Putting the IAM function at the heart of corporate strategy

Almost all readers of this magazine understand the strategic importance of IP to companies' competitiveness and financial performance. The challenge is to make the C-suite see it too. Only a change in the way IP value is communicated will help

By **Mark Blaxill** and **Ralph Eckardt**

A few weeks ago, we were having lunch in a famous Palo Alto seafood restaurant with our friend Damon Matteo, VP and CIPO of Palo Alto Research Center. He told us this story: "I was sitting in a conference room with a CEO [not PARC, by the way], talking about the company's challenges, its opportunities and the pivotal role of IP as a vehicle for addressing them both. As I spoke, the CEO was suddenly overcome by what I can only describe as 'creamed spinach face' – you know, that pained, assaulted look an infant gets right before he spits out the stringy green mush you just fed him. The CEO said, 'Patents? Patents? Are you talking about patents?' as if the very act of pronouncing the words was distasteful."

If you've been in this business for any length of time, you've probably encountered "creamed spinach face". We've seen it more times than we'd care to count and more than anything else we can think of, it captures the fundamental disconnect between the world of intellectual property and the senior executive suite.

Like many of you, we believe that strategic IP management is the key to competitive advantage and should therefore be a top priority for every CEO. To make that a reality, the top priority for every IP executive needs to be convincing the CEO that IP should be a strategic priority – in other words, overcoming creamed spinach face.

Now it's great sport for IP professionals to sit around the bar at the IP Business Congress or LES and complain about the fact that senior management "just does not get it" – but in reality, the onus is on us to communicate the value of what we do. As IP professionals, we will do an enormous service for our companies, ourselves and our profession if we can bridge this gap – giving those in the C-suite a new lens through which to view the importance and value of intellectual assets.

Towards that end, we'd point to four key areas of disconnect that need to be addressed before most senior executives will be able to see IP for what it truly is – an invisible edge for their businesses:

- **Adopting a new strategic lens**. In a knowledge economy, IP has become the principal source of competitive advantage. IP professionals need to understand this shift and be able to make the case for it coherently, consistently and forcefully to those involved in setting corporate strategy.
- **Understanding the invisibility of IP**. Understanding why C-suite executives misunderstand IP is one of the first steps towards bridging the perception gap. With a clear understanding of its root causes, IP executives can propose fixes that will help intellectual assets gain appropriate recognition for their contribution to the company's financial success.
- **Overcoming the communication gap**. IP executives need to learn how to translate legalese and IP terms of art into the kind of corporate finance lingo that management understands. Even more, we must be able to demonstrate

the link between IP and profits in the only language that executives understand – financial accounting.
- **Breaking out of IP's organisational silo**. Organisational structure is one of the most critical elements of effective IP management. Keeping the IP function in a silo is both source and symptom of this fundamental disconnect. IP executives must push for deeper integration of IP management into the business, where it can have its greatest financial and strategic impact.

In a new era of global competition, the winners will be the companies that are best at using IP to create a sustainable edge. As IP professionals, it's up to us to make it happen.

Adopting a new strategic lens

We do not originally come from the world of IP. We spent most of our careers on the other side of the divide – specifically, in strategy consulting. So before we could learn to appreciate the secrets of the IP community, we had to go through a kind of awakening – one that most executives have yet to experience.

To appreciate the significance of this awakening fully, we have to go back a couple of decades. We studied at prestigious schools (Harvard and MIT), and went on to successful careers in management consulting – applying all the conventional lessons about economics, management, competition and competitive advantage. Like many in our field, we thought we had a pretty good handle on how business worked, but over time we came to feel increasingly dissatisfied.

As strategists, it was our job to help our clients find an edge – to achieve "sustainable competitive advantage", in consulting jargon. But while we helped many clients to operate efficiently, drive out costs, improve market share and increase profits, we rarely (if ever) actually showed them how to gain truly sustainable competitive advantage.

Most businesses seemed stuck on a never-ending treadmill striving to achieve best practices. However, the reality is that these do not provide advantage; they merely allow you to stay even with your competitors. We discovered that working harder didn't necessarily lead to sustainable advantage. After a while, we came to suspect that many senior executives had given up on the *sustainable* part and instead focused on the temporary advantages afforded by what they do best: operational efficiency, cost cutting and ruthless execution.

