become less valuable to Jeppesen or *Feist*. If anything the value of pure data and database collections has only increased with the coming of the Information Age. The Supreme Court merely said that the copyright laws only protect works of a minimal creativity and originality (i.e., a cause of action for copyright infringement was not the correct cause of action). It did not say that protection could not lie elsewhere.

At least four general types of IAM strategies still exist to protect information, namely: 1) Contract; 2) Trade Secret; 3) Privacy and, if we look at a global strategy; 4) we find specific provisions in the rules for the European Union that protect databases. In other words, depending on the circumstances, datum and database collections that are used or published without authorization from the purported owner, may be unlawful and the taking may be redressed through a variety of “causes of action.”

A signed contract between two parties not to use or disclose data can be enforced by one party against the other. Typically we may think of non-disclosure agreements where information is shared for some business purpose (e.g., due diligence), as the written promise not to use it or disclose it for any other reason. That however, is a tactic, not a strategy.

Contracts can play a strategic role in a “strategy,” for example, when the business involves providing data of some sort for value. A classic example these days is in direct mail advertising or solicitation. Advertising is expensive and with the increasing cost of mailing, everyone who wants to reach a potential customer or constituent is interested in lists of persons that are the most likely targets. Many companies compile and “sell” such lists. In reality, for reasons that will become clear, they *rent* the information in the lists.¹⁸

Think of an example where the business model involves providing useful marketing information. Suppose it is in the nature of detailed aerial photographs of future commercial building areas. In one model, you could compile the photographs into a book, claim copyright protection in the book, and then sell the book. However, once the book is sold the *information* in the book is no longer protected and can be freely used and disseminated by the purchaser.¹⁹ Perhaps, if there will be fairly regular updates to the information, the business plan may evolve into a subscription service where for an annual fee, the purchaser receives updates as well. Still the information is free to use and disseminate once delivered.

Now consider a situation where the subscription is sold through a written contract that the purchaser signs and the contract contains a provision requiring that the purchaser only use the information for a limited period of time and, further, agrees not to share it with anyone not part of his business. In that instance the information can be thought of as an asset that is being leased for a certain period of time. This begins to look like a business strategy that is executed in part through basic *contract law*.

With contracts, two parties can agree to do or not to do many things that they might otherwise have a right to do (e.g., use or not to use particular information, even if the information is otherwise in the public commons). In that way, protection, not otherwise available, becomes available one person at a time through contracting with each one.

What about selling the books and limited subscriptions to all the local libraries as part of the sales plan? Think about the nature of a library's business. Selling to a library presumes the library will put the book on the shelf to be read by anyone who will have access to the information. Libraries do not ask their readers to sign contracts limiting use of the information in their stacks of books and so there is no basis for restricting the use and dissemination of the information by the readers. In this scenario, the best strategy for maintaining the asset base, while making profit through sharing the information, seems to be to limit sales to those who will contract not to permit others (not also bound by the contract) to have access to the book. For example, drilling log information that is collected might typically be sold to major oil companies under such a scenario.

Data is an intangible asset that can have value. As an intangible asset it can be "sold" over and over again because using it does not deplete it. One strategy for managing and maintaining the asset value is based on "contract."

Suppose one comes into possession of such data without signing a contract. Are they free to use and share it? The answer is still only "maybe." Depending on the factual circumstance, other "causes of action" might be available to the "owner" of the data. If you are a corporate officer or in some other trusted relationship with the owner, it seems *unfair* that you could take the information simply because you never signed a contract. In fact, it may be unlawful for you to use or disclose the information because that would be a breach of your "duty of loyalty" or that, because of your close relationship, the law *implies* a contract of confidentiality and noncompetition and holds you to that inferred contract even though nothing was written or signed.

Similarly, it seems *unfair* if the information is stolen, that the use of stolen property should be lawful, and, in fact, it is not. If the information is highly private (e.g., the aerial photograph shows a local person in a private but embarrassing, situation) then it may be an unlawful invasion of that person's privacy to put that picture in a book.

The fact of the matter is that in the U.S. and many other places, there is a sense that anything in business that seems *unfair* may, in fact, be remedied through a cause of action for “unfair competition.” This concept of wanting to require that business dealings be “fair” often runs right up against the public policy of limiting monopolies in manners that are also fair and predictable. Once again, we need to know what can and cannot lawfully be done when it comes to business.²⁰

UNFAIR COMPETITION AND *INTERNATIONAL NEWS SERVICE V.* *ASSOCIATED PRESS*²¹

There is no part of the law that is more plastic than unfair competition, and what was not reckoned an actionable wrong 25 years ago may have become such today.

—FRANK I. SCHECHTER,
THE RATIONAL BASIS OF TRADEMARK PROTECTION, 1927

This is another famous story involving an intangible asset, “time-sensitive data,” that did not seem to fit into the normal “causes of action.” It has been said that this case “introduced” the cause of action for competitive behavior that was simply “unfair” (i.e., the tort of unfair competition into U.S. law).

Let’s look first at the factual situation and at what the Court did in the light of activities that it deemed to be “unfair” on the part of International News Service (INS). Then we will look at (1) how the Court characterized the “unfair” activities of the parties, (2) what was of value that the Court was trying to protect, and (3) how the law was changed for future activities.

In *INS*, Associated Press was delivering the final scores of sports events and similar “news” items to its affiliated newspapers. INS began getting the information from one of these early publications and using the then new invention of the telegraph to make it available to nonaffiliates. In deciding *INS*, the Court wanted to prevent the diminution of value in the Associated Press’s business, which resided in the timeliness of transmitting information or “news.” The information itself was not protected

and free for appropriation by all at some period *after* it was disseminated. But clearly, taking it at the outset by a competitor was thought of as an unfair taking of something *while* it was valuable.

For the first time in U.S. law, the Court created a dual standard with respect to something of value, and for an intangible asset. The Court said that *as between two parties (competitors)* anything of a “pecuniary” nature can be treated as a property right and, therefore, protected. It held that INS’s actions were “misappropriation” and thereby the Court defined a new kind of Unfair Competition. In other words, the Court decided that misappropriation of “*quasi-property*” *by a competitor* constitutes a form of Unfair Competition. The same is true of any activity that is found to be an *unauthorized interference* with the normal operation of another’s legitimate business. And it isn’t just a direct competitor who can be guilty of misappropriation. Anyone who capitalizes on someone else’s effort may be prohibited from so doing.

In settling the matter, the Court:

- 1) Enjoined appropriation until it was no longer “hot news,” and until its commercial value *as news* had dissipated (i.e., gave protection for a limited period of time to information otherwise in the public commons).
- 2) Defined “quasi-property” as between competitors, even when there was no property right against the public at large (i.e., non-competitors were free to use and copy the information since that did not negatively affect the Associated Press.
- 3) Prohibited “trying to reap where one hasn’t sown.”

What was of value that the Court was trying to protect?

- 1) The “thing” is not data or information (news), but relates to the *business* of making it known to the public.
- 2) The “thing” is of value due to large amount of organization, skill, effort, and cost that the gatherer can profit from.
- 3) The “thing” is also of value to someone who misappropriates it.
- 4) But, for whatever reason, the “thing” has not been called out for protection under the laws of intellectual property (i.e., it is not protected as a patent, copyright, trademark or trade secret).

Moreover, the “thing” was taken by a direct competitor. Rather than give protection to the “thing” by appending it to the laws of patent,

trademark, trade secret or copyright, the Court defined a new type of property, *quasi-property*, by its ruling that “as between two parties (competitors) anything of a ‘pecuniary’ nature can be treated as a property right.” In a sense, it could then apply the existing laws of “misappropriation” or even “theft” to this new property or property right.

How does all of this relate to IAM? Successful and strategic IAM looks at the needs of business whether from the perspective of the owner of something of value that they want to keep exclusive (the quasi-property) *or* from the perspective of a competitor that needs to do the same or similar things in order to be in the market at all.

In both cases, it is having an understanding of the reasonable boundary between the protected property and the “commons” or public domain, at the specific point in time that a conflict may be taken to court. Understanding this balance is key to maximizing the value of intangible assets and the existing legal cases form a basis for helping business under that theory.

Clearly, future planning and strategies might involve timing activities *or* selecting markets so that a “conflict” is less likely. And they must always bear in mind that, as we have seen, the boundary can and sometimes should change.

Most businesses have a sense of what is right and wrong, and from the perspective of the law, we like to think that “for every wrong, there should be a remedy.” Nevertheless, genuine use of what is in the public commons should not be prohibited and should not necessarily be avoided. Weighing the risk of conflict *and* the probability of success in defending a claim are very different, but equally important. Often there is a propensity for the lawyers to opine on both, whereas in most cases the business persons are the most likely to know what a competitor will or will not do when faced with a particular situation.

In summary, what were the Courts doing in these cases of unfair competition like INS? It seems as if they were just trying to establish “fairness,” in legal terms, and apply equitable principles in situations that didn’t “fit the mold” of the time using economics, lack of lead time, and “reaping where one hasn’t sown” as some of the reasons. While protecting the “fruits of labor” may have merit, there are also business interests in being able to capitalize and advance on ideas and information, though not your own, that are rightfully in the “commons.” Thus it can easily be said that the public interest is equally served by strict limits on the

monopolies granted, and not just by courts finding ways to create new “quasi-property” to be protected.²²

WHAT ABOUT TRADEMARKS AND BRANDS

*What's in a name?
That which we call a rose,
By any other name
would smell as sweet.*

—WILLIAM SHAKESPEARE, *ROMEO AND JULIET*

In some respects the ongoing changes in law of trademarks are the most reflective of the increasing change in the value of intangible assets in general. For trademarks to exist, they must indicate a single source of origin, and must represent “the good name” of an enterprise built over time. The concept of trademark emanates from the early practices of artisans (e.g., Paul Revere) to identify wares they made and even older “guilds” who had exclusive rights to manufacture or use certain symbols to identify their wares as authentic. From society’s point of view, the purpose was to protect *consumers* from being duped in the marketplace by unscrupulous practices through which they would be sold goods with the false impression of who or where the goods came from.

It was the trademark owner who could go to court to stop the infringement. He could define what he owned through the “cause of action” he could bring and they were normally based on some form of deceit. As such, someone had to be deceived, and from that proposition, trademark law evolved with the consumer as a silent third party to the action. In other words, for a trademark owner to prevail against an infringer, he had to prove that the public was or was likely to be deceived into purchasing the wrong product. The law evolved as a form of consumer protectionism without too much regard for the trademark solely as the “property” of the trademark owner that warranted protection.

The ever-increasing importance and value of trademarks in commerce dates back to the advent of the Industrial Revolution when goods were manufactured in factories and the ultimate source of the product might

have been harder to identify in the absence of meaningful trademarks to distinguish the goods of one manufacturer from another. The intrinsic value of a trademark as something that could enable success in the market for other than the original products evolved. The value of trademarks as brands and as something of value to *others* who might be willing to pay for the right to use or license a trademark emerged during the 20th century, increasing exponentially as compared to the law that was available to protect such a valuable commercial assets. The reason was that the law remained rooted in the idea that someone might be confused or misled. However, commerce and “the market” understood that a trademark could be a valuable asset whose value could be diminished or tarnished by unfettered use by others, even if circumstances were such that there was no confusion.

Think about the situation where a third party unrelated to Alcoholics Anonymous used AA[®] as a brand for alcoholic drinks. It is unlikely consumers would think a product came from such a renowned ‘antidrinkin’ body, yet somehow we think that Alcoholics Anonymous should be able to stop the use of their brand for that purpose. From a legal claims point of view, what was needed was protection that permits a trademark owner (Alcoholics Anonymous) to prevent harm to its “good name” (other than a common law form of “libel” or “slander”) or that permits the trademark owner to prevent others (AA[®] alcoholic beverage producer) from “reaping” benefits from unauthorized (i.e., unfair competition), without having to overcome any type of consumer protection hurdle and prove consumer confusion.

The world’s laws are indeed in flux as the demand for this kind of protection for valuable trademarks and brands is coming into existence. In the U.S., the primary change has been in the evolution of the laws against trademark *dilution*. The roots of these laws hearken back to the protestations of a Harvard Law professor, who in 1927 published an article in the *Harvard Law Review*, entitled “The Rationale Basis for Trademarks.”²³

Professor Frank Schechter argued that the law should protect trademarks as property independent of the likelihood of confusion. He opined that even back in the 1920s, the outcome dictated by the requirement of finding a likelihood of confusion in order to protect the trademarks of the day was too restrictive to serve the needs of “modern business.” He reasoned that trademarks were much more than a symbol of an enterprise’s

“goodwill” but rather were valuable instruments of commerce, in and of themselves, and that their appropriation and use by others in any form (independent of consumer confusion) was harmful to their value.

For some 70 years after Schechter’s arguments, the law changed but only on a state-by-state basis. Almost half the States tried to offer protection to trademark owners on the basis of property rights with Anti-Dilution Statutes. Only in 1995 did Congress seek to act for the nation as a whole in this regard. It added a cause for trademark dilution to the federal Lanham Act²⁴ under the Federal Trademark Dilution Act of 1995.

But today, from a purely economic point of view (i.e., trademarks as property), and the demonstrated value of brands in the world of mergers and acquisitions, the law is still lagging reality. Not all trademarks qualify as “property.”

CURRENT STATE OF THE ANTIDILUTION STATUTES AND CASE LAW²⁵

Begin at the beginning . . . and go on till you come to the end: then stop.

—LEWIS CARROLL

According to the reasoning behind the current state of the Federal Dilution Act, as amended under the Trademark Dilution Revision Act of 2005, the cause of action for dilution stems from use of a trademark on goods or in other ways unrelated to those of the “owner,” and there is often no deceit (i.e., no likelihood of confusion). The problem with this scope for dilution is that not all marks of value are protected. As Schechter wrote back in 1927, “quite apart from the destruction of uniqueness of a mark by use on other goods . . . once a mark has come to indicate to the public a constant and uniform source of satisfaction, its owner should be allowed the broadest scope possible for . . . [expansion] to other lines or fields of enterprise.”

As it currently stands, federal protection under dilution is now reserved solely for “famous marks,” namely, those widely known among the general public. This excludes marks that are widely known within a niche market. In this day and age, with the ever-increasing value of intangibles in general and brand (if not all trademarks) in particular, it seems

unwarranted to suggest that only widely known (i.e., those of consumers products or lavishly advertised (think Archer Daniels Midland) products are to be treated and protected as true property without requiring an element of deceit.

Can there be a reason not to provide protection from dilution and tarnishment to every brand of value?²⁶ To read the cogent remarks of scholars like Schechter makes it seem unreasonable.



Notes

1. E.g. *Edison in the Boardroom* and *Rembrandts in the Attic*
2. Records at the USPTO disclose that several applications filed for the Michael Kors Company for “Kors” as a trademark were abandoned after being opposed by Coors Brewing Company.
3. In *International News Service v. Associated Press*, 248 U.S. 215 (1918) (INS), the U.S. Supreme Court coined the term “quasi-property” to define something that could be protected in commerce as between competitors. In their decision, the Court deemed a protected intangible asset was hot news items, e.g. recent sport scores.
4. *Parker v. Chakabarty*, 447 US 303 (SC 1980).
5. The concept that the laws of the United States could and would change can perhaps be traced back to “necessary and proper” or the “elastic” clause. In some respects, the debate over that clause was about limiting the power of the federal government vis-à-vis the states. However, whether intended or not, the “elasticity” of our legal system guaranteed from the outset that laws would and could change to the same extent a monarchy or dictatorship could be presumed to have power to enact a “change of mind.”
6. *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989). Hereafter *Bonita Boats*.
7. The U.S. Supreme Court declined to permit a state law to protect the design of certain boat hulls from being copied by reverse molding. It held that state laws were preempted by the federal statutory scheme of copyright protection. According to the Supreme Court, to allow the states to regulate against such copying in essence was an impermissible extension of the definition of copyrightable subject matter to include functional aspects of a boat.

8. In fact, Congress amended that new law later, and later amended that new section of the law when a subsequent judicial interpretation suggested that the deck portion of a boat hull was not protected.
9. The Copyright Act amendments of 1976 resulted in a major overhaul of U.S. copyright laws. The Senate version included a design provision in its version, but it was deleted in conference.
10. Bonito Boats.
11. The Berne Convention for Literary and Artistic Works is an international treaty under which signatories (now at about 163 countries) beginning in 1886 cooperate to uniformly give protection in their respective countries to certain rights of authors and artist in their works.
12. The potential for statutory damages and the award of attorney's fees can be a major enticement for alleged infringers to settle.
13. The almost immediate presence of knock-offs of the modestly priced Crocs® shoes was commented on in the Legislative History of the Fashion Design Act in comments put forward in favor of the Act.

“With the recent democratization of style, creative design originates from many sources and at all price levels. Fashion is now as likely to flow up from the streets as down from haute couture, and reasonable prices are no guarantee against copyists. Some of the most aggressively copied designs are popularly priced; consider this summer's popular Crocs “Beach” style shoe at \$29.99 and its battle with copies sold for as little as \$10.00.”
14. According to the public records, the owner of the Crocs brand did, indeed, file for copyright infringement in both Canada and New Zealand in the time frame prior to issuance of any patents. Once patents were issued, the company sued multiple patent infringers at the International Trade Commission with some successes. In the interim, the company drove brand awareness and desirability to a point where customers continued to choose the Crocs® branded product over cheaper imitations. Crocs was the subject of one of the most successful recent IPOs. The stock, which opened at a price of \$23 in early 2006, saw a demonstrable increase after instituting the ITC proceedings and has capitalized on its strong brand equity to expand its product line both through innovation and acquisitions.
15. The background information is restated from the display at Denver International Airport's Jeppesen Terminal (with the permission of the City of Denver).
16. 449 U.S. 340 (1991)
17. In legal terms there was a “split in authority” among the federal courts.
18. This idea of what looks like a sale as being really a lease is common these days in the field of software and any place else that “the strategy for protection” involves trade secrets. The reason is that a normal sale transfers title and all rights of ownership and unlimited use, etc. to the owner. If the business model requires limiting the use and sharing of the product, it is a “lease” or license (a form of contract), and not a typical contract for sale that does the trick.

19. In the case of a copyrighted book, no one may be free to photocopy the pages containing the information, but information from the book can be used and passed along.
20. The question of whether everything lawful is necessarily ethical is addressed in Chapter 8.
21. *International News Service v. Associated Press*, 248 U.S. 215 (1918) Hereafter *INS*.
22. Contrary to *INS* is the case of *Am. Safety Table Co. v. Schreiber*, 269 F.2d 255, 272 (2d Cir. 1959) wherein the Court remarked: “[I]mitation is the lifeblood of competition. It is the unimpeded availability of substantially equivalent units that permits the normal operation of supply and demand to yield the fair price society must pay for a given commodity.”
23. Frank I Schechter, “The Rational Basis of Trademark Protection,” 40 *Harv. L. Rev.* 813, 821-22 (1926-1927).
24. This is the uniform federal U.S. trademark and unfair competition law in effect today. It was enacted July 5, 1946, when, after the onset of post-War development, it became essential to have uniformity in a nation where interstate commerce was dominant. Its purpose is to eliminate unfair competition in marketing goods and services and to provide the owners of marks protection against “unfair competition” in the form of prohibiting the use of similar marks to confuse the public with respect to the sales of goods and service. The Amendment to include Trademark Dilution is the first major substantive revision since enactment.
25. For a sound recent report on the detailed state of the law as it is today from the lawyers’ perspective, see the article in *IP LAW* 360 by Jonathan Hudis entitled “Trademark Dilution: Where We Are Going, Where We Have Been,” 10/25/2006.
26. Opponents of expanding protection beyond that needed to avoid “deceit” say that such nonfamous marks are adequately protected by trademark infringement. Even if true, the authors suggest that to exclude such marks from protection under the statutory scheme of dilution is to continue the practice of changing old laws (Lanham Act) on the basis of old criteria rather than updating both the laws and our thinking based on the economic realities of the day. In reading the legislative history of the recent dilution amendments, it seems as if those most contented with the limited scope of beneficiaries were those who would clearly be afforded protection as part of the intended beneficiary class, or those with vested interests in the scholarly legal analyses of the past.



Intellectual Asset Management

IP STRATEGY—THE ROAD MAP

If you don't know where you are going, then any road will do.

—LEWIS CARROLL, *ALICE IN WONDERLAND*

Intellectual asset management (IAM), as discussed in this chapter, encompasses all decisions as to which Intellectual Assets (IA) to have, to hold, and to use or whether to have them at all. Within IAM are many of the day to day activities of knowledge workers, right down to the details of organization, budget, time-lines, and action plans.

For any aspect of IAM to be optimized, it must be executed in accordance with a sound “IP Strategy” that in turn should, of course, be aligned with the corporate mission and business plan. But “what is an IP Strategy?” and “where can I find one?” are the unanswered (and sometimes unasked) questions of many who are already functionaries in the IAM of many enterprises.

Conceptually, IP Strategy is at the very least a guiding principle that is behind each individual decision relating to IP that has been taken. Every branch of a decision tree is akin to a “road” that may or may not be taken and the IP Strategy can be thought of as the “road map.” But how do we actually create an IP Strategy?

First, at a minimum, look at a “Business Strategy,” or if you must, create one. In some enterprises, this may be articulated in a “Mission Statement.” In most, it can be espoused by the principals and executive management.

Next, assess “IP Competencies”—the portfolio of all enterprise competencies that affect or relate in any way to IP and that have been used or may

be needed for use in the future anywhere across the whole enterprise to successfully implement the business plan. This portfolio is created in part by identifying how the enterprise will gain or maintain competitive advantage, market share, and the like.

John Nevard, Chief IP Counsel of Inverness Medical Innovations, Inc., suggests the following classifications of IP competencies:

1. Freedom (as in Freedom to Operate) is the ability to identify and assess actual and potential competitive threats and to neutralize them.
2. Protection (which could be equated with legal rights, property, or intangible asset) is the ability to identify and assess potentially protectable and relevant intellectual property and to obtain appropriate protection.
3. Enforcement is the ability to use appropriate IP law to position the enterprise at a competitive advantage.
4. Transfer is the ability to maximize the value to the enterprise of IP that is created or acquired.
5. Intelligence is the ability to accumulate, assimilate, and process information and to monitor and predict what competitors do or will do.
6. Culture is the ability of the enterprise through its principals and executives to be educated and open to seeing IP as an important influence on its decisions.

By way of example, a typical start-up in a fast-growing industry or market where there is no doubt that growth can be sustained might want to grow market share as rapidly as possible as a business strategy. The point-by-point corollary in their IP Strategy might be the following:

- Neutralize actual and potential barriers to entry.
- Erect barriers to entry for industry followers and blocks for existing and potential barriers to entry.
- Gain reputation as a “feared” industry leader, meaning the company is willing to defend encroachments on its IP assets.
- Acquire control of the industry by actively seeking partnerships/licenses/technology.
- Anticipate followers and existing and potential parallel competitors.
- View IP as a highly valued asset and actively employ IP as a business tool.

Once there is an IP Strategy, the IAM functions and activities with respect to creation and maintenance can, and should, become just as strategic as IA leveraging.

WHO MANAGES INTELLECTUAL ASSETS AND WHAT EXACTLY DO THEY DO

Too many people overvalue what they are not and undervalue what they are.

—MALCOLM S. FORBES

More jobs are included in our definition of IAM than just those that are charged with the success and strategic business planning of an enterprise. Not all knowledge workers practice in the field of IAM. However, if you work in a particular industry (e.g., publishing), or have had a job where you hear of or are required to know the word(s) or anything else about “patents,” “copyrights,” “trademarks,” or “brands,” or are required to sign a nondisclosure agreement, then chances are you are either practicing in the field of IAM or giving information or ideas to those who are.

