The law and the ultimate intellectual asset

While intellectual property has risen to an elevated position of strategic significance and monetary importance in our society, many fail to realise what has changed and how incisively the law itself has become central to enterprise strategy

By **Lindsay Moore**

Many executives and their IP attorneys still do not recognise why trademarks (understood as brands) and patents (understood as technologies) have been strategically relocated from the legal department, marketing department and even the office of the general counsel into the hands of CEOs and chief intellectual property officers (CIPOs).

To comprehend these changes and their attendant opportunities, it is necessary to understand:

- The rise of intangible assets in the economy.
- The essential differences between tangible and intangible assets.
- How brands and intellectual property drive market capitalisation and wealth.
- Why the brand is the ultimate intellectual asset.

The rise of a new class of intangible assets

Since the beginning of the 1990s there has been a tremendous increase in economic activity. It has been caused by a confluence of co-emergent factors - including the boom in mergers and acquisitions, the development of complex new financial vehicles, the rise of the Internet, globalisation and the new importance of intellectual content - which have worked together to radically and permanently change the economic landscape and, increasingly, our entire worldview.

The rise in mergers and acquisitions during the early 1990s created new problems in setting company valuations. Book value, a measure of traditional asset values, and market capitalisation (book value plus intangible assets) were for the first time often significantly different. Prices were being paid for companies that greatly exceeded their book value, largely because of the value of their intangible assets. It became common to hear acquirers justify purchase prices that exceeded book value by saying: "Yes, the price is over book value, but the brand is so valuable."

Under these circumstances, the traditional approaches to valuing an enterprise were proving inadequate to address the new importance of intangible assets and previously unspecified elements of goodwill, such as brand equity and patent portfolios. Looking back, we can see that a new asset class was emerging onto the world stage.

As the last decade of the 20th century gained momentum, intangibles became primary sources of value and generators of substantial wealth. As this recognition crystallised, these intangibles - which had previously been known proximally as 'intellectual property' - became known variously among financial and accounting professionals as intellectual assets; among economists as knowledge assets, in recognition of the knowledge economy; and finally, in the corporate world and among executives, as intellectual capital. This new capital in its critical mass formed a new asset class in juxtaposition to the traditional assets of plant, property, equipment and financial capital which were codified in balance sheets as book value.

Figure 1. **S&P 500 asset distributions**

Year	Tangible assets	Intangible assets
1978	95%	5%
1982	62%	38%
1992	38%	62%
1998	28%	72%
2002	13%	87%
2004	20%	80%
2008	25%	75%
2010	20%	80%

Data source: **investopedia.com, Brookings Institute, Balanced Scorecard European Summit, OceanTOMO, Vanguard 500 Index Trust Fund**

In time, this new intellectual capital became the wealth of the new economy and the most important strategic asset in the world of enterprise strategic planning.

In 2002, *Fortune* magazine columnist Tom Stewart captured the spirit of the time when he claimed that intellectual capital had become more important than traditional capital. In a pivotal series of articles, he argued that intellectual capital was becoming the "new wealth of organisations" and, by extension, the western world: "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."

During the past 35 years, the asset base of the economy and modern business has shifted from the traditional tangible physical and financial assets of the industrial era to an asset base that is predominantly composed of intangible, knowledge-based, intellectual capital assets. A tabulation (see Figure 1) of the asset distribution in the S&P 500 makes clear how intangible assets have dwarfed traditional tangible assets in the major corporations in the United States.

In 1978, only 5% of the assets in the S&P 500 were intangible, primarily known as goodwill; but by 2010 intangibles accounted for 80% of the value of the S&P index.

This shift from tangible to intangible assets brought with it new strategic and financial challenges for managers, executives and the professionals who serve them.

As a general rule, the market capitalisation of a company consists of the book value as shown on the company balance sheet, plus the intangible assets as valued in the financial markets. A more detailed look at the shifting value of S&P 500 companies reveals that the most valuable assets within these companies are increasingly intellectual capital assets. The Figure 2 illustrates the growth in the S&P 500 market index from 1973 to 2005.

The overall value of the S&P 500 is segmented into three elements: tangible book value, intangible book value and the attendant market premium.

The book value reflects the value of the combined companies in the S&P Index as reflected on their balance sheets. It includes all traditional tangible and financial assets within each company, being plant, property, equipment, cash, receivables and other financial entities.