Then we took a step back and took a hard look at a range of cutting-edge competitive situations for signs of a pattern – for example, open-source software, genomics, mobile commerce and social networks. We found that at the heart of every one of these novel managerial situations was a critical IP issue. Each situation was strongly influenced by IP, whether it was the patenting of genes, software patents or the General Public License (GPL).

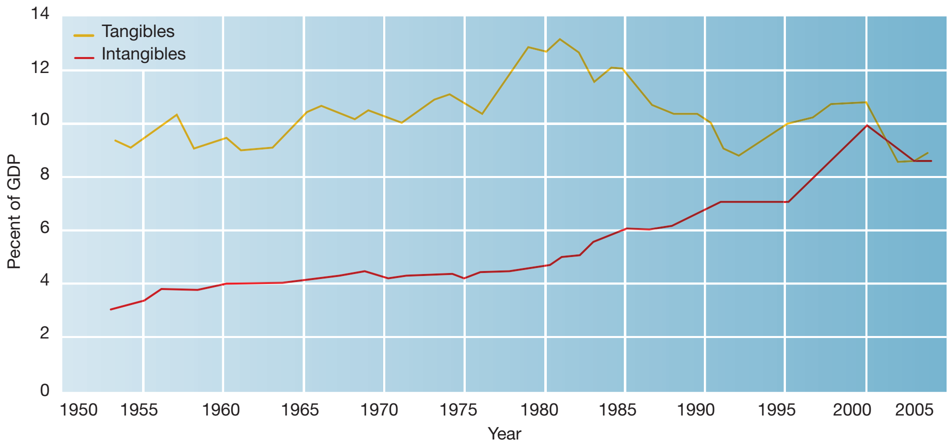
Eventually we hit upon a simple and profound idea: the source of sustainable advantage is owning the distinctive parts of the business that create value. And the only way truly to own your distinction is through IP. Although this idea was not novel, it was new to us, and we soon discovered that it is new to most senior executives as well.

In corporate finance lingo, "IP plays a crucial role in both the creation and apportionment of value", allowing companies to command premium prices, capture market share, sustain lower costs and even generate income directly. Without it, companies lack differentiation and can only compete on price, and no matter how well run they are, they lack any sustainable advantage. Such companies limp along on razor-thin margins, subject to the vagaries of supply and demand.

From the perspective of decades in the strategy consulting world, we have had a front-row seat for the emergence (actually, the rediscovery) of this source of advantage. Business strategy has evolved through a process that we describe as having three key stages:

- First, in decades past, the winning company was *Cheap Company*, using low-cost production and mass-market dominance. Companies in this era competed with huge fixed-asset investments and production capacity commitments. In these companies, successful executives were hard-nosed, industrial-style managers who often came up through operations. This was the era of industrial competition where tangible assets dominated.
- Next came the era of *Fast Company*, built on a strategic foundation of process economics, re-engineering and best practices – that is, the temporary advantage of doing something a little better or faster, at least until competitors catch. The successful leader was the corporate process engineer, who knew how to redesign core people processes using tools such as process re-engineering, Six Sigma and time-based competition.

US investment in tangibles and intangibles



Source: Blaxill and Eckardt, *The Invisible Edge*

- Now we are in the era of *Smart Company*, whose main source of advantage is the ownership, through intellectual property, of the methods or features that make its products and services unique or its processes defensibly more efficient. Successful executives will be those who appreciate IP as the primary driver of value creation and are able to manage it most effectively.

The problem for many businesses today is that leaders are wedded to business school nostrums developed for a world that is rapidly fading. The management imperatives of today's knowledge economy are very different from those of the past. Traditional sources of advantage have evaporated: scale can be purchased or rented; best practices are easily copied.

IP executives must learn how to make a vigorous case, to all those involved in strategic planning, that IP ownership is the only way to win in the modern competitive marketplace and establish a defensible position. Whether your company makes steel or software, pharmaceuticals or mobile phones, IP is the source of advantage. Are you able to make a compelling case to your CEO in the context of your business?