For example, crafting patent claims is a part of creating intellectual assets. To the extent a patent attorney or a patent agent decides the end result of the final claim language, he or she is forming the edges of the property right and the very existence of the intellectual property asset. Similarly, those who name new products to be introduced to the market are not only creating new intellectual assets (i.e., trademarks), but are presumably implementing strategy and/or executing in conformance with the brand architecture of a company.

Portfolio managers, copyright, patent and trademark administrators, and many others work to keep track of numerous copyrights, trademarks, and/or patents. As they implement decisions, whether their own or that of others, with respect to the maintenance of these assets, they are part of the IAM of the enterprise. Those who execute enforcement actions, from letter-writing to litigation, are a part of IAM to the same extent as those who decide upon or authorize such actions.

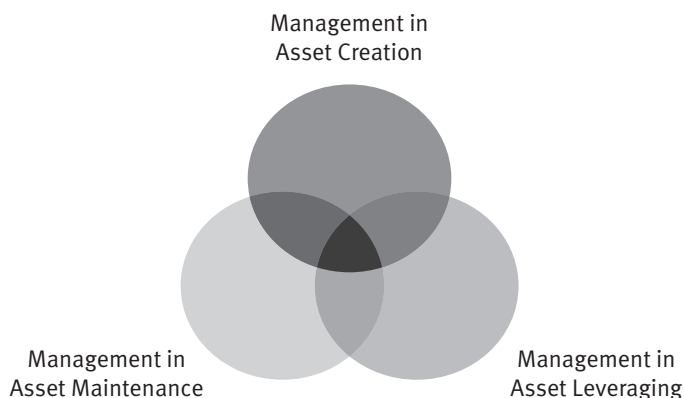
IAM IS DIVIDED INTO THREE PARTS

I pass with relief from the tossing sea of Cause and Theory to the firm ground of Result and Fact.

—WINSTON CHURCHILL

Tackling large problems in parts has been successful for many centuries. IAM proves to be no exception. Assessing what role one plays in the new discipline of IAM is easier if one *segments* the different activities that play a part in strategic asset management. Referring to the chart below, we conceptualize three different aspects of IAM, namely, management in asset creation; management in maintenance; and management in asset leveraging, represented by the three circles in Exhibit 5.1. The area of overlap among the three circles is a simple recognition that some workers in the field of IAM can and do execute functions in two or three areas depending on the particular company, industry, and job structure.

Intellectual Asset Management in the Creation of Assets concerns itself with activities that surround the time the asset is being formed. Of course, with respect to patents, there are the inventors. However, for our purposes we will be more inclusive. We include those involved at the time the patent is being drafted and filed.¹ This includes not just the patent attorney or agent who drafts and prosecutes the patent application, but also those who take



part in the steps by which the innovation is disclosed and the decision as to which innovations will be patented and in which countries. These could be the persons on a patent evaluation committee or the Chief Technical Officer or even the people that are part of or work with the patent evaluation committee. For example, IA Managers in the creation of patents as assets are occupied with deciding what and where to patent and then defining, filing, and ensuring the scope of claims. With respect to trademarks, the same is true, except it is in the selection of trademarks and the decision as to which classes of goods or services will be the subject of trademark registration.

Intellectual Asset Management in the Maintenance of Assets concerns itself with activities such as cataloging of the intellectual assets and, if and when the IAs must be renewed or maintained through government filings and/or payment of government fees. The sheer cost of maintaining patents in many countries requires constant attention if monies allocated for Intellectual Property are to be husbanded. This is particularly true where large portfolios are involved. One tactic widely practiced is a form of “triage” for processing large numbers or analyzing large problems by “dividing” all holdings into three segments or sections. One model for patent “triage” contemplates cataloging patents as (1) key to the core business; (2) tangential to core business, related to planned expansion, or valued by third parties; and (3) neither (1) nor (2). Another “triage” on patents is to classify the patents according to whether the patent is (1) revenue generating (e.g., it protects core business products or processes or is licensed and brings in royalties); (2) potentially revenue generating (e.g., infringed by third parties who could be sued or forced to license); and (3) neither of the above. In both cases, maintenance costs are allocated accordingly to (1) and/or (2). Patents in (3) are then abandoned by nonpayment of any maintenance fee as they become due. Often, there is also a periodic review of the status of those in (2). An interesting statistic from the I.R.S. (circa 2003) in this regard, is that by the twelfth year of existence, two thirds of all U.S. patents are abandoned, presumably because the march of technology has moved past their respective invention.

IA Maintenance Managers for most enterprises also include those charged with policing against infringement of trademarks, copyrights, or patents. Particularly in the case of trademarks, where lack of enforcement can diminish or destroy the value of an asset, policing can be an extensive and expensive activity requiring lots of attention (i.e., *management*). Similarly,

even with leveraged or performing assets, such as licensed patents, trademark, and copyrights, the licenses and royalty payments often required oversight and management.

The need for “*management*” and for “thinking like a *manager*” is everywhere. It is more evident with trademarks because lack of policing may destroy the intellectual asset itself. Trademarks are by definition designators of a single source. Once there are too many competitive uses, the public can no longer depend on the symbol to identify a single source and the exclusionary “trademark” right is lost. However, lack of policing against patent and copyright infringers can also destroy the “economic value” of those intellectual assets. After all, why would a licensee pay money to license a property when others in the market are using it for free?²

Intellectual Asset Management in the Leveraging of Assets is our name for what most people think of entirely as IAM. Those involved in this aspect of IAM know that they are involved in IAM or at least think of themselves as integral to the strategic decisions of an enterprise or business that has significant intellectual assets. Thus too, the majority of what is written about and discussed as the management of intellectual assets focuses on asset monetization or “leveraging” to create revenue. However, strategic intellectual asset management also happens during the process of creating assets, maintaining assets, and in enforcing the exclusivity of those assets to create and preserve the value that is to be leveraged.

Many people, both within and outside of an enterprise, may be engaged in the leveraging of intellectual assets. Investment bankers are involved in mergers and acquisitions where IP is a significant asset. Technology transfer officers in university settings are involved in searching for potential licensees of technology. Brand managers and marketing departments are charged with enhancing market share and competitive advantage. Attorneys who counsel on such matters are involved, while not necessary, at the forefront of the decision process. When it comes to management in intellectual asset creation, the lawyers or their administrators are likely the ones to monitor, execute, or orchestrate the IA maintenance policy. However, these “downstream” persons are not always thought of (and do not necessarily think of themselves) as contributors or even as actors in the field of IAM. The authors of this book think this should change as evidenced by the discussion in Chapter 1 of the changing role of all intellectual capital executives as the asset base of companies shifts.

MANAGEMENT IN THE CREATION AND MAINTENANCE OF PATENTS

The patent system added the fuel of interest to the fire of genius.

—ABRAHAM LINCOLN

The question, what can we patent? remains the true purview of patent practitioners (i.e., agents and attorneys, the ones charged with knowing the current law and technical requirements for the issuance or registration of valid patents). A much more strategic question is what should we patent? Of course, the answer changes within different industries, with differing positions in the value chain of an industry, and even among direct competitors within the industry.

Nevertheless, a partial answer common to all includes the goal of acquiring patents that (1) advance the overall business strategy; and (2) could or does provide a competitive advantage. One such advantage useful against competitors might relate to consumers. In that case, desirable patents might protect the products being sold by providing a monopoly that cannot be bridged by competitors who do not hold a valid license to make, use, or sell the patented inventions.

A second category of patents that might be advantageously obtained are those that could be used in cooperation *with* competitors *or* with partners. In that case, desirability of particular patents might be judged by what *they* value. The third type of patents that might be advantageously obtained are those that have extrinsic value to third parties or provide a return on investment through sale or licensing.

But one might still ask, for example, how do IA managers actually *know* what to patent; what to keep as trade secrets; and what not to bother about? Often it is a process of “trial and error.” There are numerous “IAM tools”³ available and the purveyor of each tool can provide information and recommendations as part of the sales effort or consultancy services provided. Sometimes, the IA managers are fortunate enough to have mentors or to know others with similar responsibilities and can learn of and deploy or amend the best practices of or recommendations by others. With respect to *patent* managers, it can be said that “best practices” tend to be those that that: 1) spur innovation; 2) create incentives

for those who innovate to disclose their innovations in a useful way to the patent managers (i.e., maximize cooperation in gathering ideas, innovations, and inventions so that they can be efficiently evaluated⁴); and 3) increase efficiency with respect to creating, filing, and prosecuting applications based on the disclosed ideas and innovations. Mostly, successful IA management at the creation and maintenance stages of IAM involves asking the right questions and using the information advantageously. Some questions include: “Is the protection even worthwhile?” or with respect to patents, another is: “Can infringements be easily discovered?” For example, where patents relate to improvements to a manufacturing process, infringements are difficult to discover from the competitive product produced by that patented process. In comparison, with patents covering a visible feature in a different or improved product, infringements are typically more obvious. With limited resources to create patent assets, it is probably better to patent the latter and maintain the improvement to the manufacturing process as a trade secret. In fact, one simply articulated strategy is to keep one’s own process information confidential (i.e., protect it through trade secret protection and seek patent protection for products and applications or uses for those products).

In truth, the analyses and decisions with respect to what to patent versus what to maintain as a trade secret can be extremely strategic. People tend to think of trade secrets in terms of secret formulas, recipes, and other processes. Consistent with that is what many consider the world’s greatest secret—the Coca-Cola formula.

There are a lot of confused legal and judicial writers who think that if information is available from a directory, for example, then the company use of that information cannot be a secret. The truth of the matter is that almost anything can be a trade secret if 1) it gives the company a competitive edge; and 2) it is kept and maintained by the company like a valuable trade secret. An enterprise may invest vast amounts of time and money, through trial and error, and possess know-how or even “negative” know-how (i.e., information relating to processes or inventions that do not work or, perhaps even just that certain suppliers are preferred for good reason). Such information is within the valid confines of “trade secret” protection—whereas it is not normally suitable under patent law despite the fact that such information if made public would be highly valuable to competitors or would be competitors without the benefit of

such knowledge.⁵ In general, virtually any information can qualify as a trade secret so long as it is “useful” and “secret.”

Another sound question is, “would it be injudicious to sue the likely infringer?” By way of example, in the U.S., patents for methods to treat or cure a medical condition or disease are available. Such patents may not really constitute intellectual assets of significant value given that the infringers are likely to be individuals *with* the condition or disease, or maybe the doctors who treat them and are the source of the recommendation to use the patented cure. Nevertheless, when such patents are for new *uses* for a manufacturer’s unprotected product, they might be quite valuable if, for example, there is a competitive edge to being the only manufacturer in an industry that can *advertise* the new use.⁶ Proficient IA Managers use competitive intelligence to know where to focus research and development (R&D) and intellectual asset acquisition. For example, patent managers might look to create patents in a field where their companies have the greatest “freedom to operate.”⁷ One creative patent manager was known to urge the R & D department to innovate and then patent in technical areas covering the most valuable products of competitors with whom he had licenses or other relationships. Having patents that competitors infringed in production of their product line with the highest profit margin gave him quite a leverage point when it came to future negotiations!

One may not think of patent *maintenance* as being a part of strategic IAM. In many companies, the execution of patent maintenance is handled by many who do not consider themselves a part of the strategic IAM process or team. However, if we think of Intellectual Asset Maintenance in the same terms as Intellectual Asset Creation (i.e., of there being a vision or mission statement or even just a guiding principle or goal [a policy]—a long-range plan for achieving the goal [a strategy], and systems or methods or procedures [tactics]—then maintenance more clearly can be viewed as a tactic and often both as a strategy *and* a tactic.

In a knowledge-based economy, business opportunities present themselves far earlier to enterprises than in prior times. The Internet has made exchange of information instantaneous and has provided a global market for almost any product. To enforce against patent infringement in any given country, there must be patent protection in that country. However, the cost of worldwide patent protection is enormous. It is available to few

and worthwhile only for certain patents held by those few. Different industries have different needs. For example, patents on blockbuster drugs are among the exception in that they often can warrant broad worldwide protection. Conversely, in the semiconductor industry with its massive patent portfolios, what has evolved as the common practice is to typically file and expend the dollars to patent primarily in the United States, Japan, and perhaps one or two other countries of strategic relevance to the business. Other IA Managers may look to the level and ease of successful patent enforcement actions under the comparative legal systems of a number of markets. They then strategically seek patent protection where success is most likely, most timely, and least costly. Obviously, such managers know or learn what the “best practices” within their own industry are. Their goal then is to create a strategy that is an *improvement* over the industry norm in order to achieve a competitive advantage.

Someone *knowledgeable* about the details of intellectual asset creation should address issues such as what program to invest R&D in, what product features to include, what technology to invest in or buy, and at what price relative to the potential gain. Similarly, at some point in time, it should be someone with such knowledge that sorts out what to file, why to file, and finally, where to file. Otherwise, even where budget is not the primary constraint, the decisions cannot be assuredly made in furtherance of the business strategy. When cost savings is accomplished based on criteria other than consistency with a sound IP strategy that is well-aligned with the corporate business strategy, serious opportunities are lost.

MANAGEMENT IN THE CREATION AND MAINTENANCE OF COPYRIGHTS AND TRADEMARKS

Don't fight forces; use them.

—BUCKMINSTER FULLER

For the most part, unlike patents, copyrights and trademarks respectively “spring into existence” at the time an original work is fixed in a tangible medium or used in commerce of the trademark commences. What’s more, with respect to both copyrights and trademarks, anything might qualify.

For copyright there need be only sufficient originality and creativity; and worldwide treaties provide protection against copyright infringement without really *doing* anything.

It is only the U.S., and perhaps one or two other countries, that afford a registration process. In fact, U.S. Courts *require* a registration in order to bring a “cause of action” for copyright infringement. While there are definite advantages if one registers before any unauthorized copying, it is not a requirement. However, from an IAM perspective, at least in those situations where the works are the substantial asset for a business, registration becomes a best practice.

What about registration of unpublished works which, as in the case of software, often include trade secrets? What to do is strictly a question for U.S. practice and it primarily involves weighing the costs and benefits of trade secret disclosure as compared to not registering.

With respect to trademarks, in the United States and other use-based systems of law, the rights in a trademark self-create at the initiation of public use. In some sense, one *can* trademark “anything under the sun.” After all, the test is with the relevant purchasing public. Whatever there is that the relevant “public” comes to recognize as that which identifies a single source of origin is likely to find protection as a trademark under the common law or laws of unfair competition as “something of pecuniary value.” The question “What should we trademark?” is mostly in the domain of branding experts in the sense of selecting trademarks that will be successful with respect to sales and the building of brand equity. But some knowledge of the impact of the law on strategy can only make trademark selection easier and better. Trademarks are classically thought of along a continuum of strength or “source-signifying ability” with respect to particular goods and services, and with “arbitrary,” “fanciful,” and “suggestive” marks providing less strength and merely descriptive marks being largely unprotectable without evidence of “secondary meaning.” As weaker marks are selected, the opportunities for brand extension may be limited. However, this is not necessarily a bad choice if it does not impede an otherwise clear business strategy for future growth.

In the market today one can find Celestial Seasonings’s Sleepy Time® tea and Origins Sleep Time® aromatherapy “mood enhancer” gel, both herbal products. But, they did not always coexist. At one point, after Sleepy Time® tea had been in the market for over 25 years, Origins

entered the market with an herbal-based aromatherapy product named Sleep Time, forcing Celestial Seasonings to assess whether the rights of their famous trademark were being infringed. From the perspective of Celestial Seasonings, Sleepy Time® was a flagship brand for the company who was fairly renowned for its expertise with herbs. As such, brand extension to topical and aromatic herbal preparations might have been reasonably contemplated as within the future of the company. In fact, years earlier, Celestial Seasonings, Inc. had made a foray into selling herbal hair care products. For these reasons, Celestial Seasonings contacted Estee Lauder, the owner of Origins, with a request to cease and desist, and eventually began an opposition proceeding against the Sleep Time application that was being processed by the U.S. Patent and Trademark Office.

The cost of any fight—the value of a fight over noncompeting goods, as well as the likelihood of prevailing in such a fight—are all strategic considerations. The key questions for management in such a situation are: What is the business strategy for future growth? Does future growth entail expansion into all sorts of herbal products? And if not, which ones? After much deliberation, Celestial Seasonings concluded that aromatherapy and noningestible herbal products *per se* weren't likely to be in their future nor to warrant undertaking what may have become a “scorched earth” defense of their right. Also, the cost promised to be substantial and the likelihood of prevailing was questionable. It was a strategic decision made at the level of long-term strategic planning. In the end, Sleep Time was registered and its use continues for a line of aromatherapy lifestyle products. Celestial Seasonings never extended any of its brands to noningested herbal products; rather its successful brand extensions have been in the direction of herbal supplements and cough drops. Thus, one can speculate that the decision was a good one from an IAM perspective. After all, Estee Lauder was a much larger company and could or would easily have out-spent Celestial Seasonings in a dispute and won its trademark use rights independent of the merits of the Celestial position.

How much and against whom to police one's trademarks is perhaps the most difficult and important question facing trademark portfolio managers. As previously mentioned, and unlike other intellectual assets, permitting unauthorized use of the same or similar trademarks can negatively affect the value of the asset itself or hinder future plans for use and expansion of

the product line (e.g., given the success that Sleep Time® products had enjoyed in the above example, one cannot predict whether Celestial Seasonings was free to enter the aromatherapy market with its Sleepy Time® brand or to stop the Sleep Time trademark).

Moreover, policing is relatively expensive and ongoing as compared to the procurement of trademark rights through use or even registration. Adding to the dilemma of whether to police third party uses is the fact that many policing actions and their associated expense must be decided upon when the problem is not immediately causing economic injury (e.g., no lost sales, and perhaps when the ultimate value of the trademark has yet to be proven).

THE CONCEPT OF LEAD TIME⁸

Now, here, you see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!

—LEWIS CARROLL, *THROUGH THE LOOKING GLASS*

A basic premise behind filing for patent protection is that patents can and will provide valuable “lead time” for an enterprise to enter the market and have the commercial opportunity exclusively, or a limited monopoly, for up to the allowable term of the patent. This “lead time,” when the patent keeps competition at bay, can afford opportunity and advantage that could be substantial. During that time, the first entrant can establish the market for its innovation and form efficient manufacturing, marketing, and distribution operations, and recoup the investment behind the patented invention. The enterprise also has the chance to develop brand recognition and customer loyalty. Among the historical examples of “lead time” advantage afforded through patents is Land’s in-camera development invention that spawned the Polaroid Corporation. Exhibit 5.2 depicts a simplistic view of a “Pioneer Patent Scenario typified by the Polaroid experience.”

In this depiction, an enterprise owns a “breakthrough” patent that dominates an entire field. The patentee enjoys the full patent term of exclusivity and has the time to create demand for the new product (the initially relatively flat portion of the graph) and then charge “monopoly” prices for

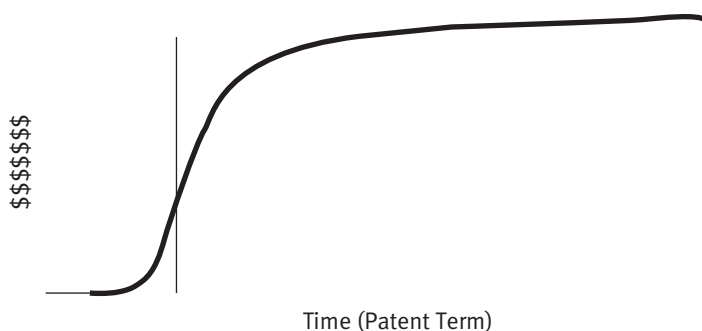


EXHIBIT 5.2 THE “PIONEER PATENT SCENARIO”

virtually the entire remaining life of the initial patent (the second relatively flat portion of the graph). The “full term” scenario is less likely today as technologies quickly surpass one another and no enterprise would be wise to base its plans and strategy on anything like full-term revenues. The vertical line in the chart represents the possible onset of a new disruptive technology or even an improvement that makes the innovation obsolete. If and when that occurs, the useful life of the patent to provide “lead time” (i.e., a period of exclusion), is shortened accordingly.

Sometimes, as in Exhibit 5.2, time is dramatically reduced, precluding the opportunity to even build a market or recoup expenses. The story about T. J. Izzo, founder of Izzo Systems, Inc.,⁹ can be viewed as a more recent evolution of this scenario with quite a different outcome. It is the story of a dedicated golfer whose back injury forced the first innovation in golf bag-carrying systems since the founding of the sport in St. Andrews, Scotland in the late 15th century. Izzo Systems, Inc. was founded in 1989 by T. J. Izzo to introduce a backpack-like, ergonomically correct, dual strap harness system for carrying golf bags. At first, T. J.’s invention drew only stares and amusement – “it looked so strange to carry a golf bag horizontally in the middle of one’s back.” There was no discernible market for this carry strap, but T. J. believed that there would be others like him, who because of injury or dissatisfaction with the traditional approach, would adopt the Izzo carrying system and never turn back.

Just as it was with Land’s invention of in-camera development, Izzo had to start out by creating a market or demand for his product because most golfers used motorized or hand-pulled carts. The Izzo System

addressed golfers who used no cart, but carried a golf bag while walking the course during play. That group traditionally comprised a very small percentage of golfers. Another example of finding or creating a market (i.e., driving demand), is Horizon Organic with its original marketing campaign for “organic” dairy products. The strategy of creating a market requires first establishing a market for the new kind of product within which anyone can compete, and then succeeding in accepting a share (sometimes smaller in percentage) of a larger overall market by differentiating an individual brand. General co-op or industry campaigns, such as “Got Milk?” and “Meat is for Dinner” are following the same principle in situations related to stimulating an industry.

To create his market, Izzo undertook a strategic campaign to gain *adoption* initially with two groups of “walking” golfers – professional golf caddies and junior golfers, especially at the collegiate level. Tiger Woods’ caddie was an early convert. At the same time, Izzo created a sound patent strategy. T. J. recognized the value of patenting his innovation from the outset. However, he was funding the operation with a modest amount of capital so patenting around the world was not a real option. Instead, patent protection was obtained on the Izzo Dual Strap Carrying System in the U.S. and in those foreign countries representing significant golf centers (e.g., UK, Canada, South Africa, and Japan. At first, the way Izzo intended to use its patents was typical, namely, to exclude competition for its two strap carrying system. Before we continue with the Izzo story, consider Exhibit 5.3 that conceptually depicts the changing pace of innovation.

In Exhibit 5.3, the sine waves represent the pattern and timing of product life cycles under the old paradigm and often equates with “Technology Leaps” that occur. In other words, there is no new technology that cuts short the life cycle because under the old paradigm, the rate of innovation is relatively slow. The distances between adjacent peaks in Exhibit 5.3 reflect speed. At such a “pace” of relatively sparse innovation, the holder of a monopoly position (e.g., the patent owner) could maximize profit over the full product life cycle.

When we talk of “lead time” we simply refer to the time one has between entering the market with something innovative and the appearance in the market of a comparable or improved competitive product. In Exhibit 5.3, the distance between the adjacent troughs reflects lead time for a given product.