The intangible book value reflects intangible assets such as brands and patents that were acquired by the respective companies through mergers and acquisitions. These items are reported on balance sheets under Financial Accounting Standards Board Statements 141 and 142. The remaining market premium reflects investors' rational analysis of the values of the companies within the index, inclusive of the non-balance sheet intangible assets.

In 2005 the combined intangibles within the S&P 500 Index comprised approximately US$10.25 billion, or 89% of the total US$11.5 billion of combined value. The tangible assets comprised only US$1.25 billion, or 11% of that total amount. Clearly, intangible assets are becoming the more valuable assets in the economy, and the trend and momentum of this shift suggest that intangible assets are becoming the primary source of future wealth. The most recent information regarding the worldwide valuation of intangible assets reports continual growth in intellectual asset valuations, and suggests that the growth in intangibles is, by some calculations, faster than the global gross domestic product during the same periods.

The primacy of brands

Importantly, the proportion of the total S&P market capitalisation that is attributable to intangible assets can be broadly subdivided into brands and patent portfolios. While portions can be attributed to other knowledge-based assets - such as copyright holdings, human capital, corporate culture and other aspects of intellectual capital - the preponderance of intangible asset value is ascribed to brands and patent portfolios, with brands being the most valuable portion.

In 2011, as reported by *Business Week* and Interbrand, the most valuable brands in the world were valued as set out in Figure 3.

Coca-Cola, the most valuable brand in the world, is valued at 46% of the Coca-Cola Company's market capitalisation (book value was at US$32.9 billion - 20.9% of total market capitalisation). When we compare the *Business Week* valuations to the respective market capitalisations of each company, we can see that for the companies concerned, the most valuable asset that they possess is their respective brand.

Because it is the responsibility of executives to leverage the most valuable assets of an enterprise, brands have become a central strategic element in delivering both competitive advantage and enhanced market capitalisation or company valuation. Once the province of the marketing department, the brand today is a central responsibility of the chief executive.

But why are these trademark-based assets so valuable - and potentially so much more valuable than patents or entire portfolios of other intellectual capital assets? While both brands and patents make up the vast bulk of the intangible assets of modern enterprise, brands have risen to a paramount level among intangible assets. They have done so because of their ability to distil the meaning and value of other intangible assets and to articulate them into a meaningful identity. But what is meant by an identity?
The fact that we speak of brand valuation, not trademark valuation, points to an important distinction between a trademark and a brand.

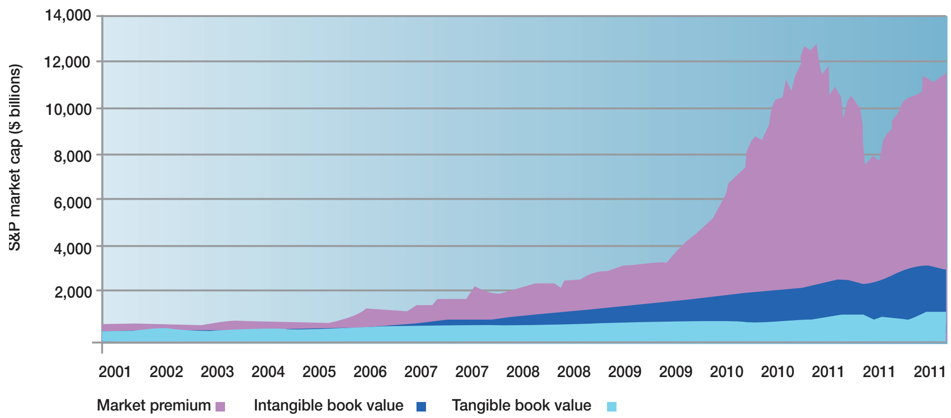
The distinction between a trademark and a brand
IP attorneys customarily assume that talk of brands or trademarks involves one and the same thing. And while that is often the case, especially among attorneys, it is important to make a subtle strategic distinction between the two if these assets are to be deployed advantageously to build strategic and monetary value. From the perspective of brand valuation, a trademark is not a brand any more than a patent is a technology. Instead, a trademark is part of or an aspect of a brand, but a brand is much more than a trademark. How so?