Understanding the invisibility of IP

If IP is right at the heart of global competition, why can't most C-suite executives see the value and strategic importance of IP in their companies?

They can't see it, basically, because it does not show up in the financial statements. Today's economic systems fall far short of the management imperatives of today's knowledge economy: valuing, tracking and measuring the stock and flow of intellectual assets.

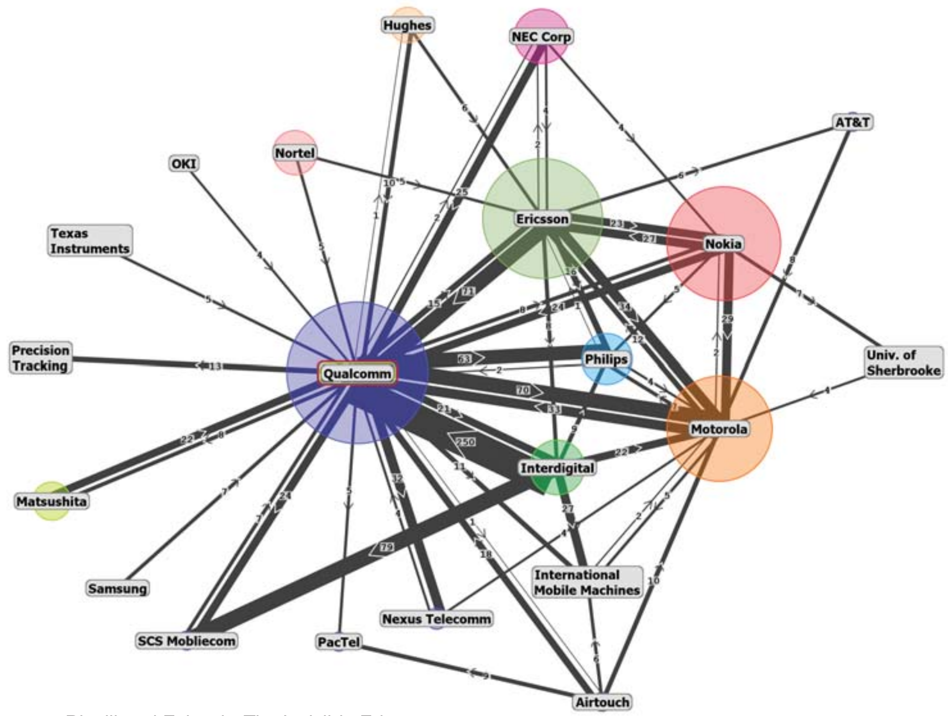
The ultimate effect is like an invisibility cloak that shields these assets from view – an ironic dilemma considering that trillions of dollars are disappearing behind this cloak and very few people seem to understand where all that money is going. Investment in intangible assets has caught up to investment in tangible ones. Conservative estimates put US investment in intangibles at more than US$1 trillion annually. Worldwide, that number has been estimated at between US$3 and US$5 trillion.

Yet for most managers, the only investments they see are those that lead to tangible assets, which show up on the balance sheet and are consumed in a way that generates profits. That is, either you generate profits by selling the assets themselves (eg, inventory) or you use the assets (eg, machinery) to produce something you can sell.

Unfortunately, intellectual assets are not accounted for as assets in this way; they do not show up on the company's balance sheet (except for "identifiable acquired intangibles" – don't get us started!); and they are generally not consumed in the financial sense of either being sold or allocated as part of production costs. Expenditures on intangible assets do not look like investments at all. They look like expenses – probably the single biggest reason why most IP departments are considered cost centres rather than profit centres.

As any savvy businessperson knows, all the power in the company is in the profit centre. If you are not directly supporting either profits or sales growth (the drivers of stock price), then you are detracting from them by spending money. Thus, trillions of

Network of essential patents for WCDMA



Source: Blaxill and Eckardt, *The Invisible Edge*

dollars of investment in intellectual assets (eg, R&D, brand building, patent filing and maintenance) are viewed as expenses. And as expenses, they are not included in performance metrics such as return on assets (ROA) and return on investment (ROI). After all, you cannot earn a return on an expense.