Old Paradigm—Technology “Leaps”

Profit was maximized for full life cycle, sparse innovation

Today—Fast-paced innovation, overlapping life cycles

More limited time to extract value before the “new” is introduced and accepted

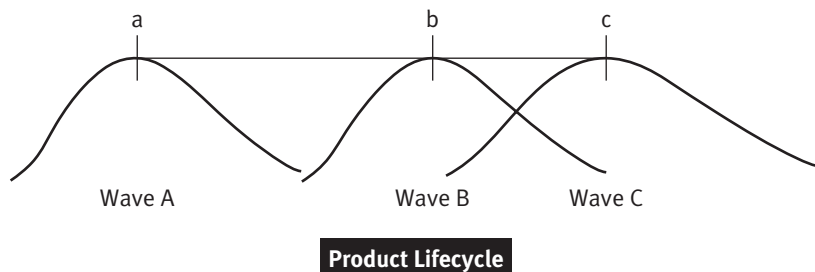


EXHIBIT 5.3

TECHNOLOGY LIFE CYCLES

Under the Old Paradigm, depicted by the succession of Waves A and B, there was lead time to develop market penetration (the increasing slopes), to saturate the market (the peak), and then perhaps a slow decline over time until the next product cycle had its beginning.

In the current information age where there is a New Paradigm, the rate of innovation (represented in Exhibit 5.3 by the shorter distance b–c between the peaks of Waves B and C) is much faster. Moreover, it is as likely as not that it is *someone else's* technology that will cut off Wave B and it can occur at anytime during a product life cycle, not necessarily after the “peak.” As with the placement of the vertical line in Exhibit 5.3, there is simply less time to extract value before the “new” is introduced and accepted. Another way of saying the same thing is that there is insufficient or too short a “lead time” to recoup costs and justify the expense invested in the new product.¹⁰

Today's pace of innovation makes it likely that improved or even disruptive technology of a competitor will abruptly cut short the time frame for exclusivity or even relevancy in a market. In the Polaroid example this may have equated to digital technology being created and developed as a competitive photography alternative to film early on in the life of the Polaroid Corporation.

This more rapid pace of overall innovation being experienced is a key factor in the need for new IAM practices. It requires turning some

conventional wisdom about how to profit from intellectual property on its head. However, as we will see, those who cultivate and achieve rapid and continuous innovation, rather than just operational efficiencies, will be far more likely to “win” in the new economy.

Under the full-term, “Pioneer Patent Scenario,” as we have defined it, there is no need to share the corporation’s best technology with competitors. This underscores the traditional role of patents, namely, to keep competitors out of the market through the risk of liability for patent infringement. Under the old paradigm, no one in such a situation would want to license core technology to a competitor who (absent illegal activity) would necessarily create a downward pressure against high prices. When innovation is slow, how long it takes to maximize profit from an invention is not a key factor. However, when the rate of innovation accelerates, the period of time to recoup investment and maximize profits shortens.

The comparative distances marked between the troughs of Waves A and B (a–b) and of Waves B and C (b–c) in Exhibit 5.3, represent relative lead times. Lead time is reduced as the rate of innovation increases. Recognizing this truth from the simple graph depicted in Exhibit 5.3 is central to understanding those enterprises that are successful in today’s information age. In previous chapters, we looked at how the laws might change to account for and protect innovators from the effect of lead times that are economically too short. Until such changes occur, new strategies can substitute to provide sufficient lead time for innovators to recoup investment.

For example, trade secrets, if appropriate, can extend protection times as discussed above. A strategy of using trade secrets rather than patents might extend the time one has to recoup investment, at least with respect to innovation that will be based upon the secret technology. But how do IA Managers come up with other viable strategies? They look at core competencies and IP competencies.

Returning to the example of the Izzo story, as it turned out T. J. was right in his belief that the double strap system would attract converts both for its obvious comfort and healthful benefits. Also, the Izzo brand succeeded in become a “strong source indicator,” identifying the small company that revolutionized the way people carry golf bags. Even today, the Izzo® dual strap golf bag carrier system, its licensees, and its imitators offer the only real alternative to the traditional over-one-shoulder golf bag.

However, in the golf equipment industry, there are many competitors and a generally declining target audience—retail sales margins for golf bags are lean and typically there is a lot of price pressure among large competitors. Almost immediately upon successful introduction of the two-strap carrying system to its select markets, copycats emerged in the golf bag lines of other manufacturers. Thus, almost immediately, the Izzo product cycle was limited, not by a wave of new innovation, but by almost immediate *imitation*.

As a typical small start-up company, the options available to Izzo were limited in view of limited capital. In plain words, there was no money to take on arguably infringing competitors through expensive patent litigation. The problem was particularly keen because many of the golf bag competitors were the much larger sports equipment companies. As a result, early on and throughout its history, Izzo faced the difficult decision of whether or not to license what we have called “core technology” to its direct golf bag competitors. In the end, T. J. developed a strategy for leveraging those patents along with the rest of his intangible assets. In the world of IAM, Izzo Golf stands as an example of how a start-up company, endowed only with the basics of intellectual property, was able to become a marketplace success by synergizing imaginative thinking, technology licensing, brand-building, and strategic alliances. Before looking at the strategy in detail, consider the following discussion about the relationship between specific “competencies” and the opposing forces that can come to bear when an operating enterprise does license core technology.

LEVERAGING ASSETS—ARE YOU FAST OR SLOW TO INNOVATE AND TO MARKET?

The clock, not the steam-engine, is the key-machine of the modern industrial age.

—LEWIS MUMFORD, *TECHNICS AND CIVILIZATIONS*, 1934

Self-assessment of enterprise competencies can be useful, even essential. Strategic IAM requires an honest assessment of core competencies, including the enterprise’s ability to innovate rapidly and continuously (“Quick

to Innovate”) and to get new innovations into the market (“Quick to Market”).

Some enterprise environments cultivate creativity and foster free, out-of-the-box thought. In “casual” California, one after another of the founding corporations of Silicon Valley (e.g., Silicon Graphics), provided crayons and creative toys to encourage employees to innovate. More traditional corporations (e.g., Eastman Kodak and Merck) have large R&D departments. None of this necessarily means that a company is “Quick to Innovate.”

“Quick to Innovate” means coming up with commercially viable new products and services, and many companies with creative cultures or massive R&D departments either come up with nothing or take forever to eventuate commercially practical embodiments of what they manifest. Traditional measures of “quick” innovation were years. And while that still may be true for truly breakthrough innovations like Apple’s iPhone, new pharmaceutical drugs, computer operating systems, or video games, almost everything else must occur within a span of months to a year or two, depending on the industry. Ultimately, with the faster speed of market introductions, “Quick to Innovate,” is only “quick” if it beats the competition.

Additionally, those who are “Quick to Innovate” may or may not be “Quick to Market.” Enterprises with well-established paths to market, such as consumer products or online businesses, can often innovate and at the same time avoid the shortcoming of being too “Slow to Market” to win in the marketplace. At the other extreme (i.e., Slow to Market) are whole new industries like alternative energy. Slow commercialization of new industries based on scientific developments may easily be compounded when the new enterprises are peopled by scientists with little business experience. Frequently, the inventor-founders reach the end of their competencies with the innovation and may experience a total lack of ability to commercialize their innovations absent the willingness to handover control. Other industries like biotech, pharmaceuticals, and medical devices are constrained by long government approval processes that cause an industrywide hurdle getting to market.

Today, there is an abundance of innovation. However, as evidenced by the vertical line in Exhibit 5.2, innovators do not necessarily have the time it may take to extract full value. Often there is less time to create a

market and/or extract profit before a new technology or disruptive innovation is introduced and accepted. One option to “trade-off” for this shortened time period is to license core technology to competitors. Under that option, dollars that are not obtainable because of shortened lead time can be offset with a royalty income stream that goes largely to the bottom-line. This option is often *not* even considered due to the perceived risk that there will be an inability to adequately share in an overall market at the same or greater level. In many instances, this risk is compounded by the fear that the market may not be as large as originally thought due to price erosion that inevitably follows with the competition created through licensing. Moreover, from a practical perspective, licensing competitors makes sales and marketing more difficult because the new product or technology no longer provides the all-important monopoly that can result in competitive advantage.

From the perspective of IAM and the decision of when to license, the trick is to manage the intellectual asset so that you do not license too early or too late. It is too early when there are no real alternatives to erode margins (e.g., blockbuster new drugs). It may be too late if, due to your unwillingness to license others, competitors innovate and then lock into their own competitive technology. In business, as elsewhere, it can be said that “necessity is the mother of invention” and many a plan to gain competitive advantage through patented innovations has blown up withholding technology (i.e. being “too late” to license because healthy competitors have “invented-around” the hot, but unavailable patented technology in order to attract and keep their own market share). Forcing invention of new technology is risky if for no other reason than it might match or eclipse your own. When that occurs, what was a competitive advantage may shift to a disadvantage.

The right strategy can also be enterprise specific and depend upon other strengths and weaknesses. If you are “Fast to Innovate,” but “Slow to Market,” you might as well license out core technology to competitors. The concept is that rather than fear competition that might likely severely reduce your “lead time,” one might as well make *something* (profit or license fee) from the entire market, however short-lived. In addition, such licensing might advantageously provide access by cross-license to improvements developed by others. One clear example of this benefit is the licensing that gains entry to an industry “pool” of patents.

“Fast to Innovate” enterprises that are either “Slow to Market” (or compete in markets where innovation is very rapid) who *do* have the opportunity to license core technologies to competitors face an additional problem – namely, the unique allure of income going to the bottom—line with none of the normal risks of manufacturing and distribution. They can be tempted to move away from the initial, more traditional mission of the enterprise which no doubt envisioned growth and enhanced profits through competitive advantage, including the ability to impede competition through a patent position.

After licensing, such enterprises must still deal with all the uncertainties of the business and the ability to have profits at all while competing in a more competitive market suffering price erosion. However, royalty payments enhance revenues with little risk and no cost for manufacture, delivery, and others. For all practical purposes, they are pure profit.

Licensing levels the playing field in that the patents no longer provide the competitive advantage. As a result, there is increased burden on the enterprise to find new routes to having a competitive advantage or else to redefine its mission (e.g., to be a technology licensing company). But even with such a change in business plan and mission, enterprises cannot escape the constant need to *innovate* to maintain and create competitive advantage. After all, patents can be challenged and, if invalidated, that source of revenue immediately dries up.

If you are “Slow to Innovate” and “Fast to Market,” you are the right candidate to “license-in” technology or make strategic acquisitions. Among other things, buying innovation or other competencies may be less expensive, faster, and more certain, than independent development. Joint ventures, where you contribute your core competency to a good partner are another alternative (e.g., to joint venture with your market distribution strength or brand development expertise as your ante).

Conversely, for enterprises that are “Slow to Market,” partnering or being acquired may be the best strategy. In industries with long approval processes, such as the medical device industry, ostensibly, everyone is faced with the same hurdle, so “Quick to Market” is a relative measure among competitors. Enterprises are still judged based on the quality and quantity of their personnel and on the systems necessary to gain market share post-approval. Start-up medical device and specialty biotech companies often perform more as if they were in a totally new industry when

compared to large established competitors. This may explain why so few are successful as independents and most have a strategy aimed at the goal of being acquired.

When we left off our Izzo® story, a very small company was faced with the challenge of how to handle major industry giants who were selling golf bags with “imitation” two-strap carrying systems. They had been driven—by Izzo’s success in developing market demand for golf bags having a two-strap carrying system—to “invent around” the Izzo® patents and there was at least an argument that some or all of the imitations infringed the Izzo® “breakthrough” patent. Izzo® had patents on its invention but little or no money to engage in litigation with companies with far greater resources.

Should Izzo® just agree to license its technology if it could? On the one hand, the prospect of generating revenue without risking any capital is very appealing. On the other hand, Izzo® used traditional sales “reps” who wanted the Izzo® dual strap carrying system to be available solely with the line of Izzo® golf bags. Referring to the prior definitions and discussions, it seems that Izzo, as a company, was both “Fast to Innovate” and “Fast to Market.” Under normal circumstances, this might indicate that the best strategy for Izzo® might be to keep the market for dual strap golf bags exclusive to themselves for some period of time using its patent position to maintain that exclusivity.

The option of “when” to license the core technology is hypothetically available by every strategist with a patent portfolio. The ideal is to find the perfect time to maximize benefit from the company and that clearly depends on the industry and the nature of the competition. If the trick to a good patent license strategy is to license, but not too early or too late, it is not “too early” whenever you can no longer stave off the competition—for whatever the reason. The truth of the matter is that for most small companies, the determining factor is not necessarily the rate of innovation by third parties. Most often it is simply the lack of sufficient capital and the competing needs to spend money elsewhere than for patent litigation.

However, yielding because of money and licensing out core technology to tough competitors need not be a bad strategy and, should prove relatively easy. Nevertheless, to be a successful strategy, the licensing enterprise must have alternative means to maintain a competitive advantage once the

patents are licensed. One answer is to have other competencies and intellectual assets that remain unique to the licensor and drive differentiation in the market.

The most obvious asset is a strong brand. In the Izzo story, the company was highly successful under Joe Barrow, its later President, at building the Izzo brand. However, in the competitive world of sports equipment, the larger companies with comparatively larger advertising budgets can easily outshine the small innovator.

In our opinion, Izzo came up with and executed quite a unique strategy using a strong readily available strategic tool that is often overlooked and underutilized—contracts.

CONTRACTS, CONTRACTS, CONTRACTS

What I tell you three times is true.

—LEWIS CARROLL

Tactical implementation of many new strategies is readily aided by ordinary contract law. However, the strategic benefits to be gained (or lost) by their use, and the overall importance of contracts, are often overlooked by strategists. There are laws to protect the unwary consumer from deceptive practices. However, in normal situations, *enterprises* that “sign on the dotted line” and then find themselves with the unexpected when it comes to their intellectual assets are very likely to be held to what is written. Successful intellectual asset management strategists know how to create advantage through contract language and others often learn through negative experiences.

This point is illustrated by an interesting story about a woman who had an idea and received money through royalties for the use of her idea under a *contract* even though she never received a patent. What’s more, she received those royalties for a time period way beyond the term of any patent she might have gotten.

Over 50 years ago, Jane Aronson developed a relatively new but simple and easily copied keychain or key holder. In October 1955, she filed for a patent and shortly after that, while her application was still pending, she “negotiated” a contract with the Quick Point Pencil Co., for the manufacture and sale of the keychain.

According to the contract documents, the terms agreed to were as follows:

1. Payments — Quick Point agreed to pay Mrs. Aronson a royalty of 5% of the selling price in return for the exclusive right to make and sell key holders of the type shown in her patent application. Mrs. Aronson also received a \$750 advance on royalties. Additionally, if Mrs. Aronson's patent application did not issue into a patent within 5 years, the 5% percent royalty could be reduced by Quick Point to 2.5% of sales for as "long as [Quick Point] continue[d] to sell same."
2. Length/Term — Unspecified, except that Mrs. Aronson was entitled to rescind the exclusive license if Quick Point did not sell a million keyholders by the end of 1957; and Quick Point retained the right to cancel the agreement whenever "the volume of sales does not meet [their] expectations."

As it turned out, no patent issued within the five-year period and Quick Point asserted its contractual right to reduce royalty payments to 2.5% of sales. Quick Point continued to pay at that rate for more than a decade despite the fact that in September of 1961, there was a decision by the U.S. Patent Office to the effect that no patent would issue. When Mrs. Aronson did not appeal that decision, it meant that no patent would ever issue on her keychain.

The keychain was a great market success and, initially, Quick Point had the market to themselves. However, by the late 1960s, copies by competitors who, of course, were not paying Mrs. Aronson began to appear. In November of 1975, after some fourteen years of paying at the reduced 2.5% royalty rate, Quick Point Pencil Co. simply stopped paying and the legal dispute over whether Quick Point should be made to "honor its promise" to pay so long as it continued to manufacture and sell the keychain began.

By that time, "competitive advantage" to Quick Point Pencil from being first had long evaporated and they were paying to manufacture it when everyone else in the market used the keychain design free of charge. Arguably, Quick Point had not intended for that to happen. The two royalties suggest that Quick Point had accounted for a different value between having a patent and not, but they had not made a deal where royalties

would stop if no patent was ever granted. In the end, Mrs. Aronson won and Quick Point was made to honor its commitment to keep paying. From the perspective of formulating and executing IAM strategies, it is important to bear in mind the simple fact that strategic use of contracts allows you to protect intangible assets in a way that hedges against the vagaries and inconsistency in the other laws that create, define, and protect intangibles.

In this respect they provide an unparalleled opportunity. How so? Under U.S. laws relating to the formation and enforcement of contracts, we have the “peppercorn” theory of “consideration.” The meaning of the theory, simply put, is that if you agree to something in exchange for anything that the other party was not obligated to do or give up, even something as insignificant and small as a “peppercorn,” and that’s what you get, the law will uphold the bargain you struck no matter how much you regret it.

Mrs. Aronson told Quick Point Pencil Co. about her keychain and agreed to allow them to make and sell it for a promise of money while it was still a *trade secret*, at a time when she did not have to and Quick Point promised to pay her something (5 or 2.5%) so long as they manufactured and sold it, something they did not have to do. That was the bargain and Quick Point was stuck with it! Remember that—absent running afoul of certain limits on “inequitable” or fraudulent behavior—most courts will hold two businesspeople to the bargain they agreed upon.

WHAT MAKES A CONTRACT?


A “contract” between two parties is simply a legally binding exchange of promises — an “I’ll do this, on the condition or *promise* that you will do that” exchange. Under normal circumstances, where the parties are each capable and empowered to make their own decisions as is typically the case in business settings, the unequal value of what is being exchanged will not be questioned. In other words, if “one’s dust is another’s gold,” the law will not question the business acumen of either as to the deal they made. If one agrees to do or forego something of value (no matter how small that value may be) and that is the *consideration* (the

promise given in exchange) accepted by the other for his own promise, the law will enforce such a contract.

Of course, there are different kinds of oral and written contracts and promises (e.g., the social contracts as espoused by John Locke and others) but for our purposes we are concerned with *written agreements*, undertaken in the ordinary course of business, that are *enforceable* under the law. In other words, those under which there is a legal remedy if either party reneges or fails to deliver on its promise.

Formation of a binding contract is a serious matter. It is usually preceded by *negotiation* during which each party offers and/or accepts changes to the details of its promise or undertaking. Upon reaching agreement (“offer and acceptance”), a contract is formed.

Since the beginning of civilization, contracts (honoring one’s word or “shaking hands”) have been recognized as an essential building block of living in a cooperative world. From the Bible’s Old Testament, we learn that it was the ancient custom in Israel for a man to “pluck off his sandal and hand it to his neighbor” as a symbol that the deal was agreed to, the binding exchange of promises concluded, and a legal agreement reached. This symbolic gesture gave notice to the contracting parties and to others who could “bear witness” to the existence of a contract in a time when contracts were often not in writing.



As for Izzo, when forced to license the “core technology,” contracts in the form of licenses, could accomplish several things beyond just securing a promise of a royalty stream. Izzo was “Quick to Innovate.” The company wanted to and did expand with innovative products. It did not want to be solely a patent licensing company that collected royalties and thus needed to keep a motivated sales and marketing team.

With the cost and burden of real patent litigation probably being too much for the small company, Izzo, in our terminology, was forced to license core technology “too early,” facing early cannibalization of its market, and with potentially demoralizing effects on its sales and marketing departments.

However, Izzo used a *contract*, instead of litigation, to leverage the patents it had. “The Izzo Solution” was to slice and dice the “core technology,”

keeping what it deemed the most advantageous combination of design elements exclusive for the Izzo® golf bags. In other words, instead of licensing the technology as a whole, or even individual claims in a patent, Izzo strove to have each licensee exclusively license its own version of the two-strap carrying system. This could be accomplished through limiting the license grant to a particular version or specific depiction as shown in a license-specific single embodiment.

In addition, having licensed out the technology into a saturated U.S. market, Izzo still needed to innovate and strategize for growth. Developing brand equity and leveraging the brand was a key aspect of that plan. In the late 1990s, Izzo began to extend its brand to cover a line of carry products, golf clubs, and a variety of other products. In addition, Izzo formed a joint venture with large U.K. distributor of golf equipment to implement its plan to extend globally, and sponsored the Izzo Cup, an international competition for junior golfers.

Izzo realized that there would be more licensing of the Izzo® dual strap carrying technology to more sporting goods companies to sell with their lines of golf bags, and that those golf bags would be sold under the famous brands of the licensees. As such, it could be advantageous for this small company to have those licensees cobrand by requiring some use of the Izzo® brand on their product. A highly successful program of that nature in the technology field is the Intel Inside® example. The presence of Intel Inside® on every brand of computer which employed the licensed Intel® technology, is an enormous factor in the strength of the Intel® brand that has developed over the years. What better source of “free” advertising could there be for a small company like Izzo?

The benefits to be gained from this type of licensed third party *trade-mark* usage by a technology licensee, even when royalty-free, may seem obvious, but what would make licensees agree, particularly if they themselves have famous brands? One situation where the licensee might willingly accommodate placement of another’s brand is when the use of that brand would be of benefit to the licensee. Such is the situation among coequals in branding, as in the case of more typical cobranding.” In other words, once there is significant brand equity there is likely to be less resistance to “forcing” addition of the brand on a part or feature of a product onto patent licensees’ products and into patent licensees’ advertising.

What occurred in the Izzo situation is that each licensee decided they must have a dual strap offering within their golf bag line and decided on

a license of the Izzo® technology; Izzo had the technology each felt the need to license; and that is what served as the “stick” for licensing the Izzo trademark as well. In other words, Izzo “bundled” two intellectual assets using the desirability of the patent license to benefit the other (i.e., to build brand equity even when the independent value of the brand might not have been sufficient as an independent “carrot” for trademark licensing).

Contracts are an effective tool irrespective of the type of intellectual asset involved. An interesting question raised by any strategy of licensing is one typical to most licenses, namely, the duty to keep nonpaying infringers from using whatever is licensed. After all, it should occur to most licensees that they might be at a significant disadvantage in the market if they must pay a royalty when others do not.¹² Remember, even Quick Point Pencil Co. addressed the matter (i.e., there was an agreement to consult in the event of any infringement).

Given the undesirability of engaging in litigation for most companies, a good IAM strategy must take into consideration strategies or tactics, such as licensing, that may typically be accompanied by *the obligation to litigate*. Thinking through a number of the lessons from earlier chapters, we want to think in terms of what might substitute for enforcement (e.g., innovation and bundling) because of the risk that the licensed asset could be invalidated or otherwise lost. Most patent and trademark owners that eliminate the burden to enforce by handing it over to the licensee understand that such a delegation can be a double-edged sword. The licensee may lose a competitive advantage if the patent is invalidated or the trademark is found to be weak, especially if the license is exclusive, but, with either of those events, the licensee has no further obligation to pay royalties and the licensor cannot otherwise license or enforce that asset.

A contract, most commonly referred to as a Nondisclosure Agreement (NDA) is the only means of leveraging the value of trade secrets. Nevertheless, NDAs are often treated as forms without much thought to what the appropriate promises should be given to the particular situation. Most NDAs have provisions to terminate after a specified number of years. While probably appropriate in fast innovation industries, think of what Coca-Cola would give up if such a “normal” NDA were used with respect to its formula. Often, nondisclosure agreements are mutual and for that reason are used for making the terms softer. While that makes for

a smoother negotiation, it may not be appropriate for information of unequal value. Nothing prevents a contract from containing two or more categories of information with different “rules” for when and if the obligation not to use or disclose terminates. The promises contained within NDAs “not to use or disclose information” are sometimes confused with “promises not to compete,” often contained in contracts that are referred to as “noncompetition” agreements. There are often restrictions related to the enforcement of noncompetition clauses, but typically, that is for situations that run counter to the public policy restraining one’s option for employment.

Except in the situation of true monopolistic situations (i.e., involving companies with dominant shares of a market), the limitations regarding promises “not to compete” are *not* there to protect businesses from bad bargains. For example, if Company A agrees not to use what is in Company B’s black box in exchange for a look inside, the law may well enforce that promise *even if* what is inside the box is common knowledge practiced by everyone else in the industry. In some sense, the *inability to use* may equate to a promise not to compete but it still may be enforced in a court of law.