One could have a stack of trademark registrations on a table and yet not have a single brand in evidence. The respective marks may be used in commerce, but in terns of the brand that is not enough. Initially, a brand is a further development of a trademark, but ultimately it always remains much more than that because brands have distilled and articulated meanings from all of the intellectual assets within an organisation into a greater signification — and this is where the value comes from. Thus, when we speak of deploying the leverage of a brand to effect the total strategic positioning of an enterprise, we imagine 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 which may consist of words and symbolic content. However, a brand is everything that an enterprise stands for: the brand promise to employees, customers, consumers, investors, suppliers, the industry, society and everyone else that it touches. Thus, when we speak of the brand or of brand strategy *per se*, we are holding a complex entity in our mind's eye and envisioning ways to leverage the variety of significations it has collected from other intellectual properties and the entire enterprise. The

"The fact that we speak of brand valuation, not trademark valuation, points to an important distinction between a trademark and a brand"

Figure 2. **S&P market capitalisation – segments and trends (1973-2005)**



Data source: **"The Power of Intangible Assets: An Analysis of the S&P 500", Keith Cardoza, Justin Basara, Liddy Cooper and Rick Conroy, published in *Les Nouvelles*, March 2006**

brand indicates the source of its respective goods and services, but more importantly, the entity which may achieve phenomenal monetary and strategic value.

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, and different from, a trademark.

In both a brand and a technology, the intellectual property subtends the respective higher-order entity of a brand or a technology, but the brand or technology transcends the respective trademark or patent - much as the meaning and significance of the architecture of a building may exceed the title to the property upon which it stands.

Therefore, in thinking about brands, it is important to realise that they are an intangible thing - often 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; thus, it is meaningful, when speaking of well-managed brands, to speak of brand equity as revealed in market capitalisation and brand valuations.

How trademark law structures a brand

Among the various intellectual assets, the brand stands forth as the only organising, assembling and synthetic asset that is capable of orchestrating all other intellectual assets.

In its optimal deployment, a trademark - and ultimately the brand - has the ability to organise the meaning and significance of all other intangible assets and their related intellectual content into a rational whole and to communicate it as a unique identity. While indicating the source of goods and services at its most basic level, at its highest level it teaches an entire set of significances and thereby often speaks volumes to its respective audiences. Thus, the purport and worth of other intangibles find realisation in a well-articulated brand.

The ability to carve out under trademark law and own a certain word, words or a symbol has created a set of the most valuable enterprise assets in the world. The ability to protect and enforce a trademark, without any end term, against confusingly similar or tarnishing usages - coupled with the ability to expand its periphery of rights beyond its original usages, and even to the entire economy as a famous mark - has created an intangible asset with a potentially unlimited set of legal and structural rights that turns the word, its prose and the significance of its intellectual content into a property that can be owned to the exclusion of others. In this sense, a trademark may be best understood as the essence of a brand.

A trademark confers the power to own words themselves. When manifested as a brand, it is the ultimate intellectual asset

The nature of a brand

While Apple may have patented a mobile phone function that recognises and collects telephone numbers in text messages, the function takes on its meaning within the total look and feel of the Apple interface: its buttons, its ease of navigation, the size and

Figure 3. **The top five brands in 2011**

	Brand	Brand valuation Billions US$	Market cap Billions US$
1)	Coca-Cola	$71,861	$157,320
2)	IBM	$69,905	$232,540
3)	Microsoft	$59,087	$268,420
4)	Google	$55,317	$195,160
5)	General Electric	$42,808	$201,360

Data source: **www.interbrand.com/en/best-global-brands/Best -Global-Brands-2011.aspx**

weight of the Apple iPhone, its trade dress in its entirety and all the various features and dimensions that merge to create a brand. The brand does this by collecting, assembling, associating and articulating the meaning and equity from other intangibles into a highly faceted and nuanced entity and complex identity that distil meanings and creates brand equity.

For most companies, the brand has come to be viewed as the central element of strategic leverage and monetary value. Specifically, and from a brand strategy perspective, the brand can act to organise the individual meanings and significances of all the various traditional and intellectual assets within a company. The brand, when well articulated, possesses an ability to orchestrate everything that brings value and advantage to a company into a meaningful whole, giving it a recognisable significance.