So what is an IP manager to do? You will probably not be too successful trying to convince your CFO that the world's accounting system is screwed up and that your company should treat investments in intangibles as assets. Instead, IP executives need to learn how to track their company's investment in intangibles themselves and demonstrate the link between those investments and the profits they help generate.

Here is a quick example that gives us hope. In 2006, Sears put its most valuable brands (Kenmore, Craftsman and Diehard) into a separate, wholly owned subsidiary. It now licenses those brands both internally and externally. Now, Sears' product managers have to account for brand use in their products, just like their private label manufacturers do. By placing an explicit internal price on the use of IP, Sears turned an invisible asset into one that management can easily see.

What if your company's IP were treated that way? What would happen if you could establish a real market price for your IP by licensing your technology or brands on a limited basis? How would that change internal perceptions about IP and its role in your company?

Why we need to speak the language of management

If the C-suite needs to correct a deficit in its understanding of and accounting for IP, then IP executives must improve their ability to speak in business terms. Much of what IP departments do languishes in a silo, behind a Chinese wall, because the information either never gets out or is not communicated in a way that senior executives can understand and use. Responsibility rests squarely with IP executives to bridge the communications gap.

First, IP executives need to see the business landscape strategically, as their management counterparts do. Who is our competition? What are their IP strengths? Where is our position defensible and where are we vulnerable? Where might we and our competitors have common interests? How can we maximise the strategic use of our IP assets to drive sales and profits?

But more importantly, IP departments need to make better use of the information at their fingertips – the wealth of publicly available IP data. This information can inform everything from capital allocation through strategic alliances to product design and marketing. The challenge is packaging IP information and feeding it back to management in a useable way.

For several years now, we have been investing in tools and methods that make the competitive IP landscape understandable to senior executives. On this page there is a picture that shows all the major patent portfolios supporting Europe's wide-band CDMA (WCDMA) standard and the citation relationships between those portfolios. Notice that Qualcomm is the central hub of innovation and IP ownership – a shocking revelation, given that Qualcomm did not even participate in the creation of the standard. Now, replace the arrows with dollar signs and you get a pretty good idea of where the revenues and profits from IP ownership are flowing in the WCDMA business. That is a message that CEOs can understand.

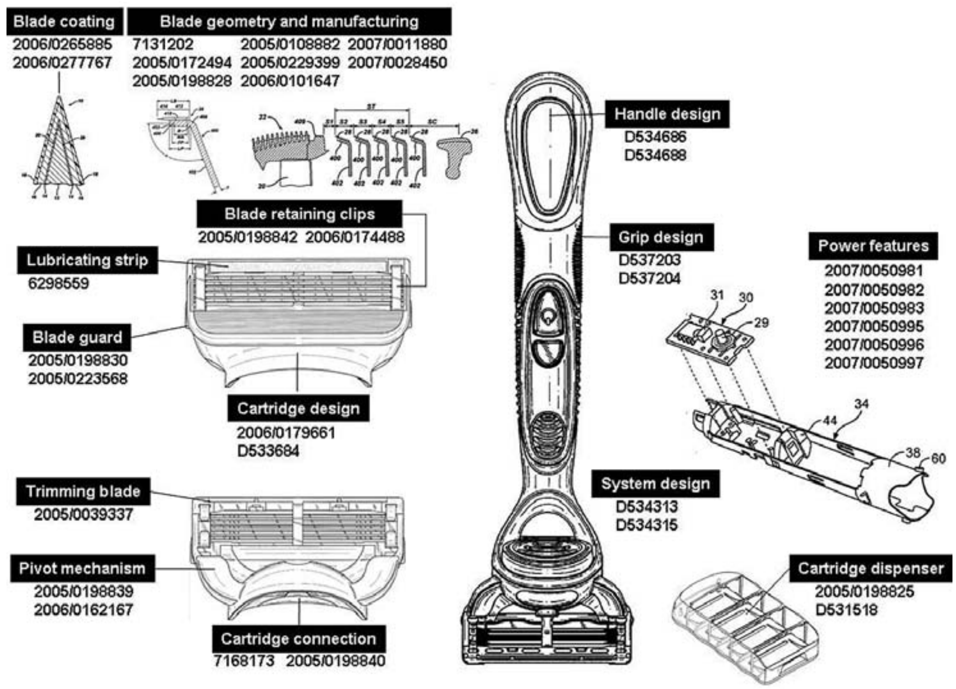
The picture on page 30 shows how Gillette has built a formidable wall of patents to protect its Fusion razor. Have you ever seen a generic replacement blade for a Gillette razor? The reason you have not is because Gillette has virtual immunity from generic competition – the company owns every unique feature of the razor, including the way that the blade cartridge attaches to the handle. Shaving products might not be what most people consider as high-tech, but they give Gillette a virtual licence to print money. Can you build a chart like this for your next-generation product; or your competitor's? Has your CEO seen it?