Contracts can serve as protection against specific individuals even if they are unprotected from the public at large. This is the lesson from the story of Mrs. Aronson. Sometimes, having protection against just some of the population, whether by contract or claim for unfair competition is enough as we learned in the INS story in Chapter 4.

However, in the press and desire to obtain full worldwide protection for intangibles, especially those that are not clearly among the protected class of intellectual property, it is easy to forget that most of the time, it is two parties who start out with a business relation or know of each other as competitors that end up in a dispute over intangibles. And for that portion with whom there are business dealings, there is almost always an opportunity and need to have a contract that addresses intellectual assets. Even wording in a standard purchase order can suffice.

For example, where costs preclude registering a trademark in every country where one has sales, a validly constructed contract clause within a distributorship agreement to the effect that the distributor will not register the trademarks or will and does assign all trademark rights that it might acquire is a good alternative. After all, who is the most likely entity

to know the value of your unregistered trademark in that particular country and to want it in the event the distribution agreement does not work out? Similarly, in the Far East, where outsourcing predominates, manufacturers by necessity have trade secrets and other know-how about your business and products. A contract clause that is a promise by the manufacturer not to use or disclose anything he learns from you or anything about your products, will be a lot cheaper than a Chinese patent that you may or may not be able to acquire or reasonably enforce.

Lastly, joint ventures and mergers and acquisitions are just a few of the other situations where contracts can be key. There are many sources for learning the art of negotiation and for what terms can and should be negotiated in licenses and other common contracts related to intellectual assets. For our purposes, let it suffice to remember, that you may well get what you contract for and that “the devil is in the details.”



Notes

1. Inventors might well be creating trade secrets, but absent complying with the legal requirements and following proper procedures created or explained by others, the discoveries might not become intellectual assets. It is these others who more typically fit within our definition of IA *managers*.
2. As you might expect, most contractual arrangements (i.e. licenses), under which the intellectual asset holder receives value for the use of its assets include provisions regarding the obligation to police against unauthorized users.
3. E.g., portfolio management software, patent mapping software, and consultants; patenting decision software focusing on commercialization criteria; just to name a few.
4. In its simplest form, execution can be with incentives for employees with valued suggestions or inventors who timely report innovations into an enterprise disclosure system. Simplifying systems for invention disclosure within the enterprise is likewise deemed an encouragement and a best practice.
5. According to the Uniform Trade Secrets Act, which has been enacted in one form or another by virtually every state in the U.S., a “trade secret” is defined as: information, including a formula, pattern, compilation, program device, method,

technique, or process, that (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

6. The deterrent to other manufacturers' advertising the use is that they might be liable for contributory infringement.
7. By "freedom to operate," we mean able to do as they plan with the least likelihood of infringing the patents of others.
8. Often discussed in terms of "First Mover Advantage."
9. Facts may have been changed to better elucidate teaching points and to protect confidential or privileged information.
10. Sometimes such innovations are created within the same founding enterprise. When such enterprises timed *their own new* technology early into the decline, they were accused of "planned obsolescence" in order to keep continually high prices by accelerating introduction of those products into, and simultaneously removing the prior products from, the marketplace.
11. For more on alliances where two brands are involved, c.f., "Co-Branding-*The Science of Alliance*" Tom Blackett and Bob Boad, 1999. Macmillan Press, Ltd.
12. Most patent licenses address obligations of the parties with respect to "policing against infringers." Typically, the patent holder will take on this obligation (with or without monetary assistance from the licensee) because to delegate it would mean someone other than the patent holder would be in control of how well the validity of the patent is defended. (Think about the conflict a licensee might have given if the patent is invalidated. He would no longer have to pay royalties, absent some license of separate technology or a brand.)

Strategy Revisited



Intellectual Asset Strategies

THE STRATEGIC POSITIONING OF INTELLECTUAL ASSETS

Throughout the centuries there were men who took first steps, down new roads, armed with nothing but their own vision.

—AYN RAND

Despite the increasing recognition of intangible assets within the corporate world and the greater economy, integrating them with the strategic planning agenda inside an enterprise often remains elusive.

Since the late 1990s, much has been written about the importance of these intangible, intellectual assets, heralding them as the intellectual capital of the new millennium and casting them as the critical strategic instruments of modern business and the ultimate sources of vast societal wealth.

Consultants and CEOs, economists and chief marketing officers, and attorneys and accountants have all risen in profusion during these years to advocate the importance of these assets in delivering the ultimate benefits of competitive advantage and driving market capitalization.

Simultaneously, thinkers and practitioners of the emerging arts and sciences of leveraging intangibles have advanced important theoretical models, demonstrative case studies, and a range of best practices designed to guide the effective deployment of all forms of intangible intellectual capital assets.

Intangible assets have made their way toward center stage in a world increasingly dominated by knowledge-based assets. While their impacts are abundantly evident in market capitalization numbers, and while

success seems to be intuitive with good managers, true deliberate strategic deployments are less evident. Many strategists still struggle to execute with intangibles, let alone intellectual assets or intellectual property *per se*. For the most part, the opportunities presented by intangibles still remain unrealized and unexploited.

If these intellectual assets possess such potentially untapped and unlimited value, how could they be so overlooked within organizations that have otherwise mastered the optimization of their tangible capital, instituted state of the art “best practices,” and achieved the highest levels of operational effectiveness in human history?

Even though many organizations in the world have heard about intangible assets, only a handful have learned to shift the paradigm of their strategic thinking adequately to apply this new body of knowledge to their enterprise strategy. Clearly, the strategic positioning and optimization of intangible assets or intellectual capital requires more than theory and practice and more than recognition and esteem. Successful positioning requires vision, leadership, and wisdom on the part of those who would unlock the value within these assets.

What stands in the way of the strategic use of intangible assets?

Often, there is a fundamental lack of awareness as to the nature of intangible assets as set out in Chapter 2, as well as a failure to recognize the value and opportunity of managing such assets. For such enterprises and their executives, the fact that a brand is more than the paper of a trademark registration may be a revelation. In the same vein, all too many organizations perceive patents to be of value only if they have the fortune and fortitude to engage in extensive and expensive patent litigation.

Today, as more of the bundle of intellectual property assets emerge into strategic significance, we see the emergence of a new discipline known as intellectual asset management. This discipline assumes the burden to straddle both the legal and strategic worlds, often remaining responsible to represent the legally protectable aspects of intellectual capital, while simultaneously assuming responsibility, under the leadership of individuals of executive caliber, for the strategic role of these assets within the organization. This new discipline, and its vision, depends upon this executive leadership.

Because corporate strategy is not formed at the level of functional disciplines, this is where the matter of vision and leadership come into the successful, strategic positioning of intangible assets within an organization.

INTERVIEW WITH JOHN NEVARD, GLOBAL IP COUNSEL:
“CHANGING THE ROLE OF IP IN A TRADITIONAL CORPORATION”

Mr. John Nevard is at Inverness Medical Innovations, Inc., headquartered in Waltham, Massachusetts. Formerly, he was the Global Intellectual Property Manager of Huntsman Polyurethanes, a former business of ICI plc.

Lesley Craig: You have been a part of the intellectual asset or intellectual property (IP) management function in major corporations for many years. Have you observed a difference in the expectations of executive management with respect to intangible assets over that period?

John Nevard: Yes, I have. To paraphrase the historian Sidney Mean, “you have to analyze the past in order to understand the present.” This is true with organizations as well. The current behavior of an organization is rooted in its past.

If you look at a chemical company, such as ICI, where I was previously the Global Intellectual Property Manager for one of its businesses, it was a technology organization, and so the IP strategy was often directed by the technocrats to serve their interests. Older style technological companies usually see IP as the output or by-product of a research program as opposed to an asset. Thus, such companies measure the number of patents produced per year, without regard to the market applicability or commercial application of the patents *per se*. They don’t see IP as an asset but as a byproduct of the research process.

At Unipath, where I am now the Global IP Counsel, the organization is focused upon the market. We look to see what is needed in the marketplace and then we deploy IP to protect our investment and to enhance our competitive advantage in that market. Top management views IP as an asset, no different than bricks and mortar, to be leveraged to fulfill market demand and provide competitive advantage.

Dr. Lindsay Moore: When did you realize that IP could play a more strategic role within organizations?

John Nevard: It seemed like common sense to me that IP could be used to generate money, offset expenses, or deliver a business position.

If an organization is going to embark upon a capital investment to drive a project forward, it seems clear to me that it must provide a profitable return on that investment. Therefore, given the often immense cost of securing a set of patents, a commensurate return is necessary. It is just basic economic common sense.

Lesley Craig: But a traditional patent attorney wouldn't normally think that way. Wouldn't they view the expenses involved in securing patents as merely a cost of the project?

John Nevard: Yes, but at the end of the day, you have to reflect on who is actually paying your salary and ensure that your organization is adequately profitable.

Before I became a patent counsel, I was originally a chemical engineer and I quickly learned that all of my projects were regulated by budgets and that I had to think about the worth of my activities in terms of return on investment. Working in a corporation requires you to learn the vocabulary of budgets, profit and loss, and return on investment to be successful.

Dr. Lindsay Moore: How do you position IP to get the attention of executive management?

John Nevard: Early in my career, I noticed that most attorneys spoke to their executives in a kind of "legalspeak" that caused them to quit listening and their eyes to glaze over. I saw how ineffective their communication became, and I learned to adopt the business vocabulary, to listen carefully to the business problems, and to try and understand the business issues. Attorneys are often like monks sitting in their cloisters. You have to get out and make contact with the business people and understand the business terminology.

So, I don't position IP, I go out and I listen to the business problems. Then, when I have an idea I say, have you thought about this or that. Making IP a part of corporate strategy can best be understood by an analogy with marketing products. You don't force a product into the market. Rather, you see where the demand is, and then you develop a solution that fits that need. The same is true with the role of intellectual asset management. I don't bang the drum for IP. I look for business problems I can solve, and because I am a patent attorney, my solutions often involve IP.

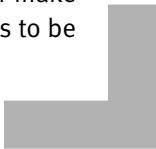
Dr. Lindsay Moore: What has made you most successful in your career as a patent executive and a strategic thinker?

John Nevard: A willingness to take risks. Dare I say that the patent profession isn't known for its excitement or risk-taking. But you have to exercise a kind of judgment and demonstrate the ability to make decisions, and that is often risk-taking for an attorney. I am not advocating any irresponsibility, but attorneys often have a hard time deciding that they have enough information to make a decision. But in business, you often have to make decisions without all of the information you may wish to have, otherwise the business opportunity will pass you by. The judgment is in having the right balance of information to make good decisions. As one senior executive said, "you don't get fired for being wrong, you get fired for not trying." Although that wouldn't be true to all companies, you have to be willing to make decisions and take appropriate risks.

Dr. Lindsay Moore: What advice would you give patent attorneys who are excited by the new strategic dimensions of IP?

John Nevard: "Good luck!" No, seriously, my advice would be to avoid being overly concerned with the law and to get to know the business and see where the law can be applied.

Whenever I interview prospective attorneys for our organization, I always assume their knowledge of the law, and I focus on how they think. Do they think, this is an invention and I will patent it, or do they think, this is an invention, and how do I make money with it? So few attorneys think that what they do has to be commercially relevant.



In fact, intangible assets are strategically positioned only in the persons of the CEO, the Chief Marketing Officer, the General Counsel, the Vice-President of Intellectual Property, and the like. It is only in the hands of individuals at this level that intangible asset matters are able put on the table and the expertise is present to form the appropriate organizational strategy. Under the new paradigm, the functional disciplines and IA managers are presumed to have the ability and opportunity to supply the asset-related information and expertise to corporate management (i.e., the strategists).

INTELLECTUAL ASSET STRATEGIES THEMSELVES

Discovery consists of seeing what everybody has seen and thinking what nobody has thought.

—ALBERT SZENT-GYORGI

IAM, as the new strategic thinking about intellectual property, intellectual asset management, focuses on creating and leveraging intellectual property *as* intellectual capital for strategic and economic gain.

Intellectual capital and *intellectual assets* are no substitute for the basics of good business, such as high-quality products and services, operational effectiveness, or a brilliant strategic plan. Intellectual capital assets can deliver unique market advantage, enhance market share, margins and profitability, and even open up whole new industry opportunities.

Broadly, intellectual asset strategies could be divided into many categories. The purpose of this book is not to exhaustively list such strategies, but rather to model how to think strategically with them. Some of these categories include strategies that can be articulated and are designed to leverage intellectual property, drive innovation, sophisticate knowledge management, monetize intellectual property, differentiate brands, and anticipate market or technological shifts.

The strategies in practice today map the natural evolution to date of the emerging recognition of intangible intellectual capital assets. Even public policy lobbying and corporate social responsibility may be counted among intellectual asset strategies when so deployed. Most strategies are grounded in intellectual property and are concerned with leveraging technology, knowledge, or brands. In this sense, intellectual property provides a prism that allows us a comprehensive and representative view of intangible asset strategic thinking in the world today.

Trademarks

While it may always be true that trademarks, whether as a name or symbol, are used to indicate the source of goods or services and thus as a *source indicia*, “branding,” or using broad trademark rights to create

WHY A TRADEMARK ISN'T A BRAND

It would be so nice if something made sense for a change.

—LEWIS CARROLL, *ALICE IN WONDERLAND*

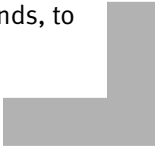
It is customary for intellectual property attorneys to assume that talk of “brands” or “trademarks” is about one and the same thing. And while that is often the case, especially among attorneys, it is important for strategists of intellectual capital to recognize that *a trademark* is not *a brand*. In fact, the way we propose to think of it is that a trademark is part of a brand, but a brand is much more than a trademark. How so?

One could have a whole stack of trademark registrations on a table and not yet have a single “brand” in evidence. Initially, a brand is a further development of a trademark, but ultimately it always remains much more than a trademark because of its unique ability to distill meaning from *all of the intellectual assets* within an organization, and to organize those meanings into a greater significance. Thus, when we speak of deploying the leverage of a brand to effect the total *strategic positioning* of an enterprise, we are imaging leveraging a composite entity, “the brand,” that transcends a trademark *per se*.

Specifically, a trademark is a legally enforceable right to exclude others from using a certain brand mark that may consist of words and symbolic content. A brand is everything that an enterprise stands for the “Brand Promise,” to the employees of the company, the trade, customers, consumers, investors, suppliers, the industry, and all the public that it touches. Thus when we speak of “the brand,” or the strategy of “brand building,” we are holding a complex entity before our mind’s eye, and envisioning ways to leverage the variety of significations it has collected from the entire enterprise.

Accordingly, when we speak of trademarks, we are speaking of this legally enforceable right, and when we speak of a brand, which may or may not even be formally protected by a trademark registration, we are speaking of something that is more than a trademark.

In thinking about brands, it is important to realize that they are an intangible thing, an entity of sorts, or a largely invisible substance that has properties and qualities. Hence, a brand is a differentiated “something” to which properties can inure, and thus it is meaningful, when speaking of well-managed brands, to speak of *brand equity*.



substantial *differentiation* and orchestrated meaning in the marketplace, has arisen to become one of the most important strategic deployments of a trademark in the world today.

Brands, trade names, trademarks, and even trade dress are terms used variously to refer to the branding of products and services. Over the decades, these many branding deployments have grown beyond their original understanding as trademarks to become valuable business assets and business equities as brands. Today, brands have become a major factor in intellectual capital analysis, and it has become commonplace to assess their value in mergers and acquisitions, licensing arrangements, as a metric in brand management contexts, and for placement on balance sheets in the U.K. and elsewhere.

The importance of brands has grown so exponentially that for many companies, the branding of products and services has emerged to occupy a place of paramount concern and has often become *the corporate strategy*. It has certainly become a new part of the job description for CEOs, corporate executives, and marketing officers. Every day, we see new articles and books on the subject of branding; numerous consultancies have emerged that specialize in branding and creating every aspect of a dominant, winning identity in the marketplace; and finally, magazines such as *Financial World*, *Fortune*, and *Business Week* now annually track the “most valuable” and “most admired” brands in the world.

But why is there so much concern about brands and branding?

First and foremost, as detailed in Chapter 1, because it was brands that gave birth to the new economy and the recognition of intangible intellectual capital assets during the upsurge of mergers and acquisitions (M&A) that occurred during the early 1990s in the U.S., the United Kingdom, and Western Europe. It was the very existence of significant

levels of “excess purchase price”² in many of the M&A deals that forced the very recognition of the value of brands, the attendant emergence of brand valuation methodologies, and in the end, as brands were brought onto the balance sheets of U.S. companies, the importance of learning to manage these newly valued assets to avoid a loss of shareholder value.

Originally, as *source indicia*, trademarks allowed consumers to purchase the same goods from reliable manufacturers. The marketplace is now flooded with products and services, and consumers find themselves with less time to shop, brands have become essential to consumer behavior. Just looking at the supermarket, there are more than 20,000 new product entries per year and growing. We live in a society where there are hundreds of messages coming at us each day, and we have come to rely on brands to help us sort the flood of impressions and make rapid decisions. Consumers insist upon branded products because they know what to expect from a branded item and because it makes shopping quick, easy, and even virtual. Thus, brands are the only way to identify and claim your “position” in a world of niche marketing.

And most importantly, a brand can be a piece of intellectual capital that drives margins by adding value to products and services. If managed well, a brand creates brand equity for an enterprise, and may turn out to be the primary asset of the enterprise.

While this isn’t a treatise on brand strategy, “brand-building” has come to be the term used to designate the strategic deployment of brand assets and thus that which creates brand equity. There are hundreds of major brands in a world of thousands of brands. Because brands have become a major economic force in the modern world, they require intelligent management and wise exploitation. In other words, there are right and wrong ways to manage brands. “brand-building” stands for managing the brand always in such a way as to build brand equity. It refers to those ways that articulate valuable meanings and keep the brand deployments focused on values. The wrong ways are misguided marketing and sales approaches to selling (e.g., trivializing, dealing, couponing, promotions, and the like), that can in the end devalue brands rather than enhance brand value. As opposed to those activities that reinforce or more thoroughly articulate the meaning of a brand, devaluing tactics are typically those short-term activities designed to stuff yet more products into the market, perhaps more than there is a demand for.

Licensing, of course, is a possible intellectual asset strategy that can be used with a brand. Often referred to as “carrot licensing”³ in the world of trademarks and copyrights, it refers to a situation where an intellectual asset or property is licensed to another company because that company believes it could profitably commercialize the intellectual asset as new products or services in an appropriate market.

Carrot licensing fulfills a strategic purpose when it strengthens the licensor’s brand or intellectual asset, and the property is used to expand the scope of a brand or a copyright because it is deployed to enable new products and services that would not otherwise be able to enter the market. Brand merchandising, a form of carrot licensing, is estimated in 2007 to be at over \$170 billion per year worldwide. Such licensing is highly attractive to parties that hold desirable intellectual property, primarily for two reasons, 1) it allows them to commercialize their IP in other market spaces without having to undertake the investment or the risk of introducing developing and marketing products or services that may lie far afield from their core competencies, and 2) because it allows the licensor to enjoy royalty income. Royalty income is not burdened with the expense or cost of goods sold or any substantial operating expenses. As such, royalty income falls to the bottom line as free cash flow, immediately enhancing operating income, and in the case of public companies, improving earnings per share.

A notable instance of brand-related carrot licensing is provided by The Walt Disney Company. As the world’s number two media conglomerate, the company produces movies, music, radio and television programming, and operates theme parks while simultaneously licensing rights to their characters and productions for a range of character and story-based toys, books, clothing, and other children’s products. In these case, licensees often charge more for the same products that are in the marketplace without the Disney property, both to offset the royalty expense and because the Disney brand allows them to command a more premium price.

The brand, with its unique distilling nature, provides an exceptional strategic opportunity for transferring and collecting equities, not just from patents, but from copyrights as well. The *Harry Potter* books, written by J. K. Rowling and commercialized by Scholastic, Inc., their American publisher, evidence how a series of copyrighted books over a period of ten years transferred their individual equities into the Harry Potter brand that encompasses the original books in a plethora of sizes, colors, and

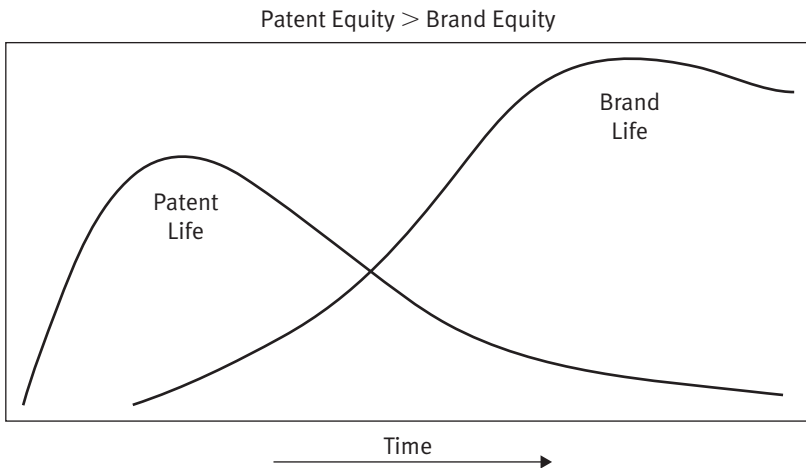
formats, Hollywood films, games, theme parks, and a massive merchandise licensing engine for a whole generation of young people.

Importantly, because brands collect and orchestrate meaning, they can be used to take equity of value out of one kind of intangible asset and to transfer it into another kind of intangible asset (see Exhibit 6.1). The authors refer to their most commonly used example as “the Intel Strategy.” Intel transferred equity from a whole series of their microchips into their Intel Inside brand—a brand that thus came to be known as the gold standard for innovation in chip speed and capability.

Patented technology, which is susceptible to the maximum 20 years term of a patent, can transfer its equities and what it stands for, into a well-articulated brand by properly associating those meanings in a synthetic way with an overarching brand.

Intel provides an excellent example of a technology company that appears to have borrowed a brand strategy technique from consumer packaged goods and applied it to their manufacturing concern. Year after year, they associated the “Intel Inside” brand mark with each of their microprocessor chips, beginning with the 8086 chip and continuing on through the Pentium, the Pentium II, the Pentium III, and finally the Pentium IV, while at the same time “sub-lining”⁴ the same chips into *Multimedia Pentium*

Patent/Brand Dynamics:



and other special configurations, and often sub-lining them further by assigning them various additional model numbers. Thus, the company was able to accumulate the history of their microchips into their Intel Inside brand, carrying forward technology and patent equities that otherwise would have been lost to patent expiration or obsolescence.

Interestingly, all intellectual property assets have finite lives, except the brand and trademarks, offering yet another reason why in many enterprises, it can be viewed as the reason for which all other IP assets exist.

Even open sourcing, while apparently antithetical to trademarks or brands, may be creatively deployed as a brand-building strategy. In 2004, MIT put the bulk of their university courses online, for free, for international access. Reportedly, their action was undertaken, in keeping with their status as an educational institution, to provide instruction to those (especially in developing countries) who did not have access to higher education. While undertaken for the greater good, it was *de facto* a brand strategy designed to boost the reputation of the university. Subsequently, it was reported that many of the parties who made use of the MIT educational opportunity, later, despite the availability of free courses, were drawn to enroll at MIT because of the quality of the online educational offerings. With the notable result on the stature of the MIT educational brand, now other universities are moving to make their standard courses available online as well.