IP executives can demonstrate extraordinary relevance if they can package data in ways that show IP's value explicitly. But this can happen only if the information is provided in terms that management understands: markets, customers, sales, costs, profits, market share and margins.

The second part of the challenge is one of language. IP professionals generally use the language of law and technology: trademark searches, patent prosecution, product clearances, prior art, freedom to operate, infringement and injunctions. They manage dockets, meet their budgets, hit their patent filing and grant targets, and minimise the risk of patent litigation.

All of this is important work. But again, executives will not recognise it unless it is translated into business-speak. Below we offer a rough IP to CEO Lexicon that demonstrates how IP managers can better communicate with the C-suite.

US patents and patent applications protecting the Gillette Fusion razor



Source: Blaxill and Eckardt, *The Invisible Edge*

IP term = patent/trademark prosecution and filing fees;
Translation = asset investment

As mentioned earlier, the cost of building a factory or producing inventory is considered an investment. But investments in intangibles are thought of as costs. IP executives need to correct this disconnect by co-opting the language of investment: "Hey Ms CEO, owning this technology will give us a cost advantage for the next decade." Or: "Hey Mr Division Manager, our brand investment will help us command a price premium over our generic competitors."

IP term = injunction/exclusion
Translation = market power

Every IP professional knows that IP ownership is an exclusionary right. In the C-suite, this is called market power. It lets you raise prices, which means higher profit margins: "Hey Mr CEO, our IP gives us some real market power in this product category. We're not selling a commodity here. With the right marketing and distribution, we can command premium prices and really capture some terrific margins."

IP term = balancing payment
Translation = sustainable cost advantage

Unequal cross-licences between two companies typically result in a balancing payment from the company with the weaker IP portfolio to the company with the stronger one. Why should that matter to senior management? Balancing payments do not just generate revenue; they impose a cost on your competitor – in management lingo, that is a "sustainable cost advantage". Moreover, if you take your balancing payment as a running royalty, rather than a lump payment, your competitor will be forced to embed it in its product's cost structure. In management-speak: "Hey Mr CEO, we have got a sustainable cost advantage relative to Competitor ABC. We're getting US$5 in licensing for every unit they produce. That gives us a US$10 per-unit cost advantage. If we lower our price, we could really use that cost advantage to take market share."

IP term = licensing expense
Translation = cost of goods sold

On the other side of that same coin, the cost of using someone else's technology is part of the cost structure of your product – part of the cost of goods sold (COGS). What most executives do not realise is that internally generated IP should be accounted for and internally licensed the same way. This approach gives a clearer picture of the true cost of the product and in this context product profitability often looks very different: "Hey Ms CEO, we're losing money on Product X because the technology component of the cost of goods sold is killing us. If we stopped making the product and licensed our technology instead, we could turn a money-losing product into a high-margin business."

IP term = infringement
Translation = negotiating leverage or partnership opportunity

In our experience, when infringement is discovered, there is a tremendous hesitation to litigate, because it is somehow seen as ungentlemanly. But infringement does not have to end in litigation (although it might). Rather, it provides valuable negotiating leverage for business leaders to shape the relationship with the competition. How you use that leverage is limited only by the context and the creativity of the person wielding it: "Hey Ms CEO, XYZ Company is using our proprietary technology in their latest product. That gives us a lot of negotiating leverage to shape our relationship with them. We've got the better technology, but they've got the stronger brand. Maybe we should rethink what we'd like that relationship to be."