Patents

The primary patent strategy, and that for which patent law was originally created, is that of protecting an invention, technology, or most recently, a business method, to create a limited monopoly. The patent holder can exclude others from using it, and gaining a lead time during which the inventor or developing company can attract investor capital, recoup its research and development investment, and earn a profit as well. This approach is especially important for technologies requiring long development and government approval processes. Viewed from the perspective of “The Shifting Paradigm” between the old and new economies, this strategy, in its classic execution, excludes others, polices against infringers, and probably foregoes the opportunity to form alliances with other companies or with infringers.

Examples of this strategy are those presented by the Polaroid Corporation that became famous for inventing instant photography and the Xerox Corporation that revolutionized modern business with their invention of the copier. In each case, the companies filed multiple patents to protect their invention and enjoyed years of limited monopoly. Other examples are offered by pharmaceutical companies, who invest hundreds of millions of dollars in developing and perfecting drugs that change the lives of millions of people for the better, and who expect to receive the full twenty-year term of patent protection granted under the law to earn back their substantial investments.

Dell, Inc., known widely for their “built-to-order” sales model, and Amazon.com, with their “one-click” ordering system are examples of companies that have also leveraged their intellectual property in the form of business method patents to protect and flourish under their business models.

Beyond protecting core technologies, the three primary strategies used to leverage patent portfolios are known as i) “bracketing,” ii) creating “thickets,” and iii) “cross-licensing.”

“Bracketing” refers to delivering “disruptive” technology (i.e., discontinuous innovation to the marketplace) by jumping ahead of the competition and leapfrogging their technology. Consider the example of how cordless telephones bracketed phones that were attached to their base unit with cords, and how cellular telephones bracketed wireless landlines. In the area of computer technology, consider how wireless peripheral devices have bracketed and made largely obsolete peripherals connected to computers by cords and wires. In these instances, the companies that effected a bracketing of their competition focused on developing disruptive technology that would render the competition obsolete. This can be an effective strategy for a breakthrough technology, for a company that heavily funds research and development, or for a brilliant invention.

Less time and resource-intensive is creating a “thicket,” often referred to as a “patent wall,” a “patent cluster,” or more graphically, as a “patent minefield.” A thicket is created by surrounding a core technology with a number of often lesser, incremental patents to make the proprietary technology more invincible to noninfringing incursions from competition. Small patent thickets are common with most patented technologies as an expression of the natural evolution of the technology and its ongoing

development. However, deployed strategically, creating a patent thicket is more about deliberately blocking a natural path of incursion with an incremental invention. Thus, it is undertaken more as a defensive strategy than as the natural course of technological development. In some cases, the proliferation of blocking patents has become so extensive, and the quality of the patents created so minimal, that these patents are referred to disparagingly as “junk patents,” to suggest how they litter a technological landscape *only* to block competition without providing meaningful invention or innovation to the related technology.

In general, patent thickets are intended to sustain a business and maintain its competitive advantage beyond the original term of patent for the basic innovation. However, as the example of “junk patents” may suggest, a major factor in the successful execution of such a strategy is to be successful, but not so successful that your dominance becomes unlawful under antitrust or monopolization laws.

Patent thickets are in common use by companies that possess large patent portfolios. A large patent portfolio has other advantages as well. For one, a strategy involving creating a lot of patents can be a good *defensive* patent strategy.⁵ This is the way it works if a company is approached by another asserting infringement of their rights, defensive patents may provide the basis for a counterclaim against the asserter, and thus too, a basis upon which to negotiate a settlement. When a goal of a business strategy is to enter an existing market, either established by an innovator or already the domain of several other companies, a defensive patent portfolio, with the correct patents, i.e. some of which are practiced by competitors, can also be a strategy to protect “freedom to operate” or to avoid the dominance of another’s patent.⁶ Alternatively, one might ultimately decide to aggressively assert the patent thicket that was initially created for offense or the large portfolio created for defense. In its most successful form, the strategy of creating a large portfolio might result in royalties from virtually all industry players for one reason or another.⁷ However, such a scenario might be negatively seen as a “tax” on the industry through a program of nonexclusive licenses to a multitude of players in an industry space. This was said of IBM after they launched their famous patent licensing program. Detractors said that the quality of the patents was unimportant to IBM’s strategy, and eventually with thousands of licensees, the licensing program became a general “industry tax.”

An alternative approach was demonstrated by Texas Instruments (TI), who licensed important new technology to the rest of the industry. Revenues, rather than a strategy of blocking the competition, yielded over a billion dollars per year of free cash flow or profit to their bottom line. This royalty income, in a time of poor market performance, is said by some to account for the “survival” of TI.

Not surprisingly, in the “patent wars,” as elsewhere, a successful strategy can result in an even more successful counterstrategy. As more companies have developed patent thickets, an array of counterstrategies have emerged from “designing around” the thicket to invading or “flooding” the thickets with incremental patents that block and run interference with the thicket holder’s technology. “Flooding” is often a counterstrategy when “design-arounds” would be either impossible or ineffective. Competitors faced with the prospect of a patent thicket or other serious barrier often develop the counterstrategy of filing applications to minor incremental changes to the thicket. In such cases, a company invades another company’s patent thicket much as water would come in around cattails in a swamp. While “design-arounds” are motivated by the desire to advance a technology one way or another, “flooding” may be used only to counter competition. The intent behind this strategy is to create a situation wherein a company becomes unable to practice its technology without infringing the other company’s IP. Others have found the strategy useful in eventually gaining access to the other party’s core technology through extracting a cross-license in settlement of patent infringement claims.

Another patent strategy, popularly deployed by large technology companies, is “cross-licensing.” In the case of cross-licensing, one company has usually discovered, often through reverse-engineering, a competitor’s product or service, that another company is infringing its technology and on that basis has approached the infringing company seeking to put them under a license and charge them with ongoing and even back royalties. At other times, the patent holder simply sues to stop the infringing activity. Cross-licensing emerges when the infringing company notifies the first company that they too are infringing the second company’s portfolio. While any one company may wish to see the infringement cease, for many, a settlement between the mutually infringing companies is the objective, and they agree to a cross-licensing arrangement whereby they

exchange the technology each seeks rather than pursue mutually-self-destructive or pointless patent infringement litigation against each other.

Licensing, of course, has been around for a very long time, and at least in the U.S., for trademarks, copyrighted materials, and patents, it dates back to the emergence of licensable properties and has risen prodigiously with respect to consumer packaged goods, media, and entertainment industries, and with the rise of computer technology. It is the oldest and most basic intellectual property commercialization strategy.

Generally, licensing comes in two varieties, “stick licensing” or “carrot licensing,” which is based upon the attractiveness of the property to be licensed. It is frequently a strategy for trade marks and copyrights in addition to patents.

Stick licensing refers to policing infringers of a technology or an invention by putting them under a license to sanction their illegal use, and charging them royalties for the time of the infringement. There has been so much technological development in recent decades that in many market areas, it is almost impossible to avoid infringing one or another of the over 6 million active patents in the world.

Companies with large patent portfolios, often including many patents that they don’t practice, have been urged on by the claim that it can be lucrative to assert patent infringement to provide royalty income or to obtain needed technology from the possible infringers. Known as “portfolio mining,” practitioners use tools, such as topographic style patent maps, to identify patent clusters and target infringers with near surgical precision. Cross-licensing is a new variant of licensing that has emerged in the world of technology to trade needed technologies between competitors and often to allow more rapid technological development in crowded areas of innovation. The open source movement and standards pools are among the most recent embodiments of cross-licensing.

Portfolio mining largely emerged onto the intellectual asset management stage with the phenomenal story of licensing unused technology at IBM. A holder of tens of thousands of patents, it wasn’t until the early 1990s that IBM began commercializing its unused IP. Since the late 1990s, they have become a legend in intellectual property circles for creating possibly the world’s largest patent licensing machine. Leveraging a rapidly growing portfolio of purportedly unused patents, they were able to build a licensing business that grew from \$30 million in annual royalties in 1990

to over \$2 billion annually by the middle of the first decade of the 21st century—all by settling with infringers to avoid patent infringement litigation and collecting the subsequent royalties due.

Notably, however, and in support of a main thesis of this book, is the fact that no matter how much free cash flow the activity delivered to the IBM bottom line, it was not a *strategic undertaking* for the company. Initiated to offset large losses, to this day it does not provide competitive advantage to drive market capitalization as “strategic” initiatives do. Some activities are tactical and some are strategic, some deliver efficiencies and others provide strategic positioning to the enterprise.

It did not take long for yet another different patent strategy to evolve as its own innovation. After all, a patent portfolio that is aggressively asserted need not evolve from some original offensive or defensive patent strategy in the pertinent industry or from a business purpose. Instead, one can acquire a patent position and aggressively assert patents and collect monies, in the form of royalties or damages, as *the primary* business. Called “patent trolls,” or less pejoratively, “patent licensing and enforcement companies” (PLECs), these enterprises acquire patent holdings that are well-positioned for enforcement activities, provide them with the advantage of being immune from the threat of counterclaims for infringement, and that allow them to extract maximum revenues because there is no fear of counterclaims under the defendant’s patent position. This relatively new practice is heralded by its proponents, both as a business and the salvation of small inventors.

One of the most famous of these “small inventors” is Jerome Lemelson. Lemelson was granted numerous patents in the field of electronic vision and manufacturing, and his Foundation systematically extracted royalties from almost every large company in the industry. Lemelson detractors accused Lemelson of abusing the “continuation practice” in the U.S. Patent Office and *submarining* his patents, that is availing himself of the opportunity to keep his patent application secret and pending for an unconscionably long time, and rewording certain portions to encompass newer innovations by others, until the industry had matured and the damage awards he would be entitled to were as large as possible. Patent law changes have now been enacted that largely prevent “submarine patents” like those of Lemelson. Such changes were perhaps in no small part due to Lemelson.

Given the success of Lemelson, others began to form corporations that do not invent, but simply buy up patents for the sole purpose of compelling royalty monies from purported infringers.

Whatever the strategy, patents only have a 20-year life at best, so it is important to realize that the protection afforded by a patent is temporary. At their expiration, they enter the public domain and may be practiced by anyone. For this reason, some companies rely on trade secret protection to gain an indefinite term of protection for their invention. Of course, trade secret protection lasts for as long as the secret can be kept. However, a real threat to a trade secret is not just the loss of the secret, but the threat of “independent derivation,” or that someone else could come up with the same invention.

Coca-Cola is the classic example of a trade secret *kept since 1886*. It was originally invented by John Pemberton, a former Lt. Colonel in the Confederate Army, in 1886 in Columbus, Georgia. The beverage was named “coca-cola” and flavored with kola nuts. Today, the stimulant in the drink is caffeine, but the flavoring is still done with kola nuts and coca leaves. While the Coke secret has been kept for well over a hundred years, this is probably not representative of the average term for a trade secret. The issue of trade secret protection versus patent protection depends upon the ability to at least keep the secret for longer than the lead time a patent would have provided, knowing that then, even if the secret leaks, it may not leak to the whole world. Despite Coca-Cola’s ability to keep its secret, surrounded by drama and legend and apparently locked in a bank vault, in the world of business, with employees coming and going, it is often very hard to keep a secret for a prolonged period of time or even as long as the 20-year term of a patent. However, in an industry with rapid innovation the prospect of keeping a secret until the next disruptive advance (normally in a period must less than 20 years) is more conceivable.

In other cases, companies adopt an “open-source” strategy, whereby they inject their inventions directly into the public domain, or take already patented inventions, and prior to reaching expiration, make them available to open-source developers to obtain the potential benefits of broad market development, possibly for follow-on technology. IBM offers a classic case with their donation of thousands of patents to the open-source movement in 2005. Ostensibly, the action was undertaken

to gain the public relations benefits from supporting open-source software development and to be seen as something of a “white knight” to the growing open-source movement. However, IBM rationalized their actions as designed to stimulate innovation in selected technological areas. Irrespectively, as a corporate strategy, the action also acted to empower the open-source platform against Microsoft, and to drive sales of the open-source hardware sold by IBM.

Copyrights

Copyright law provides protection to authors and creators of “original works of authorship” once they are set in their medium. Copyright protected properties include the creations of literary works, visual arts, performing arts, musical compositions, publications, movies, software, and other published or unpublished intellectual works, and grants the author exclusive rights to the reproduction, distribution, performance, display, and preparation of derivative works.

The rise of the Internet and the ease with which digital content can be copied and manipulated with computer technology has opened many doors and delivered innumerable new vehicles and commercialization opportunities to copyright holders to separate, combine, and recombine their works into innumerable combinations. Once informal, some copyright commercialization techniques have today achieved new levels of sophistication and strategic stature. Today copyright executives prepare strategic plans that are designed around the primary strategies of “bundling” and “unbundling” content, “microparceling,” portfolio mining and “product form extensions.”

Interestingly, much as patent holders such as Intel borrowed branding strategies from the world of consumer packaged goods to leverage their holdings, recently formalized copyright strategies have also found many of their new leveraging ideas in the world of consumer goods strategy. In some sense, there is nothing new under the sun, but given the importance of intellectual assets, consumer product strategies of brand architecture and “sub-lining” are finding new deployment with copyrighted content.

“Bundling,” one of the earliest content strategies, is based on the consumer product strategy of “adding value” and features. By taking one

thing that has value and adding to it one or more other things that have related value, sales volume can be enhanced. “Bundling” prominently emerged with copyrighted computer software during 1983, when Apple Computer introduced their then revolutionary personal computer, the “Lisa.” It was the first easy-to-navigate operating system, that included a spreadsheet, a word processor, and other software tools that allowed individuals to create and assemble business reports involving content from more than one type of software. Microsoft Office, borrowing a page from Apple’s playbook, later emerged with a much more sophisticated assembly of related software programs under the Microsoft Office brand in 1989.

For many of us, a recent and obvious “bundling” is the popular practice of offering DVDs of popular movies with scenes that were deleted from the final movie, interviews with the lead actors and the director, automatic foreign language dubbing, and other extras. Movies, music CD cases, and content-heavy Web sites all bundle together related and unrelated materials to create new value, much as luxury automobiles add features and luxuries, all to leverage the underlying asset(s), and to deliver revenues and profitability through adoption, use, and consumption.

“Unbundling” is a strategy that allows the copyright holder to extract more value from the asset. Thus, rather than licensing a whole asset like a technology, we license the individual aspects of the asset to receive royalties on each property. An example using a copyrighted asset could be selling music CDs, and then turning around and selling three bars of the most popular songs as a ringtone for a cellular telephone at an additional price. Small purchase price unbundling like this are often called “micro-parceling.”

Product Form extensions, as a tool of capitalism and growth strategy, allow us to unbundle the concept of a specific product and extend it by a feature. For example, a popular beverage product like Coca-Cola or Pepsi (the concept), extended by feature (color, flavor, shape, size, and etc.) into cherry, vanilla, and other flavors, into other sizes, in holiday versions, into calorie reduced, and so on. Each new line extension and each new entry leverages the brand as core intellectual asset, and *creates* a new user of the product thus more and more highly leveraging the asset. With copyrighted content, in publishing for example, a bestselling book can be extended in commemorative editions, new hardbound editions, large type editions, boxed sets, paperbacks, reprinted paperbacks,

movies, soundtracks, and et cetera. Each extension or formatting of the content asset extends the market for the whole concept. Copyrighted content, like literature, movies, and music, all of which can be digitized and parceled down to the level of bits/frames, offer tremendous opportunities for the commercialization and leveraging of protected content that are limited only by the imagination of copyright holders. The *New York Times* more than offsets the free subscription to their newspaper that is available online by selling all slightly older articles for \$4.95 each to online traffic. Images are sold by holders *in toto*, by “insets,” enlargements, reductions, re-compositions, recolorings and distortions, to name just a few of the ways in which they are customarily unbundled for commercialization.

Consider iTunes, who began primarily as a service to populate the popular iPods with music of the right file type, sold by the song. They have expanded their business from \$30 million in 2003 to over \$1.2 billion dollars in 2006 by revisioning their delivery vehicle and deploying their platform as a parcelization of all digital media from movies and music videos, to television shows, audio books, educational content (college courses), games, and even podcasts.

GOOGLE'S COPYRIGHT STRATEGY

If everybody is thinking alike, then somebody isn't thinking.

—GENERAL GEORGE PATTON

Google, in selling their *Ad Sense* advertisement placement services *by the word searched*, has become an archetypal unbundler of the content of their massive search engine. With the announcement of Google's “Print Library Project,” also called “Google Print” or “Google Books,” Google has embarked on an initiative that is reminiscent, on the virtual level, of the ancient Royal Library of Alexandria that was built in Alexandria, Egypt during the 3rd century B.C.E. Google's stated intent was to ultimately scan all the books and publications in the world, and to then make them available online in a virtual library as the “democratization of content.”

The company announced in 2004 its intent to begin digitizing books from some of the largest libraries in the world including the New York Public Library and the libraries of Harvard University, Oxford University, Stanford University, and the University of Michigan. Under this program, users could enter book titles and read snippets of books or entire books, depending upon their copyright status and the wishes of the respective copyright holder.

They envision the program offering entire books for search when the books are out of copyright and in the public domain, and something less than a full book according to what either author or publisher copyright holders are willing to authorize. Such options range from full page views to masked snippets surrounding the view of the respective word or words searched. Users could then review the information revealed, explore the publication further, or purchase the book online directly from its publisher or other bookselling sites.

In so doing, Google has embarked on an intellectual asset strategy that challenges the apparent current understanding of the law of copyright, and may be designed to move the delineation of permissible copying within existing copyright law. If successful, it would provide Google with a competitive advantage over all other search engines and database enterprises. Google will have leveraged “the greater good,” making the world’s knowledge available to all comers to change the law of fair use and the shift the boundaries of one of the fundamental planks of copyright law—that being the holder’s right to reproduce and create derivative works. Google’s basic public policy argument is that the social philosophy benefits, in an era of globalization, digitizing, and centralizing all content and thus making the world’s knowledge readily available outweigh the infraction of scanning entire books.

Needless to say, many copyright holders, publishers, and authors’ organizations have variously complained that Google’s activities constitute copyright infringement; do not fall under “fair use” because of Google’s profit motive and large scale commercialization; and will cause irreparable harm and deprive them of their rights under the law to control the display, reproduction, and distribution of their works. Google’s counterargument is that authors can opt-out under the Digital Millennium Copyright Act (DMCA), and that because only small, *de minimis* portions of

copyrighted works are displayed, the fair use defense is applicable. Some copyright attorneys have been quick to point out that the very scanning of an entire book, however much is displayed in an online search, is a copyright infringement and an activity that steps well beyond fair use. Others see precedents of “compulsory licensing” for public benefit.

While the courts address the law and endeavor to balance the interests of content owners and those of the public, Google proceeds to implement its strategy to enhance its competitive advantage in the world’s digital content, to build its virtual library, and to lobby Congress and related public officials to change the law to address a changing world.

Google’s activities, and to a lesser extent those of other media and content-related initiatives, are finding their way to new bundled and unbundled formats that often redefine rights. All of this content from unbundled elements to each product form all allowed under license or contract. Thus licensing is no less common with copyrights than with trademarks or patents, as the legal document underlying strategic execution.

Importantly we must bring this section to a close with a brief discussion of the strategic nexus of trade secrets. We have briefly mentioned their role in the original decision about an invention or technology, that being the question of “whether to patent or to protect as a trade secret” The best answer is always to choose whatever path will most greatly benefit the company or enterprise.

One case in point is Wal-Mart, the immense global retailer that during its earlier days, banked their sustainable competitive advantage on providing the lowest possible prices. Their core competency thus resides in their resourcing machine, their ability to buy in quantity, their ability to obtain manufacturer commitments to pricing that could only be profitability because of the extremely high volume, and their competency at operational effectiveness.

Wal-Mart relied upon trade secrets, as opposed to patents, to protect their business model and its business processes. As employees left the company Wal-Mart lost portions of its proprietary knowledge, such as supplier relationships, the knowledge of *how* the company obtained ongoing price

reductions from their manufacturers, and how Wal-Mart developed its own products to replace those of its suppliers when the suppliers couldn't cut their prices any further and stay in business. This was Wal-Mart's knowledge base and its talent. Thus it is the tale of a secret lost.

A polar opposite could be Dell, Inc., who protected its built-to-order sales model with business process patents, reportedly gaining 42 patents, and then used its intellectual property to prevent others from copying its system and eroding its competitive advantage. Dell is also known for negotiating a deal with IBM to supply modular components that are central to the Dell business model, and thereby to obtain them at discounted prices that made it hard for other companies to compete.

Some trade secrets are licensed properties, but the more people know a secret, the harder it is to keep. That doesn't mean trade secrets can't be shared, but they must be protected as trade secrets.

In summary, the battle lines have been drawn since the early 1990s, so that today new strategic thinking with intellectual assets is more possible than ever before.

INTELLECTUAL ASSET STRATEGIES AS VIEWED BY EXECUTIVE LEADERSHIP

It is time for a new generation of leadership, to cope with new problems and new opportunities. For there is a new world to be won.

—JOHN F. KENNEDY, TELEVISION ADDRESS, 7/4/1960

Sliced another way, intellectual asset and the strategies and tactics with which they are leveraged and deployed are increasingly undertaken to fulfill primary strategic roles in companies and enterprises.

Whether it is to assure the consumer as to the source of goods in increasingly crowded markets, to protect core technologies or business methods and drive innovation, and to protect original creations and stimulate the economy, or to reduce costs and risk, and obtain financial advantages, assert legal rights, attract new capital, guide research and development toward strategic objectives and enhance corporate value, intangible intellectual capital assets are becoming the new *means of production* in the new global economy across all industries and in enterprises of all sizes. In this role, intangible assets are now in a class by themselves in a sense they are a new class of assets.

For many, what is most engaging is the way in which the shifting asset base as described in Chapter 2 has opened new opportunities for commercialization and the creation of wealth. Purveyors of commodities, like bottled water, are beginning to learn how to brand their entries to vacate their commodity status and to gain the margins and strategic differentiation provided by branded products and services. Industry and manufacturing enterprises are learning to use brand strategies to articulate “corporate brands” that outflank competitors, or to use intellectual property as currency to enter new business alliances and other arrangements.

As the preponderance of evidence builds, it is hard or foolish, to resist the opportunities provided by the thinking behind intellectual asset strategies. Intellectual property managers in today’s enterprises have heard the call and want to understand and apply this emerging art of IAM to join the ranks of strategic thinkers enhancing corporate earnings and advancing their careers. For others, IAM is limited to a large patent portfolio and means enhancing revenues with a program of patent enforcement. 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 cobranding arrangement.

Those with any familiarity of the realities involved in extracting money from infringers through such “stick licensing” know that it is hardly a simple matter. It has evolved into an art that involves the strategic acumen and financial wherewithal required to successfully threaten patent litigation (hopefully without the need to see the matter through to trial and perhaps an appeal). In such dealings, 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-practiced 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 assertedly infringed by the would be licensor, and a series of civilized 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 patent 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 intellectual property-holding companies or licensing entities.

For years, 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 utilize such intellectual property for a price. 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 yet of value to them,” and finally, that they should pay what you deem is its worth, is simply not that easy either. Similar models, albeit often for precommercialized 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. Now the evidence of experience suggests that the effort expended to mine noncore properties may not be worthwhile. The real question, while more difficult, is to examine core competencies, assess speed to innovation and to market and to decide when to license.

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 intellectual property portfolios to “mine.” Even if a company can identify patents it owns and likely businesses that either infringe or might benefit from a license, few have the organization or clout to simply pick up the phone or send a letter to quickly gain a new revenue stream.

This does not mean that intellectual asset management is not a worthwhile option for most companies and certainly not without merit for companies where patents are not *de rigueur*. Books like *Rembrandts in the Attic*⁸ and *Edison in the Boardroom*,⁹ may have grabbed center stage with an exciting story, the promise of easy new revenue streams, but in reality, that promise may ring as hallow for most enterprises. Neither does it mean that all the recent hoopla about the value of intangibles in the newly arrived knowledge-based economy applies only to those large companies or to those few additional companies with truly famous brands, like Coca-Cola. Nevertheless, much has been written about “classical licensing” and relatively little about avenues more easily adopted by the average enterprise.

Perhaps it is just that the pioneering activities occurred in companies with the most to gain from classic licensing, and so that was the method they could capitalize on to grab the low-hanging fruit under the then new theories of intellectual asset management. Perhaps if we study the underlying theories applicable to the new paradigm of creating wealth with intangible assets, other strategies become more evident. Such study, even more advantageously, elucidates the tools to create new strategies.

When one thinks of the broad categories of intangible assets, such as brands or intellectual property, in the light of the shifting economic factors discussed earlier, we begin to see that intellectual asset strategies are actually becoming central to modern strategy.

In the examples throughout this book, the owners of intangible assets have found ways to build, share, or allow the use of those assets by others in some form of negotiated exchange, such as a royalty, a transaction, awareness, or other benefit. Thus leveraging intangibles, whether it is in the form of intellectual property or more intangible core competencies like marketing expertise or experience in distribution, these intangible assets are a powerful means of creating wealth that can be used by one or many users simultaneously, without depletion, and for their entire life of the asset, which, with the exception of patents and copyrights, can be forever.

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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

HOW TO LEVERAGE INTANGIBLE ASSETS

1. Identify your core competencies.
2. Identify your intangible assets.
3. Identify your growth objectives.
4. Think in terms of economic paradigms.
5. Think outside of the box, and optimize your intangibles against your objectives.

**HOW SONY LEVERAGED THEIR
MARKETING SAVVY TO
REMAIN COMPETITIVE**

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


Long recognized 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 of change that is now emerging in the television market as consumers increasingly purchase flat-screen models. As Sony's Trinitron sales began to fall, the company began to realize that because they lacked a flat-screen manufacturing facility, their 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 \$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 their senior operations management and engineers with their flat-screen manufacturing knowledge to create and operate the flat-screen manufacturing operation, while Sony contributed their marketing savvy to their mutual benefit. Samsung was assured of immediate and ongoing demand for their products and the opportunity for their flat-screens to gain awareness with consumers, while Sony enjoyed a supply of flat-panels and ultimately a pricing advantage driven by their 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.



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. Intangibles, in their broadest sense, have truly become the substance of *all future strategy*.

So now that we know about the new class of assets, and we understand their fundamental grounding in the law as *creatures of the law*, and we begin to see how to think strategically about them, the question left is: But what, exactly, is strategy?



Notes

1. Coca-Cola, the most valuable brand in the world, was recently valued for *Business Week* magazine at \$65.324 billion in 2007, cf. Business Week, "The Best Global Brands," August 6, 2007 an annual brand ranking done in conjunction with Interbrand, a global brand consultancy.
2. That amount beyond the book value of a company paid in a merger or acquisition.

3. “Carrot licensing” is used to refer to licenses where the licensee sees a clear benefit to the license offered. We contrast it to “stick licensing,” where the licensee sees the license primarily as an added burden undertaken to avoid suit for infringement.
4. “Sub-lining,” refers to sub-dividing a product again to highlight another set of features. Thus Pentium chips were line-extended into the I, II, III, and IV, and the numerals were “sub-lined” or divided further into the regular Pentium IV and the Pentium IV *multi-media chips*.
5. With a defensive strategy, patents are obtained, not to exclude others from their practice, but to assert against anyone who claims you are infringing their patents. By cross-complaining of infringement, there is much more likelihood of settling the dispute without serious damage to the ongoing business.
6. If one thinks of the development of the automobile, Henry Ford might appear as the prototypical inventor who could have adopted the classic *offensive* patent strategy to his advantage. However, Ford apparently was antipatent until his industry opportunity was clouded by perhaps the first significant “submarine” patent. Selden apparently filed a rudimentary patent without any real reduction to practice or effort in that regard, kept it pending while others developed the industry and then amended it before issue to cover the industry of others.
7. Sometimes, the sheer burden of litigation results in companies paying royalties, especially if modest, rather than continue a court fight with a serious contender.
8. *Rembrandts in the Attic—Unlocking the Hidden Value of Patents*, by Kevin G. Rivette and David Kline, published by Harvard Business School Press, Boston, Massachusetts, 2000.
9. *Edison in the Boardroom—How Leading Companies Realize Value from Their Intellectual Assets*, by Julie L. Davis and Suzanne S. Harrison, published by John Wiley & Sons, Inc., 2001.



Corporate Strategy During the Era of Intellectual Capital

WHAT IS STRATEGY?

Strategy is choice on how to compete.

—MICHAEL PORTER

Strategy goes back to the Greeks. The word is derived from the Greek word, *strategia*, that refers to an act, device, or plan employed by a leader.

Aristotle, the famous Greek philosopher, articulated the classical understanding of the term during the 4th century BCE. in his work entitled the *Ethics*, as follows:

. . . as there are many actions, arts, and sciences, their ends also are many; the end of the medical art is health, that of shipbuilding a vessel, *that of strategy victory*, that of economics wealth.

At its historical origins, strategy was a way of thinking towards a certain end. In the ancient Greek mind, strategy was a way of thinking toward *victory* in the military or political sense. Today, and within the context of this book, we more likely think of strategy as a way of thinking toward the end of “success,” “winning,” achieving “competitive advantage,” or even “sustainable competitive advantage.” Simply, the goal of *strategy* is always the accomplishment of the end for which it is undertaken.

But how do we “do” strategy?

Strategy is about gaining a perspective on a situation or a state of affairs—where we are, how things are, what we are up against, what we want to

accomplish, why, and how we can get there. These are all questions strategic thinkers ask, and the objective of strategic thinking is to gain perspective so we can see what is really going on and how to accomplish our ends. Thus, it is common to speak in our modern world of the view from “30,000 feet high,” because from there we can comprehend the total landscape with its terrain in relief.

Strategy is also about understanding causality and making subtle distinctions between things and factors. The strategist seeks to understand why things are the way they are and what causes them to be that way. To do so, the strategist needs to make subtle distinctions between things and events. The intellectual capital strategist understands the nature of each of the various intellectual capital assets, comprehends the dynamics of their nature, and can effect the causality between the intangible asset and the strategy that deploys it to deliver the intended result.

In this respect, consider the requisite subtlety of the thinking that goes into defining what a brand like Coca-Cola stands for in its public, how those meanings are orchestrated to form a well-articulated brand, and the causality of the brand as the distiller of all other intangibles into brand equity. By making subtle distinction in brand definition, the brand is more effective at spinning its intangible constituents into a complex, concerted meaning that, when well-articulated to its time and opportunity, effects the leverage of intellectual capital to drive market capitalization.

And finally, good strategy is based upon *doing the right thing*. Both in the sense of “is this the right action to take,” and in the sense of “is this wise,” good strategists always ask if they are doing the right thing before implementing their strategy. They also ask if the strategy will deliver the intended results and if it will evidence brilliance or wisdom.

Strategy is necessary to achieve goals and to obtain any possible sustainable competitive advantage. Today, with the increasing speed of our world, the very concept of a “sustainable” competitive advantage is being called into question. It is hard to point to many truly “sustainable” advantages that aren’t quickly overtaken by competition and the advancement of technology. Most executives today go with the competitive advantage of the moment and are thankful for it. Sustainable or not, winning or succeeding, Aristotle’s *victory* may happen occasionally through chance, but sustained success is a function of brilliant strategy, careful planning, and disciplined execution. The endgame for all strategy is first competitive

advantage and then, insofar as it is possible, the holy grail of sustainable competitive advantage.

Strategy aligns the activities of an organization and leads to a shared vision. Unlike the “command and control” model of past decades, strategy is no longer entirely decided in boardrooms or executive suites and merely handed down to employees. With an increasingly intelligent workforce of knowledge workers, employees at all levels have become more responsible for the formulation and execution of strategy and ask the right questions to achieve strategic alignment, think strategically about their work, and make the right decisions within their sphere of influence.

Strategy is necessary to respond wisely to a complex, dynamic environment and to optimize the future. It is necessary in finding the right path through the increasing complexity of markets, players, and factors. The more complex the landscape becomes, the more essential it is to have a compass. Thus, strategy is a key part of management. It is necessary in setting direction, focusing effort, defining the organization or undertaking, and delivering consistently good work.

The fundamental principle to all strategy in the world of enterprise is the important distinction between objectives and undertaking that are *strategic*, and those that provide *operational effectiveness*. The difference between these two universes of discourse is that strategy attends the growth of the company while activities of operational effectiveness concern themselves with the operation of the company and its efficiency. The distinction has been well articulated by Michael Porter, the well-known Harvard professor of strategy, who has distinguished between “differentiation” and “optimization,” “unique activities,” and “best practices”—and between the competitive advantage of the extraordinary and that of the average that thereby fails to confer any competitive advantage upon its user.

The risk of strategy is that it will forget about its most highly differentiated job and devolve to fulfill operational objectives. Michael Porter characterizes *operational effectiveness* as “competition for the one, ideal competitive position in the industry.” We start benchmarking to achieve best practices and outsourcing for efficiencies, while strategic thinking goes beyond operational effectiveness to provide true competitive advantage that is not easily copied by competition. Thus, strategic thinking is tasked with finding the unique competitive position for the enterprise, attuning all corporate deliverables to achieving that position, saying “no”

to everything else, and building a “value chain” of interlocking unique activities that combine to lock competition out of that strategic position.

How do we apply that thinking to intellectual capital?

THE STRATEGIC EDGE—STRATEGY AND TACTICS

Good tactics can save even the worst strategy. Bad tactics will destroy even the best strategy.

—GENERAL GEORGE PATTON

Of war, it can be 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.

Originally, *strategy* referred to the difference between the *plans* of the general, the statesman, or a leader endowed with greater perspective and wisdom, 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, because the job of winning falls to the executives, they are the authors of strategy. The tactics and execution are then delegated to the functional disciplines (marketing, finance, and operations) within each organization. Today, strategy is still largely the domain of generals and executives, as are tactics the activities of those charged with execution. Still, a greater level of understanding is required of all individuals at all levels.

The growing field of intellectual asset management (IAM) is about the need to *leverage* intellectual property and other intellectual assets. However, as these assets have risen in importance, there has been little *distinction drawn between the merits of a “strategic” or a “tactical” deployment*. In some sense, any asset deployment is certainly better than no deployment. Nevertheless, to think as a strategist, it is critical to assess the deployment of intellectual assets and differentiate between those uses that turn intellectual assets to fulfill corporate strategies and those that use 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 by licensing, or by the greater return on asset realized from a patent having a long productive life. These activities are likely to be merely tactical if they are not directly in furtherance of a specific competitive advantage. Merely improving cash flow or profitability, however laudatory, is still “tactical” and fails to enhance the strategic positioning of the overall enterprise *per se*. These practitioners fail to recognize that merely making money doesn’t necessarily deliver a long-term competitive advantage to the company. Many companies today have billions of dollars of cash, but no real plans to wisely allocate the 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 programs that are pursued for the sole purpose of increasing earnings per share and giving the illusion of growing corporate value. The fact that money is neither spent on breakthrough innovation nor strategy to drive businesses forward underscores the failure to distinguish between “nonstrategic deployments” and those that, of course, make money, but more importantly have the ability to provide competitive advantage and drive enterprise valuation to fulfill the highest goals of business strategy.

STRATEGIC ASSET MANAGEMENT

You cannot define and manage intellectual assets unless you know what you want to do with them.

—THOMAS STEWART

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

Tangible assets, those that comprise the *book value* or the financial value on the balance sheet of an enterprise, are optimally leveraged with “best practice” activities than enhance efficiency and deliver what has broadly come to be called *operational effectiveness*. As we have previously discussed in this book, tangible assets have 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 optimal return on assets. These activities are important to any well-run operation, but because every company can use and similarly leverage the same assets in similar ways, they provide *neither differentiation in the marketplace* nor any sustainable competitive advantage to an enterprise, (i.e. they cannot deliver “the strategic edge.”)

As described in Chapter 1, most companies have learned how to maximize their tangible assets to deliver cost efficiencies, enhanced profitability, and functional operational benefits. In the industrial era, companies that enjoyed superior operational effectiveness *possessed* a competitive advantage through some economy of scale that allowed them to compete more effectively in the marketplace. Today, in the information age, the secrets of all such operational practices are well known to all successful companies in the world and they no longer bestow an appreciable competitive advantage on their possessor. These best practices, therefore, are necessary to compete, but are insufficient to provide “the strategic edge” that is so essential to winning.

Intellectual assets, namely those that increasingly account for the market value of a company, or the balance of value left in total market capitalization after subtracting a company’s book value, are most advantageously leveraged by corporate strategies that deliver competitive advantage and enhanced market capitalization, (i.e., 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 (see Exhibit 7.1). In most enterprises, the greatest improvement to company performance is accomplished through the strategic leveraging of intellectual assets or intellectual capital. Contrasted with tangible assets, these intangibles are plentiful and can be easily and repeatedly shared without depletion by use. Lastly, adoption, rather than scarcity, drives their value. Think how much more valuable Microsoft’s Internet Explorer has become in virtue of its worldwide success than Netscape’s pioneer web browser.

But such “strategic” use is often easier said than done. The many managers and executives that have built their careers working with tangible assets have successfully and brilliantly leveraged working capital, expanded operational scope, and achieved economies of scale. Still, they may lack

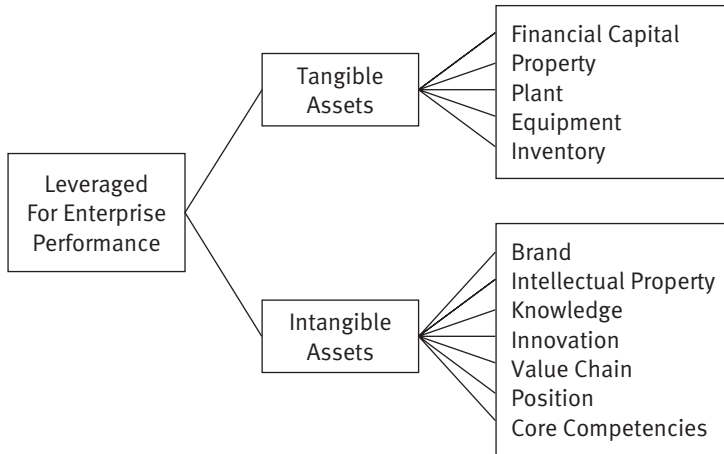


EXHIBIT 7.1

ASSET MANAGEMENT MODEL

the skills necessary to be as successful with intellectual assets that respond to different principles (e.g., consumption versus adoption). Thus, *sustainable competitive advantage* comes primarily to those organizations that have figured out how to capture and leverage their intangible intellectual assets—assets like brands, innovation, and the brain power of an organization, and how to leverage these assets *strategically*—that is, in service to some higher enterprise goal.

EXTRACTING VALUE AND SHOWING ROI—STRATEGIC OR TACTICAL?

However beautiful the strategy, you should occasionally look at the results.

—WINSTON CHURCHILL

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 on investment (ROI), or optimizing the asset in some respect. Their focus is on the asset and not its deployment in the world.

Our classic example of “patent mining” is most often merely “tactical.” 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 go under a license and enhance bottom line revenues through royalty payments for third party’s use of these otherwise underutilized, assets. Traditionally, when management “buys in” to a proposed project to mine patents, it is because they assume that it is not related to the company’s core business, (i.e., nothing of value to the company will be licensed). 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 operating income and profitability. However, the “stick licensing” therein embodied accomplishes no long-term strategic goal for the company.

The same can be said of portfolio mining designed to drive “carrot licensing,” where typically unused patents are offered to otherwise non-infringing third parties who can use their benefits. This practice of finding suitable matches is the predominant *modus operandi* of university tech-transfer licensing organizations. Once again, the gain to the enterprise is the royalty stream thereby created, but the competitive profile or the value of the enterprise in its market remains largely unaffected.

In the alternative, when cross-licensing is undertaken to obtain a competitive advantage in the marketplace, it is “strategic.” However, cross-licensing between competitors in settlement of litigation or in standards-setting may only be tactical, depending on whether the license 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 in some unique way to the differentiation of the enterprise in the marketplace. Both actions fulfill a company goal with tactics *optimizing the assets* of the company, and the strategies *leveraging the assets* of the company to provide growth, competitive advantage, or to drive market capitalization (see Exhibit 7.2).

The more we learn about intangibles and intellectual assets, the greater the tendency to drill down into each type of intellectual asset (brand, intellectual property, and knowledge), unbundling it and looking for dimensions to optimize—“Can we license this patent from this technology?” “Can we license this claim from this patent?” and so on, each more finite and leaving no stone unturned. This, of course, is well and good and even scientific, but it is often the case that the more we do it and dwell upon our

EXHIBIT 7.2

STRATEGY vs. TACTICS

Strategic Deployment of the Asset

- 1) Leveraging the asset to achieve a goal
- 2) Using the asset to provide growth, deliver competitive advantage, or drive market capitalization
- 3) Building value
- 4) Strategic positioning

The Effectiveness of the Organization

- 1) Leveraging the asset to obtain a return on the asset
- 2) Optimizing the asset (for leveraging)
- 3) Extracting value
- 4) Operational effectiveness

deconstructive results, the less strategic we become as we fail to leverage the greater entities themselves. It is the difference between maximizing income from existing patents (tactical), or leveraging entire patent portfolios to, for example, partner with a desirable joint-venture partner (strategic).

To some extent, such optimization is losing sight of the forest for the trees. It is also an expression of a natural tendency by functional disciplines within companies to drift from the overall strategy in a company and migrate and wander away to their respective tactical activities of marketing, promotions, protecting intellectual property, and policing infringers. The less directly intellectual asset deployments serve specific corporate strategies, the more they lose their *strategic edge*, and while they may benefit the company, albeit to a lesser degree, they are no longer “strategic.”

Fundamental to the strategic deployment of any intellectual asset is its link to the highest level of corporate strategy for the purposes of providing strategic positioning in the marketplace.

STRATEGIC DRIFT

The best vision is insight.

—MALCOLM S. FORBES

How does “strategic drift” work out in practice? It works out through a kind of “strategic forgetfulness,” or the tendency to devolve and lose the big picture.

While not definitive, the following analyses identify three primary activities that can lead the strategist astray in deploying intellectual capital.

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 or licensing when it does *not* establish a real link to delivering on corporate strategic goals. The much-admired IBM patent portfolio deployment initiated in the early 1990s didn't directly contribute to the strategies of the overall corporation or moving the business forward, *per se*, even though it created new revenue streams totaling billions of dollars, and leveraged unleveraged or unused intellectual property. That, apparently, was left to the now well-known consulting arm of IBM that reinvented the strategic significance of IBM 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 program was the undertaking of a functional discipline (the IP department) at a time when IBM posted a \$5 billion loss and needed income to offset its failing fortunes. In this respect, the patent licensing program primarily, by boosting the return on research and development (R&D) investment and creating substantial new free cash flow, enhanced the financial performance of the company. Financial performance is always good, but in strategic thinking circles, it is carefully distinguished from "strategic" activities that provide or directly support the strategic positioning of the company.

How so? Achieving operational effectiveness in creating and managing intellectual property is of great value, especially in larger companies that possess substantial portfolios. However, it doesn't necessarily deliver a competitive advantage because, arguably, any company that wanted to, had an IP portfolio, and the resources available could also establish and operate a licensing program—as many companies have. By their very nature, licensing programs are not the concern of strategic thinkers at the top of the organization because they will not advance the company in the marketplace. Many companies, failing to realize this point, embark on

some sort of intellectual asset management activity like stick licensing or portfolio mining, and because no strategic deliverable emerges, conclude that leveraging intellectual assets in fact does not enhance competitive advantage or drive stock value.

Relative to our earlier example, “licensing-in technology,” however, would primarily be a “strategic” activity insofar as it procured new technology that was not otherwise available but was 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 to extract value from the IP *per se*. Similarly, outsourcing may be strategic if it allows a company to focus on what it does best rather than reinventing the wheel.

At the end of the day, strategic thinking is not calling the shots unless we have been able to align the intellectual asset with the most essential corporate strategy, and we have found a use for given assets that deepen the strategic differentiation of the company. Otherwise, the asset is being deployed in service to operational effectiveness and is tactical activity in lieu of a higher purpose for the asset.

Thinking back to the Celestial Seasonings example in Chapter 5, it was strategic of the company to use the Sleepy Time brand dispute with Estee to partition a market category that was only “nice to have but not essential” to the strategic future of Celestial Seasonings. The strategic thinkers at Celestial Seasonings realized that to litigate to stop Estee Lauder from entering aromatherapy was “the tail wagging the dog.” While Celestial Seasoning may have consider entering aromatherapy one day, it wasn’t on the long-term strategic radar screen. By yielding aromatherapy to Estee Lauder, Celestial Seasonings more fully owned all the foreseeable market categories that were of strategic significance to the best thinkers in their company. To try to stop Estee Lauder would have been “merely tactical.”

Diluting Assets to Obtain Growth

Trademarks can offer an interesting example of licensing that is not simply tactical, but deleterious. Indiscriminate trademark licensing, trivializing line extensions, extensive 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* and diluting and tarnishing otherwise valuable brands, thereby reducing enterprise valuation.

The common approach of engaging in “merchandise licensing” among many popular consumer brands notably erodes brand equity. In such cases, revenues and income become more important than deepening the strategic positioning of the company and the differentiation of the core brand, leading to activities that rivals can imitate and as a result, reducing the cache of the brand. This erosion of brand equity emerges from the failure to understand the diminishing returns that eventually come with market saturation and overconsumption, and in the alternative, the often overlooked role of innovation in delivering *new* growth to a company based upon the development of new products or services.

Brand licensing programs 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 licenses using the same brand out there recede into the background. For instance, Coke makes Diet Coke and Pepsi comes out with Diet Pepsi; Pepsi enters the bottled water market with Aquafina and Coke does the same with Dasani; Starbucks begins offering sandwiches and McDonald’s establishes an arrangement with a specialty coffee company. In the end, they all reduce their peak of differentiation and look like “me too” to gain growth at all costs, as opposed to deepening their strategic positioning or unique differentiation. The assets are diluted because the company has to grow, and a truly “strategic” strategy that will deliver new growth is absent.

Weakening Competitive Advantage through the Failure to Leverage Core Competencies

The brand-related examples mentioned earlier also weakened strategic positioning by offering what rivals can easily match, rather than creating a unique product or service based on the company’s orchestrated core competencies.

Apple, with the iPod entry launched in 2001, enhanced its competitive advantage exponentially by entering a lackluster MP3 market with a unique product. Coupled with new software, technology, and characteristic Apple design, Apple redefined the MP3 as *a way to manage data and deliver media*, be it music, audio books, television, or DVD content, and

thus embarked upon a direction that competition couldn't follow because they neither possessed the design talent nor the root *core competencies* to deliver a new direction to the marketplace.

Apple worked in secret for years to develop a product that completely changed the rules of the game and leveraged their storied core competencies. The panache of their brand for design and style to create a landmark restructuring of the modern lifestyle is only now, after several years, being trumped by Apple itself with its carefully orchestrated new iPhone. Apple builds what only Apple can build with its unique knowledge base, its sense of style, its simplicity, its immediate user-friendliness, its beauty, and its brand that assembles everything into a competitive advantage that it is hard to beat—leaving competitors with only the opportunity to follow and copy.