By translating important IP concepts into the normal language of business, you've got a much better chance of not only getting your message across (and avoiding the creamed spinach face), but also having a demonstrable impact on the company's strategy and its ultimate financial success.

Breaking out of IP's organisational silo

It should be clear by now that most companies today operate in two different worlds. Colleagues sit right next to each other, but on opposite sides of a chasm. In one world you find IP executives and managers with their legal/technical worldview and language. In the other there is management, with its blinkered strategic view and outdated economic toolkit.

The final disconnect that must be bridged is the organisational one that keeps these worlds separated. Now, in our strategy work with companies, the first question we always ask is: "Who does the head of IP report to?" We have found that the answer to that question is the best indicator of the company's views on IP as a strategic issue. If the head of IP reports to the general counsel, we get a very different message from if she reports to the CEO.

There has been lots of ink spilled in these pages and elsewhere about the role of the chief IP officer and we will not add to it here. Suffice it to say that if a company recognises IP as its most important strategic lever, then its organisational structure will reflect this. But once again, you probably will not get very far by trying to force a re-org of your company's reporting structure. The best way to make this change happen is to prove the value of IP (and the IP department) through your actions. You just cannot push on a string; it has got to be pulled.

That said, there are many other ways that IP executives can break out of their functional silo. The most important way is to get closer to the business units. For example, we worked with one European technology company to restructure its entire IP department – breaking up the corporate IP group and assigning most of its members into the business units. The level of understanding between the business and the IAM function improved dramatically when members from both sides began working together towards a common goal.

By now the stories of Procter & Gamble's Connect and Develop programme and IBM's early forays into IP licensing are pretty widely known (you can read about P&G's programme in our book *The Invisible Edge*, and Marshall Phelps re-tells the story of IBM in his new book *Burning the Ships*). One of the key lessons from those stories is to make sure that the business units that created the IP see the benefit when that IP is licensed. As Jeff Weedman from P&G tells it, when the IP group can help the business unit manager make his revenue target, the line forms pretty quickly outside the CIPO's door.

The real challenge and, we would argue, the call to arms for the IAM community is to accomplish the same thing through the more strategic uses of IP. Can we make IP's contribution to sales, market share and margins so clear that it stokes internal demand for IP services – as much as when IP executives are handing out royalty cheques? We think it can. But before that can happen, we need to break down the silos and build a bridge across the chasm between the IAM function and the rest of the company.

Whoever owns the IP owns the profits

When you get right down to it, the struggle to put IP in its rightful place at the centre of corporate strategy is ultimately one of financial relevance.

Currently, management's view of IP is one of money spent, rather than value created. That has to change. And the only way to change it is to take up the struggle on each of the four fronts described here:

- The strategic frame of reference needs to be changed.
- The invisibility of IP assets needs to be eliminated.
- The communications deficit of IP departments needs to be erased.
- The organisational chasm between IP and the business units needs to be closed.

IP executives clearly cannot do it all. But we will be waiting a very long time indeed if we are hoping that the CEO or some other senior executive is going to walk by our office, pop his head round the door and say: "I need to know more about what you do because I have a feeling it's important."

IP executives should be engaging colleagues at every level, from the C-suite right down to the R&D, marketing and product groups – arming them with information and insight that no one but the IP department can provide. But that information and insight must be communicated in a way that makes it clear how IP contributes to the chief objectives of the business: to improve market share, revenues, profitability and, ultimately, stock price. As we like to say: "Innovation without protection is philanthropy."

In a knowledge economy innovation is the source of value creation. IP provides both the incentive to invest and the means to capture the return on those investments.

It's up to us to show them how. ***iam***

Mark Blaxill and **Ralph Eckardt** are co-authors of the recently published book *The Invisible Edge: Taking Your Strategy to the Next Level Using Intellectual Property* (Portfolio Press, 2009), www.the-invisible-edge.com. They are also managing partners of 3LP Advisors, an investment advisory firm focused on intellectual property transactions. Blaxill is a former senior vice president of The Boston Consulting Group and was head of its Strategy Practice Initiative. Eckardt is the former head of BCG's Intellectual Property Strategy Practice.