If we don't deeply engage core competencies, we are not leveraging the most fundamental *sources* of intellectual capital in any organization. For Starbucks to start offering sandwiches or McDonald's to offer specialty coffee is to forget what built those brands, and thus to underoptimize their opportunity, reducing any existing competitive advantage, leveling the playing field for everyone. We often get lost in the details and practices and without even noticing it, fail to achieve the *strategic edge* that arises when we align intellectual assets with corporate strategy, thus failing to deliver the company a proprietary marketplace advantage. Achieving strategic alignment is a much higher hurdle than patent mining and value extraction *per se*.

THE STRATEGY OF STRATEGIES

Give me where to stand, and (with this lever) I will move the earth.

—ARCHIMEDES, *PAPPUS OF ALEXANDRIA*, BOOK VIII

Talking about strategy suggests that we are in control of our destiny and it entails the realization that success comes from picking the *right strategy* and failure arises from picking the wrong strategy or no strategy at all.

To “be strategic” is to engage the respective asset in its most comprehensive and complete aspect, as a total technology as opposed to as a patent or as a brand rather than a trademark, and then to find its possibilities in that state and at that level of totality. We can never be in the business

of leveraging patents and move the needle on company valuation. It just isn't enough leverage. But we can introduce a new technological whole (e.g., Apple's iPhone), and move the needle substantially.

In the end, all deployments of intellectual assets are not necessarily *strategic*. Many, if not most, are “merely tactical,” and while not lacking merit, they may neither rise to the level of being *strategic* nor be concerned with advancing the highest purposes of the enterprise. Lacking such relevance, the more tactical they become, the more they can be copied by other enterprises, by the competition, and eventually by everyone, losing their strategic edge and thus not contributing to the strategic positioning of the company.

Advantage in the marketplace arises only from the *strategic* deployment of intellectual assets, and, importantly, advantage in strategic deployments arises only from leveraging those assets that produce the greatest degree of leverage, (i.e. brands and technologies). In this sense, some assets and some strategies are *the strategy of strategies*.

ALL FUTURE STRATEGY

If knowledge, rather than labor, is the new measure of economic activity, then the fabric of capitalist society must change.

—PETER DRUCKER, *THE AGE OF DISCONTINUITY*

Revisiting strategy causes us to rethink strategy in the light of intangible intellectual assets while simultaneously saying something about all future strategy.

Whether we are leveraging the corporate brand to win in the marketplace, or the knowledge base of the enterprise to drive innovation, *all future strategy* will look first to intangible intellectual capital assets as the fundamental business resource and as the topic for strategic thinking.

Like Archimedes' lever, the intellectual capital asset that offers the greatest leverage is the asset to be used for the strategic positioning of the enterprise. Thus, *strategic positioning* is the first and most fundamental purpose for all strategy from which one can then leverage the assets in their totality to advance the enterprise.

Thus, *all future strategy* will concern itself first with strategizing intangibles.



Strategy and the Future

THE NEW ASSETS OF ENTERPRISE

From now on the key is knowledge. The world is becoming not labor intensive, not materials intensive, not energy intensive, but knowledge intensive.

—PETER DRUCKER, *MANAGING FOR THE FUTURE*, 1992

As enterprise strategy increasingly becomes intellectual capital strategy, the challenge going forward will be to study the science of and to perfect the deployment of the intellectual assets of any particular enterprise. The rise of intangible assets represents the “discovery,” if one may speak in such a scientific way, of a whole new *class* of assets that can be turned to enterprise objectives.

Much as physical and financial assets were perfected across the decades of the Industrial Revolution, the new intangible intellectual capital assets are beginning their analogous refinement.

Thus, the test of the future will be to accomplish important strategic, financial, and economic goals in the worlds of business and government, and in the affairs of society, and to do it with these *new* assets. Certainly, it means producing significant levels of equity and wealth based upon the formalization of ideas, innovation, and creativity. Additionally, to use previously overlooked creations—thinking and feeling, the arts and the sciences, and the professions—for business or enterprise purposes.

During its short history, intellectual capital has achieved immense strategic and managerial significance in business because of its ability to *found markets*, create exponential value, establish differentiation, deliver sustainable

competitive advantage, drive enterprise valuation, and to create great wealth.

Hence, both socially and culturally, this new class of assets is driving a greatly expanded role for knowledge and creativity within our modern civilization. In many respects, it is “the new great hope” and the next fundamental platform for our economy and the world. In this respect, it is a basis for socioeconomic optimism.

Intellectual capital includes all the ideas and creations that have now become so very central to the modern enterprise. Thus, strategy must deploy and leverage to good ends the new means of production. These are the *new* “assets” of enterprise.

THE STRATEGIC CHALLENGES

Knowledge may give weight, but accomplishments give luster, and many more people see than weigh.

—LORD CHESTERFIELD

These “*new* assets” have, of course, long been recognized in some nonspecific and informal sense within commerce, the professions, and society.

At least since the European Renaissance and 14th-century Italy, the economic and political significance of ideas and inventions has been acknowledged in some form or another, often as business monopolies or commercial grants that were bestowed upon a citizen of the realm by a monarch or nobility.

Similarly, from the 18th century, accountants have recognized intangible assets as “goodwill,” but that goodwill never played a strategic role until the turn of the 21st century when intellectual assets rose to be on par with traditional tangible assets, and to become the new focus of much corporate strategic thinking. “Intellectual property” has also been recognized under the laws of intellectual property, and from the 18th century onwards in the U.S., as a form of property and the newly defined *quasi-property*.

The strategic significance of these historical precursors must be looked at in a new light and, with a new class of assets, their strategy must be

“revisited.” Hence, led by its visions and limited by its early ability to be understood and executed, *intellectual capital strategy* is itself evolving in sophistication and capability. Today, strategy still often struggles to implement its plans even for apparently routine matters such as portfolio management, let alone being able to regularly execute envisioned grand strategic schemes focused on driving market capitalization and creating great wealth.

Despite these limitations, intellectual asset strategies are more often and successfully being deployed successfully with brands and intellectual property to net notable results. Brands have been singularly instrumental in unlocking the broad commercialization of products, services, and ideas, and in making larger, more effective markets. The laws of Intellectual Property and Unfair Competition have codified the property, enabled the development of technology and the rising focus on innovation, and supported competitive advantage, once again underscoring how these new assets are predominantly and essentially “creatures of the law.”

Given the opportunities and problems of this situation, there are many strategic challenges to implementation to be met before a *new* asset base can fulfill its potential. Primarily, the challenges may be classified into the following broad categories: (i) achieving operational effectiveness for the “*new* asset” class, (ii) monetizing intellectual assets, and (iii) effectively deploying intellectual assets for the highest enterprise objectives.

ACHIEVING OPERATIONAL EFFECTIVENESS FOR THE ASSET CLASS

Synergy means behavior of whole systems unpredicted by the behavior of their parts.

—BUCKMINSTER FULLER

First and foremost, implementation of intellectual asset strategy requires attention to the operational effectiveness side of the intellectual asset management (IAM) discipline in order to be more efficiently executed and to more reliably produce the desired effects. This means that the people involved in execution need to become more adept at executing even complex intellectual asset strategies well.

Although this theory is often realized in practice, it is perhaps more often unrealized because of flawed execution. In many cases, the ease with which intellectual assets such as a trademark or a patent can be created has led to a false sense of security as to the level and appropriateness of strategic deployment.

Because these intellectual assets are grounded in the law, they need to be acquired, maintained, and leveraged within the limits of the current law that applies to all, yet still be in furtherance of a truly *strategic* deployment with a long-term or even sustainable competitive advantage. Strategic deployments can have unintended consequences, some far more troubling than others.

For example, the practice of rewarding inventors has seen success in encouraging participation in the patent disclosure process. However, when unmonitored, this practice can drive *quantity* rather than the *quality of patents*.

Another example is the internal practice of giving product managers in large marketing departments the responsibility to name products. Picking a name without a high sense of the enterprise' brand architecture is often counterproductive. When name selection is a product of employee suggestion processes, aimed at encouraging and rewarding "team" participation, the strategic goal of developing valued trademarks and brand equity can easily be lost.

At first, both encouraging the disclosure of innovation and tapping knowledge workers for branding services simply seems like smart, even strategic, thinking. In both cases, while accepted as a way to expand and maximize valuable intellectual property, the practices can have negative results without attention to overall intellectual property (IP) strategy.

Initially, the practice of donating patents seemed like a clever use of intellectual assets that were not essential to the core activities or business interests of an enterprise. Early participants enjoyed enormous tax benefits. Before long, there was excessive zeal to implement "donations" solely to the benefit of the donor enterprise without regard to the benefit to be gained by the recipient enterprise or to the real detriment to the public from the loss of tax revenue. The result was simply a *change in the law*, for all purposes, eliminating the tax benefit to the detriment of enterprises.

When any idea, even a brilliant one, goes too far, it can become a bad strategy and even border on the unethical or illegal.

MONETIZING INTELLECTUAL ASSETS

A billion here, a billion there, and pretty soon you're talking about real money.

—EVERETT DIRKSEN

Monetizing and gaining recognition in the financial markets is the “litmus test” for intellectual capital strategy. Because the metes and bounds of intellectual assets are always less certain than those of the traditional physical and financial assets, they are also more susceptible to manipulation.

Primary among the strategies that have emerged with the monetization of intellectual assets are the “mix-maxing” of intellectual assets that cause fluctuations in asset valuation, and the matter of “hidden assets” or unreported intellectual assets.

During the early 1990s, boards of directors and visionary executives wielded the then new power of the expanded intellectual asset market capitalization of their companies with the modern stock-based mergers and acquisitions strategy. Suddenly, even in relatively cash-poor companies, new growth was possible through the pooling of assets allowed in stock-based business combinations. In such cases where no cash or debt was involved, executives became star performers by acquiring businesses, delivering apparently unending corporate growth, and by providing stock price appreciation—while simultaneously building their careers and personal wealth. As the acquisitions of corporations progressed, and the orderly exiting of executives with their newfound wealth proceeded, it became clear that deal-makers had manipulated or otherwise justified intellectual asset valuations to enhance the value of, or to ensure the consummation of a business deal, while often suspecting that such maximized valuations would later be hard to maintain in an ongoing business.

The discovery of valuable intellectual assets and how they could be leveraged to effect highly valued merger and acquisition transactions made it also likely that many deals would be consummated at values that were unsustainable. This is because the intellectual asset valuations had been set high on enthusiasm rather than being arrived at with a proven intellectual asset valuation methodology. As the highly volatile nature of intellectual assets became more understood, overvalued, financially

unsustainable transactions that contemplated only the short term began to be viewed as unethical. While temporarily gaining from the peaks of stock appreciation, in the end, longer-term shareholders had to reconcile the losses driven by the speculation and unsustainability of the respective asset value. *Making the deal* became more important than the later insolvency of overvalued deals and their impact upon long-term shareholder value.

Subsequently, in the U.S., to discourage such manipulation, the Financial Accounting Standards Board (FASB) passed new regulations requiring intangibles acquired in a business combination be recognized on the balance sheet and be tested annually for the impairment of their value, with overvaluations entailing a write-down in enterprise valuation. Prior to “impairment testing,” when no write-downs were required, it was easier to put together overvalued or poorly valued mergers or acquisitions that allowed some financiers, corporate executives, and investors to make large amounts of money, only to later leave the company with overvalued assets and in some cases, large, potential write-offs, or potential insolvency in extreme instances. The days of “pooling the assets” were suddenly gone, as too much possibly inflated value entered the economy through the then rapid M&A market. The law changed again and the strategy book had to be rewritten.

During the early years of the 21st century, regulations and ethical best practices identified this “mix-maxing” of intellectual assets as a form of market manipulation, thus sharpening the ethical focus upon fair and accurate, (i.e. third-party and informed) valuation and long-term shareholder benefit.

At another extreme lies the matter of “hidden (intellectual) assets” that remain unrecognized and undisclosed to investors to reduce financial reporting volatility. Somewhere between the requirements to disclose “material assets” and the realization that intellectual assets are extremely volatile and can experience dramatic shifts in value, lies the proper accounting recognition and enterprise management of intellectual assets.

In this respect, managers are often caught between formalizing and gaining managerial control over intangible assets, and, for instance, leaving them “hidden” and unrecognized to avoid benchmarking them and being held financially accountable for their performance. As it is said, “what you haven’t reported, you can’t be held accountable for.” Still,

such a strategy needs to be considered carefully to be sure it is the right one. Building the asset base of the organization with a volatile intangible asset that could be difficult to manage, fluctuate in value, or unfavorably impact the stock price of an organization can be premature or irresponsible. Nevertheless, recognizing valued intangibles, such as “brands” and “patent portfolios,” even though they could impact enterprise valuation if they were recognized, is essential to gaining managerial control over such assets. Importantly, for strategic thinking, the only intellectual assets that hit the balance sheet are those procured in an acquisition. Intellectual assets that are built within the organization and have been expensed to the profit and loss statement by the finance department have no balance sheet impacts.

For many, the strategic solution lies in recognizing that intangible assets move through stages of concretization, ranging from being entirely intangible to being well-identified, formalized, managed, and eventually being benchmarked, valued, and possibly monetized. They become a potential financial reporting disclosure when they are adequately concretized and stabilized to allow meaningful management. To keep them out of financial reporting documents at that point may be an unethical or even illegal act.

To underscore the ethical and legal responsibility to disclose and manage material assets, in the beginning of the 21st century, organizations in the U.S. began to experience not only regulatory censure for the failure to disclose even intellectual assets that impact financial performance and reprimands for failing to establish internal controls for such assets, but also the first shareholder lawsuits for a failure to manage intangible material assets.

While broad and frequently undefined security interests in the latter quarter of the 20th century often included statements in contracts that bound or included reference to “all intellectual property,” it was only during the 1990s that this practice was replaced by intangible asset-specific agreements that broke new financial and monetary ground by defining, for example, specific patents or trademarks and their assigned values much as equipment or inventories may be specified in contracts surrounding tangible assets.

Soon thereafter, intellectual assets began to make their appearances as the substance of traditional financial vehicles allowing, for example, royalty streams associated with intellectual property to become securi-

tized in the public markets; intellectual property pools to emerge to set industry or application standards; sales and license-backs of intellectual property to become increasingly common; and intellectual assets to be used to secure debt or as credit enhancements in banking transactions. As these assets have become more broadly recognized, early benchmarking and more formal valuation activities have led to the appearance of intellectual assets in numerous financial arrangements. As it progresses, the full financial recognition of intellectual capital assets requires a solid strategic underpinning to establish stable asset value.

ASSETS FOR THE HIGHEST ENTERPRISE OBJECTIVES

The highest good (summum bonum).

—CICERO, *DE OFFICIIS*

Unmanaged or poorly managed intellectual capital assets that are not strategically deployed against the highest enterprise objectives represent liabilities to investors and culpabilities to management. Similarly, assets that have not been identified and formalized cannot be managed and optimized to deliver enterprise performance.

In cases where the rigor brought to the management of traditional assets doesn't also characterize the management of intellectual assets, organizations are unable to certify either proper managerial controls or the veracity of the financial reporting document, and in so doing they also renounce the opportunity to monetize and securitize their intellectual capital assets, thus leaving assets underleveraged and unoptimized. Because it is a legal and an ethical responsibility to manage and optimize enterprise assets, the failure to do so is both a strategic failure of leadership and a professional failure on the part of management.

As traditional assets fall more to be vehicles for the traditional economy, intellectual capital moves to center stage to accomplish the highest objectives of today's enterprises and undertakings. The best strategy will continue to uncover and articulate intellectual capital as it grapples with the highest enterprise objectives. Tactical deployments will remain important but only insofar as they contribute to operational effectiveness and are vitally linked to the highest purposes.

THE SOCIAL PROMISE

The wave of the future is coming and there is no fighting it.

—ANNE MORROW LINDBERGH

These and other issues typify the immediate strategic challenges in managing intellectual capital assets to enhance the fulfillment of strategic purposes and create new levels of individual and societal prosperity and well-being.

The most optimistic observers have suggested that just as we watched an industrial revolution unfold across the 18th, 19th, and 20th centuries, with the rise of intellectual assets in the 21st century economy we will behold the unfolding of an era of intellectual capital assets that may last as long, if not longer than the former tangible asset era. Moreover, they predict that the era may generate levels of global wealth and human well-being that are far beyond what could have been imagined with the beginning of the Industrial Revolution.

It is perhaps no coincidence that intellectual capital has emerged at the same time that tangible assets have begun to approach optimal levels of efficiency and leverage, even as the traditional industrial era markets have begun to reach maximum levels of saturation, signaling that maximum levels of deployment and consumption are being reached in the material world.

The hope now is that the priorities for knowledge, the opportunities for creativity, and the focus of innovation will drive future economic growth, and at the turn of the 21st century, the strategies for these increasingly conscious choices are characterized by discussions centered on intangibles such as corporate social responsibility, personal privacy, intellectual property ethics, environmentalism, globalization, and social policy, all understood as a discussion about the “the greater good.”

The shift to intellectual capital drives a great focus on its new “means of production”—thinking, imagination, invention, innovation, know-how, and creativity—all being the productions of human capital. Accordingly, ideas and talent will become the currency of an era of intellectual capital that will place a high premium on the ability of individuals to imagine and create. This represents a substantial shift in our *modus operandi* as a society, and will require the development of creative capabilities

among many that had previously been limited to a few. Progressively, more corporations are likely to become engines of innovation, increasing the importance of education, while individuals will turn their attention symbolically to the right-brain becoming more emotionally intelligent and primarily concerned with meaning and purpose, and alert to the ethical and qualitative fabric of society and the direction of civilization.

As intellectual capital becomes the new means of production, and as we shift paradigms from an industrial era and economy based on labor and tangible assets, to a new economy based on intangible assets, information technology, and the advancement of *knowledge*, the creations of the mind and intelligence will become increasingly essential to the advancement of society, culture, and civilization.

The future challenge for intellectual capital strategy lies in what it can do for the greater good.



The Ethics of Intellectual Asset Management

THE ETHICAL CRISIS—A STATUS REPORT

Tut, tut, child! Everything's got a moral, if only you can find it.

—THE DUCHESS IN *ALICE IN WONDERLAND*.

At the turn of the 21st century, ethical crisis in U.S. corporations were blamed both for their lack of ethical culture and for their failure to police themselves and their executives.

Today, most American corporations have taken large steps toward rectifying their shortcomings by installing ethical and compliance officers, creating new procedures for controlling improper behavior, establishing ongoing ethical training programs for managerial employees, and improving their corporate governance practices.

As corporations build upon these significant successes and adjust to the contemporary regulatory environment wherein criminal indictments, stiff monetary penalties, extensive jail time, and business collapse have become all too commonplace, many traditional business practices within the broader corporate world are being reversed to the betterment of society.

For example, in the past corporations were quick both to resist regulatory investigation and to provide legal defense for executives that were accused of crimes. That has all changed. Today, companies move to cooperate with authorities to avoid the increasingly certain enterprise “death penalty” that can accompany a government indictment.

Directors are doubly cooperative in their effort not to be seen as defending any sort of impropriety, and in their desire to protect themselves against claims on their personal finances. Thus, organizations now distance themselves from their executives' illegal or unethical activities, and act to shift blame for misconduct from the organization to the individual under suspicion, leaving them to handle their own defense.

Also, after the so-called "dot-com burst" in the U.S., the national regulatory infrastructure was blamed for insufficient checks and balances and a lack of scrutiny of business activities. Today, regulatory agencies are armed with the teeth of new legislation (SOX, SEC governance rules, stock exchange rules, and stiffer U.S. Sentencing Guidelines) and enhanced budgetary support. Thus, the SEC and the Department of Justice have aggressively moved forward to police and punish white-collar crime on a massive scale.

In their pursuit of wrongdoing, the terms of engagement between regulatory authorities and corporations have changed. In times past, prosecutors may have avoided pursuing white-collar crime because it was either too complex or too time-consuming. That is no longer the case. As prosecutors work on more white-collar cases, they have acquired the skills and knowledge that are necessary to seek justice even in complex business and securities law proceedings.

Most significantly, the SEC has adopted a new tool known as the "deferred prosecution agreement." Since the demise of Arthur Andersen in 2002, the SEC has learned that an action brought against a company can destroy its brand and public credibility, often leading to the collapse of the respective business and serious economic fallout for displaced clients, employees, and the economy. Arthur Andersen, one of the top five accounting firms in 2001, was dealt a death blow that put the organization out of business, leaving thousands unemployed and with tarnished reputations. Now, regulators and prosecuting attorneys, realizing the potential impact on the economy of putting a giant out of business, have developed the deferred prosecution approach hoping to punish only the truly guilty parties, thus preserving the company. Hence, regulators are slower to bring charges, and more thoughtful about the strategy that will result in justice and serve the greatest good.

In a deferred prosecution agreement, a company agrees not to contest a list of alleged violations in return for a suspended prosecution and the

appointment of an independent monitor to supervise the company's rehabilitation. If the company is able to reform itself, the agreed-upon charges are dropped after a certain period of time. It is believed that this approach stops short of destroying the company and harming the economy, while still ensuring that individuals face criminal charges and stand trial.

Deferred prosecution agreements have been developed in an effort to head off unnecessary business and economic disruption, and are for use in instances where corporate reform is likely once the bad apples have been removed.

Early examples include KPMG for their promotion of allegedly abusive tax shelters, Bristol-Meyers Squibb Company for "channel stuffing," and Royal Dutch/Shell Group for overstating energy reserves, all of which have received deferred prosecution agreements in deference to the severe and unintended disproportionate economic impact that comes with corporate indictments.

In summary, these, and other developments, evidence ongoing proactivity and increased sophistication on the parts of both corporations and regulatory authorities, as they grapple with instilling a higher ethical standard within the world of business.

THE NEW ETHICAL ISSUES

Morality is not properly the doctrine of how we make ourselves happy, but how we may make ourselves worthy of happiness.

—IMMANUEL KANT, *Critique of Practical Reason*, 1788

Since the early 1990s, the overall importance and value of intellectual property has risen exponentially until today the combined value of intangible assets accounts for over two-thirds of the value of the publicly held companies in the U.S. alone. Concurrently, business has been subjected to a broad and unrelenting ethical examination that has left few companies, their leaders, or their professional advisors untouched. While many of these individuals have been found guilty of both legal and moral violations, many have also been found to have been unable to tell ethical right from wrong.

The shift from the familiar asset base, long centered upon traditional physical and financial assets, to one increasingly based upon intangible

intellectual capital assets such as intellectual property, brings with it changing laws and new and subtle ethical problems.

Businesses and intellectual property owners are constantly involved in debates over the morality of their actions. Think, for example, of the ethical controversy brewing over the large sums being awarded in patent infringement suits to patent licensing and enforcement companies or “patent trolls,” or that the patents of pharmaceutical companies are being suspended in some developing countries. Or consider the concerns about the exploitation of children, the poor, and the elderly by powerful marketing campaigns designed to deliver shareholder value by driving wanton consumerism. Or contrast the efforts of the music industry to enforce copyright laws against unauthorized file sharing, or Google’s assertion of its right to digitally scan copyrighted books without the permission of copyright holders.

What is it about “patent trolls” and recouping the massive investment in valuable patented drugs that puts these relatively traditional intellectual asset management strategies at the center of moral controversy? Why do some brands, like Microsoft or Wal-Mart, have dramatically polarized fans and detractors? What is so dramatic about the music industry suing teenagers for file-sharing, and Google scanning the entire collection of books in libraries of major universities?

Herein, the authors seek to introduce *countervailing public policy analysis* as an ethical analytic for intellectual asset strategies. While certainly not definitive, this short section proposes to enumerate some of the basic competing public policies that frame intellectual asset ethical issues, provide some explanation for the polarizing positions in these ethical arguments, and to offer a framework for ethical analysis and ultimately, for decision-making.

INTELLECTUAL ASSET ETHICS

A well-run business must have high and consistent standards of ethics.

—RICHARD BRANSON

Intellectual assets are ethically characterized in the cross-currents created by the ruling social philosophies of the day and public policy debates that

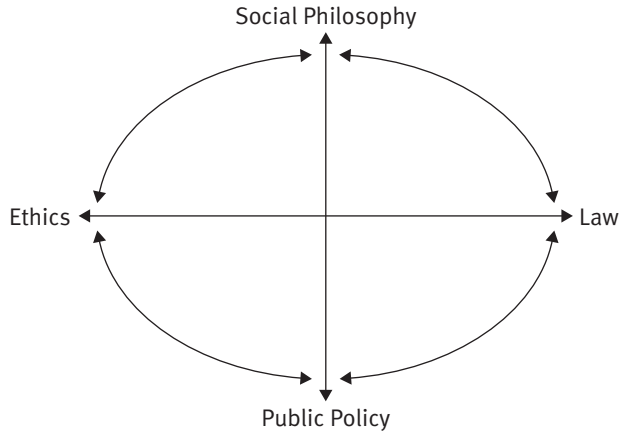


EXHIBIT A.1

THE DYNAMICS OF ETHICAL THOUGHT

influence the creation and interpretation of law and the actions of business and enterprise in the marketplace and the society (see Exhibit A.1).

What is at issue when we consider the ethics of intellectual assets is “a particular strategy” or “action” and where it falls in the public policy debate and within the surrounding social milieu.

Intellectual asset strategists use a variety of strategies to deliver their goals of monetary success or competitive advantage in a marketplace. The majority of these activities are the legitimate pursuit of business activities such as excluding others from using a patent, defending the rights of a trademark against infringers, keeping a trade secret, or protecting a work from unauthorized copying. These and many other legitimate activities present no ethical problem in their normative deployment because they fall within the general guidance of public policy and social philosophy.

PRIMARY PUBLIC POLICIES

- Promote the Useful Arts and Sciences
- Protect the General Health and Welfare
- Protect the Right to Exploit and Benefit from Private Property
- Protect the Right to Copy and Reverse-Engineer
- Protect Freedom of Speech and the Expression of Ideas
- Provide Protection from Monopoly and Anticompetitive Practices
- Provide Protection from Unfair Trade Practices

It is the new strategies that push the limits of what is considered to be “ethical” in using intellectual assets, such as the recent activity of patent licensing and enforcements companies, the attempts to patent aspects of human DNA, brand marketing undertaken to drive consumption beyond need, or extending the limits of “fair use.” These make us rethink what is right or wrong. Should patents have to be in use to enjoy the right to police infringement and receive damages, or are patents simply property, like real estate, where the owners hold title whether they built upon the property or not? Should anybody have an exclusive right to commercialize a human DNA sequence, or is mapping the human genome a part of the advancement of science and knowledge that should benefit the entire society?

Countervailing Public Policies

Promote the Useful	v.	Protection from Monopolistic Practices
Protection of Private Property	v.	Right to Copy, Reverse-Consistency Engineer and Exploit Arts and Sciences
Limited Monopoly	v.	Unfettered Competition
Reward Creativity	v.	Freedom of Speech

We can frame answers to these and similar questions by recalling how social philosophies eventuate public policies and how countervailing public policies work to create laws. For example, why does intellectual property exist? Is there an overall public good that is served by its existence? In the United States, the framers of the U.S. Constitution, borrowing from English Law, created a system for patent and copyright grants designed “to promote the useful arts and sciences.” English social thought had long since recognized that it was in the public’s best interest to reward industry and innovation by securing the inventor a limited monopoly to exclude others from the practice of his invention in exchange for a full disclosure that would increase the world’s knowledge and allow others to learn and innovate. The same was considered to be true of artists and authors who could secure the right to prevent copying and derivation of their creative works, while still allowing their work to inspire future creativity.

At the same time that public policy is served by granting these exceptions to the preferred antimonopoly free market system, there is an equal countervailing public policy not to overextend any of the granted monopolies. Thus, while there is a right to exploit private property, there is also a right to copy or to reverse-engineer. The efforts to find balance between these opposite public “goods” has resulted in a body of case law defining what is and is not the proper subject matter for patents and copyrights, and numerous rules for determining the exact limits to be set on any single protected work or invention.

Another public policy encourages fair dealings in business—the concept that individual industry should be rewarded and protected and that others should not be able “to reap where they have not sown.” This line of thought has resulted in the body of “Unfair Competition” law. These laws prohibit consumer deception and trademark infringement (preventing the use of a mark that another has first used in commerce), as well as deceptive trade practices, interference with contracts, trade disparagement, theft of trade secrets, and the like. But because this concept of protection from unfair trade practices in its extreme could infringe upon another set of public “goods”—there is a countervailing public policy that ensures our society’s belief in free speech, in the free dissemination of ideas, and in the individual’s right to earn a living, change employment, and use his knowledge and skills in furtherance of his new job. Balancing of these public goods has created a body of law setting limits to the protection and creating certain defenses to infringement, such as “fair use.”

Thus, in each of these policy examples, a balance is found between public interest and private benefit.

Intellectual Asset Policy	
Countervailing Public Policies	
Public	Private
Interest	Benefit

For purposes of analyzing intellectual asset management practices in business, we may agree that academic research that furthers science and technology is in the public interest and that it is a “good” for the society

may have found a way to resolve their ethical conundrum of losing money and shareholder value on free or underpriced lifesaving drugs, by instead building possibly more valuable brand equity by giving the drugs away as an expression of corporate social responsibility. Their efforts simultaneously speak to the belief that large multinational corporations should soft-pedal the focus on creating shareholder value to find ways to “give back” to those less endowed. Thus, counterintuitive as it sounds, fighting ravaging disease without economic gain may provide the right *social capital*.

Overall, intellectual asset ethics can be mapped against a respective strategy along a spectrum of socioeconomic philosophy that runs from respect for shareholder value at one extreme to the avoidance of greed and exploitation at the other extreme.

This approach allows due regard for the private benefit of not giving away the store, and regard for the public interest through corporate social responsibility that serves the public interest while building brand equity.

In any case, “ethical deployment” can be defined as having a sense of balance between the unethical extremes of either social philosophy or public policy, while allowing the pursuit of the reasonable concerns of business solvency and success.

INTELLECTUAL PROPERTY ETHICAL CONCERNS

The Greatest happiness of the greatest numbers is the foundation of morals and legislation.

—JEREMY BENTHAM

Each kind of intellectual property enjoys a special right in return for delivering a different “good” to society, and thus it gives rise to a specific set of ethical issues and public policy considerations.

The primary right with patents is the right of limited monopoly. Thus many of the ethical issues associated with patents have to do with “fairness” and overreaching the limited monopoly or engaging in anti-competitive behavior.

With trademarks, the primary right is the right to the exclusive use of a mark, and therefore the ethical issues revolve around violating the trust with society and “confusion” and infringement, dilution, tarnishment, and unfair competition in the marketplace.

Copyrights grant the right to publish or make public an original work in all of its forms, therefore, the ethical issues address unauthorized “copying” and “fair use.”

Each type of intellectual property creates a different context for ethical issues, and invokes its specific set of countervailing public policies.

Patent Ethics

With the deployment of patents, the ethical range runs along a spectrum of fair market practices that exclude anticompetitive activities at the one extreme and monopolistic practices at the other extreme (see Exhibit A.3).

Exclusion or preventing others from practicing an invention or business process is the basic intellectual property right: It expresses the very intent of the law and it is considered to be ethical. Creating patent thickets and cross-licensing are broadly recognized as acceptable and ethical, although either can be extended into an anticompetitive extreme.

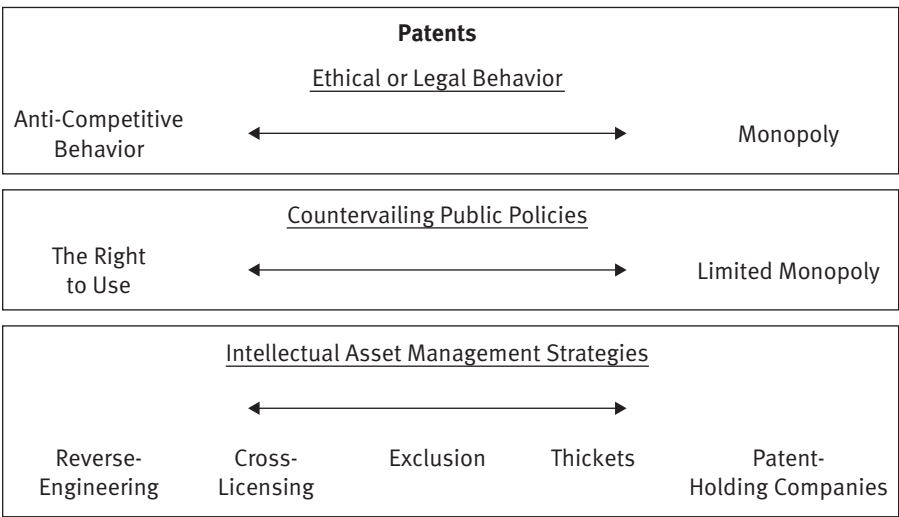


EXHIBIT A.3

ETHICAL ANALYSIS FOR PATENTS

Normatively, patent thickets are allowable under the public policies that advocate the promotion of the useful and the right to exploit and benefit from private property. A patent thicket might contain so many “junk patents” that it could rise to the level of anticompetitive activity, could block legitimate innovation, stifle competition, and become unethical. The intent of the law and public policy is to foster competition and inventiveness, and to provide society with the tools necessary for further inventions. Junk patents, to the extreme, do neither.

The concern to reward invention is balanced by the countervailing public policy or the “right to use” and to allow reverse-engineering. Licensing and cross licensing are normative when they encourage innovation and the advancement of knowledge. However, “stick licensing,” especially in the hands of a patent troll, can become anticompetitive when it erodes market profitability or acts as a hurdle or a tax on inventiveness or the industry.

Trademark Ethics

The ethical range for trademarks runs along a spectrum of fair market practices that exclude exploitation at one extreme and consumerism at the other extreme (see Exhibit A.4).

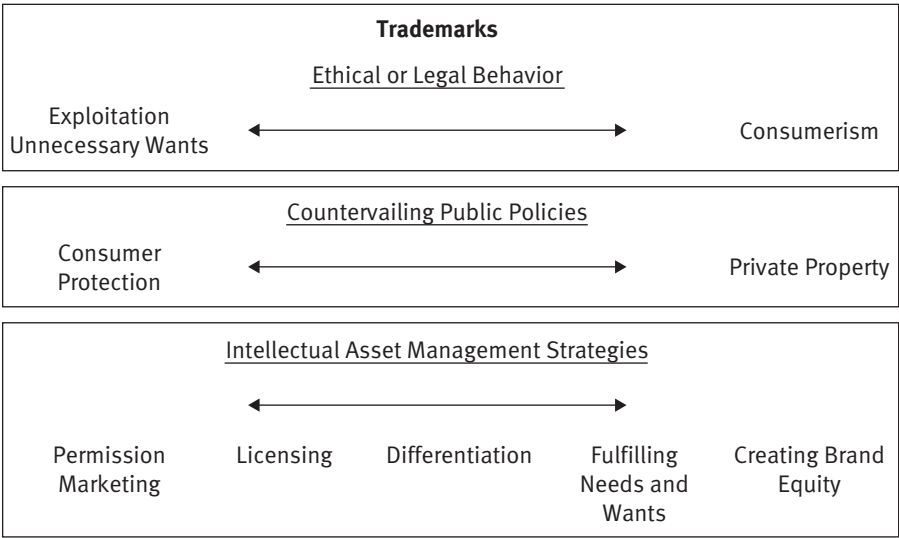


EXHIBIT A.4 ETHICAL ANALYSIS FOR TRADEMARKS

The ethical management of trademarks requires that marks be used to identify the source of goods or services and to differentiate products. Branding and marketing activities are intended to fulfill the legitimate needs of identifying and selling objects of commerce. Increasingly, brand equity is recognized as the litmus test of rightful activity, under the assumption that whatever truly builds the monetary value of the brand and drives market capitalization in a public company must be “the good” of the brand. By corollary, what destroys brand equity is generally considered to be the detriment of the brand. Discounting and price competition are examples of such practices, and while we may not wish to characterize such activities as “unethical,” they commonly wear away the monetary value of a brand and consequently erode shareholder value.

The unethical extremes for trademarks lie in the use of the trademark to violate or mislead consumers as in “consumerism” and the creation of unnecessary needs and wants, or in the need for “consumer protection” against deception. Consumerism is increasingly viewed as egregious in the fostering of “unnecessary wants,” the duping of unwitting consumers, or the “stuffing” of markets. In this respect, business ethics calls for the maximizing of returns, while public policy calls for the protection of consumers.

“Permission marketing” has emerged as an antidote to rapacious forms of marketing and to limit marketing to consumers who want to hear from a brand. To that end, the legitimate building of brands that consumers want to hear from, coupled with the intent of trademark law to allow unequivocal identification of the source of goods or services, has become the gold standard for brand marketing business ethics.

Licensing is a central trademark strategy that is highly respected when it is used to commercialize products that would not otherwise be available, however, with respect to brand marketing, “merchandise licensing” has gotten a bad name beyond a certain point because it “trivializes” a brand, dilutes its value, and thus erodes shareholder value and weakens the vitality of the economy.

Copyright Ethics

The ethical spectrum with copyrights runs from fair competition to “fair use” in its proximal extremes, as shown in Exhibit A.5.

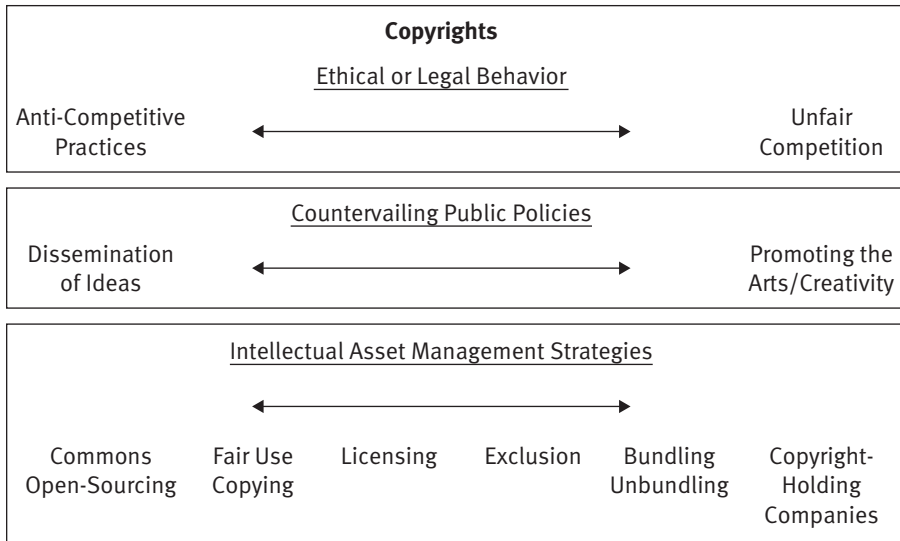


EXHIBIT A.5

ETHICAL ANALYSIS OF COPYRIGHTS

The ethical management of copyrights requires that they be used to protect and commercialize original works, and to prevent unauthorized copying or exploitation.

The technological ability to easily copy music has thrust modern society into a debate over the limits of “fair use.” While many teenagers may have had “the right” to copy music files off CDs they had presumably purchased, the plight of musicians and the music industry to protect their copyrights came into focus when these same teenagers assumed license to distribute and trade both purchased and unpurchased files online.

More recently, Google’s bid to extend the law of “fair use” to admit the scanning of entire books and libraries without permission from copyright holders exemplifies a move to change the law and shift the rules of the game. The Google argument is that scanning books in their entirety is “fair use” because in each commercial use of the material, they will only show a highly *de minimus* portion of the entire work (and will offer the book for sale as the *quid pro quo* for the author and the publisher) while importantly expanding scholarly access to an abundance of material (and creating the new “Library of Alexandria”) that wouldn’t otherwise easily be available.

This is an argument that is near and dear to the spirit of copyright protection (creative materials should act as an inspiration and stimulus to further creativity and invention), as it is to the policy that encourages the free dissemination and use of ideas.

Yet, if copyright doesn't stop exact copying in all its forms, what does it stop? Authors and publishers assert that their copyrights are being violated, and public policy is caught between the merits of the dissemination of ideas and protecting the rights of private property.

IN CLOSING

If we really want to live, we'd better start at once to try...

—W.H. AUDEN, *IF WE REALLY WANT TO LIVE*, 1930

Setting strategy is difficult, not just in respect to adopting the precise means to achieve a business or legal end, but possibly even more so in respect to “doing the right thing.”

As strategists, our first objective is always to identify an approach that will bring about the desired result. In this book, while not providing answers to the various ethical conundrums we have identified, we have endeavored to demonstrate a method of analysis that sets the terms for ethical debate and any possible resolution.

As the base of the economy shifts and intellectual assets rise in economic importance, new strategies and deployments of old strategies force us to rethink good and bad. Today, as the rules rapidly change, what was once considered to be acceptable in managing business affairs is now often seen as improper, while in other cases the ethics of new deployments have yet to be determined.

Locating intellectual asset strategies between the current ethical and public policy extremes allows us to unpack the ethical issues surrounding strategic deployments. Disagreements about the morality of markets, business activities, and strategies will likely continue, but *countervailing public policy analysis of intellectual asset management strategies* provides a reasoned technique for framing and arriving at moral judgments.



Glossary

This Glossary has been prepared for use within the context of this book and is not intended to be exhaustive.

Brand The word, words, and or symbols which articulate the meaning and significance of an entity and that indicate the identity and source of goods and services in the marketplace; that which a trademark can become if it develops brand equity. Often also referred to as a trademark by trademark attorneys.

Brand building A brand strategy that is designed to create and enhance brand equity.

Brand equity The financial or monetary value that accrues over time to a brand and makes it an intangible, intellectual capital asset.

Brand valuation The means whereby the monetary value of a brand is determined.

Confidential information A trade secret or other information not widely known that is of a proprietary nature and that when related to a business is disclosed to a third-party under a confidentiality agreement. Often, but not necessarily synonymous with the proprietary information, i.e. the trade secrets of an enterprise.

Confidentiality agreement, Non-disclosure agreement, NDA A contract under which confidential information is disclosed to a third-party in exchange for promises not to use or disclose the information.

Consumerism Excessive consumption of goods; pejoratively as a lifestyle bent on the acquiring of goods and possessions; *homo economics*.

Copyright The legal right recognized by most jurisdictions in the world of an author to prevent unauthorized copying of an original and creative work that has been fixed in a tangible media.

Countervailing public policies The ruling opposing policies that frame public debate and ultimately form the basis for legislation. In the classic example of a law prohibiting someone from yelling “fire!” in a theater in the absence of there being a fire, the countervailing public policies can be viewed as “freedom of speech,” versus “public health and safety.” When laws come down on the side of prohibiting such speech because of the fear of injury from stampeding toward the exits of a theater, one can see that protecting health and safety is the basis for the law, despite the limitation of freedom of speech.

Economic ethos The overarching ethic, moral tone, or characteristic spirit that rules within an economic time, period, style, or practice; “the way business is done.”

Enterprise Traditionally “an undertaking,” but herein, an entity that can create, develop, and hold ownership or title to intangible assets.

Ethics A traditional philosophic discipline which concerns itself with morals, defining “the Good,” the nature of action, and making moral arguments and judgments.

FASB (U.S.) The Financial Accounting Standard Board, a private, nonprofit organization whose purpose is to develop the generally accepted accounting principles (GAAP) that rule the accounting practices for public companies.

Innovation The conception, development, and use or implementation of new ideas to create and deliver value.

Intangible asset Accounting and finance terminology used to refer to the entities or factors of financial analysis that can’t be captured and reported in the traditional financial statements (Profit and Loss Statement, Balance Sheet, Cash Flow Analysis); those assets reported for accounting purposes under the term “goodwill” and put on the balance sheet as such. Also known in certain circumstances as “non-financial assets.”

Intellectual asset Largely intellectual property with economic and strategic significance that is viewed as a business asset.

Intellectual asset management The practice of managing intellectual assets to deliver strategic advantage or operational effectiveness.

Intellectual capital An intangible intellectual asset that cannot be physically touched and which provides a competitive advantage or confers value, such as a strong brand, intellectual property, technology, enterprise reputation, corporate culture, or employee morale; the sum of the knowledge-based assets within an organization or enterprise. A synthetic term referring to all the intangible, intellectual, knowledge-based assets within an organization or entity.

Intellectual property Those ideas, inventions, processes, names, creations that can be protected under the law of patents, trademarks, copyrights, and trade secrets.

Knowledge-based assets A foundational term used to define intangible assets or intellectual capital. Data and information that has risen to the level of knowledge.

Know-how Knowledge of how to do a specific thing, including technical ability and practical knowledge; information and expertise not otherwise a part of traditional intellectual property and sometimes used synonymously and even erroneously for trade secret. In a broader sense, talents that are not easily communicated or formalized.

Legal claims The facts of a situation that in total give rise to a legally enforceable right or “cause of action” which in turn can form the basis for litigation. In the context of this book, legal claims are injuries involving the intangible assets or intellectual property of an enterprise. They primarily fall within the general category of business torts (injuries) although in some instances there are also criminal penalties for the same wrongful behavior. With respect to business torts, the legal claim is also the articulation of elements which must be proven to be successful in litigation. The authors suggest that analysis of potential legal claims is also a mode of determining the existence of whether and to what extent certain intangible assets exist within an enterprise. For example, if the facts of a particular situation, including what was secret and how it was

maintained as a secret, can be said to support a claim for theft of a trade secret, then one can surmise that a trade secret existed.

Litigation The process by which legal claims are adjudicated.

Market capitalization The combined value of an enterprise inclusive of its book value, intangible assets, and market premium that is calculated by multiplying the value of the company's stock at any one moment, times the number of shares in existence.

New economy The current economy that is based upon knowledge-based intangible, intellectual capital assets.

Patent A legally recognized contract between an individual and the government under which an inventor is granted a legal right to a monopoly, that is limited in time, in exchange for full disclosure of his invention. In a typically anti-monopoly society, the public policy is in favor of adding to the world's general knowledge and encouraging further innovation by obtaining the full disclosure of inventions as the basis for the decision to grant such monopolies.

Patent mapping A modern technological technique whereby the distribution of patents in specific market or technology areas are visually presented as a topographic map.

Patent trolls The common, and somewhat pejorative term for PLECs, an acronym given to "patent licensing enforcement companies." Such companies are a relatively new business development. They own patents not to use them in industry, but for the sole purpose of collecting royalties or damages by licensing and litigating against third-party infringers.

Strategy An approach to mastering a situation and turning its dynamics to a benefit; a perspective, plan, purpose, or objective, for accomplishing a goal; the actions of a strategist.

Trademark, Trade Mark (Brit.) The legal right recognized by most jurisdictions in the world to a word, phrase, symbol and/or logotype that publically identifies and distinguishes one company as the source of goods or services used in commerce from the goods and services of others.

Trade name The moniker under which an enterprise does business and which may not be its formal or its legal name [cf. "doing business as" (dba)].

Trade secret Proprietary knowledge and know-how that provides an advantage to an enterprise in that the subject matter is not known or widely known.

Traditional assets The traditional physical and financial assets such as plant, property, equipment, cash, and financial instruments.

Traditional economy The economy, based on traditional assets, that has been in ascendancy since the beginning of the Industrial Revolution.

Unfair competition One or more causes of action used to redress unfair business practices, misappropriation of trade secrets or business values, tortious interference, trademark infringement or passing off, and other antitrust law matters.



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