In forming a complex set of meanings, all of the parts are leveraged more highly and revealed as a means to the ultimate end of the brand. A patented invention may be nothing without the part that it plays in a product sold under a brand. By themselves, individual intellectual assets can, for example, be licensed or sold to others; but in the world of enterprise they are developed or procured to be part of a product or service that is most successfully taken to the market under a brand. The brand alone, among all intangible assets, has this unique, distilling and refining ability.

Figure 4 portrays the brand as the ultimate intellectual capital asset and also as the *raison d'etre* for all of the other forms of intellectual capital. From this perspective, each form of intellectual capital - such as an idea, innovation or patent - may exist unto itself, but only when it is organised towards the end purpose of a brand does the individual asset become optimally leveraged and commercialised.

Thus, by extension, the knowledge base that underlies innovation or 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; but it would be more highly leveraged by the company that takes it to market under a brand and builds brand equity. All assets united under a brand are synergised to create geometric value.

Through its dynamic, the brand - when strategically positioned in its market as a complex identity replete with multiple meanings - acts to assemble and leverage the intellectual content within a company. Therefore, by their very nature brands distil and articulate. In this sense, they refine and transform the individual intellectual assets within an organisation into what the enterprise stands for and what differentiates the company, and so confer the greatest competitive advantage on the enterprise. Thus, the brand may be seen as the one end in itself, while all other intellectual assets are merely a means to that end.

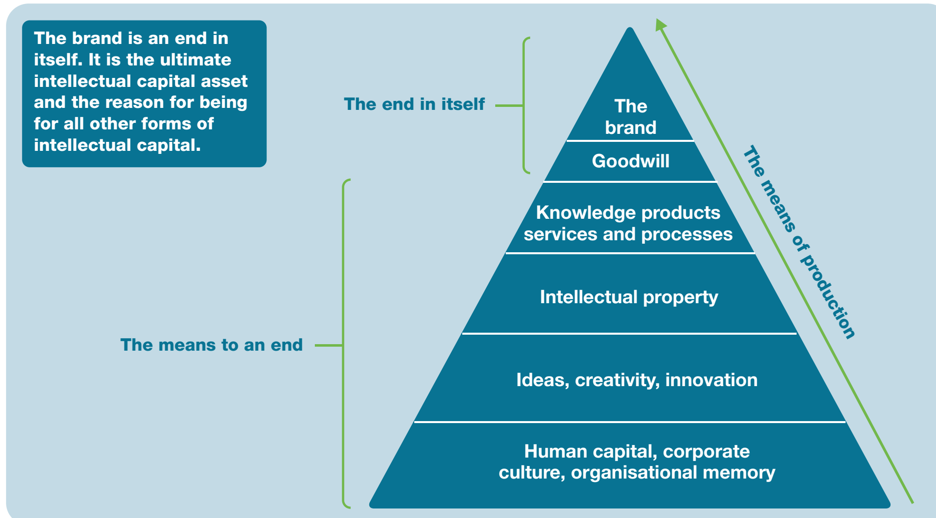
Monetising intangible assets

Financially, intellectual capital assets can be parlayed to generate geometric monetary value in a remarkable respect. When equity is transferred from one intangible asset to another, the value remains in the original asset while it is also transferred into the other, thus potentially increasing the combined value of the two.

In the case of the synthetic nature of the brand, equity is transferred from one or more other intangible or IP assets into the brand, thereby expanding and multiplying the monetary value of the respective assets. In this association, the value of the original asset is left largely undiminished, or in certain cases is even enhanced through the mirror-back of the new asset value. Associations between intangible assets thus create reciprocal value that leads to the geometric creation of new wealth.

Strategically, this is important. IP assets possess varying lifespans, so the brand offers the opportunity to take an asset with

Figure 4. **The brand and intellectual capital**



Data source: **©2005, 2007 Dr Lindsay Moore and Lesley Craig. All rights reserved**

a fixed term of existence, such as a patent, and to conserve its equity within another asset which possesses a potentially unlimited lifespan (see Figure 5).

When properly accomplished, the transfer of equity into a brand also mirrors the brand back into the IP assets, creating reciprocal value. Thus, to continue with the example of patented technology, once other smartphone manufacturers realised that they could bring a winning feature from the Apple iPhone into their smartphones, that patented feature then possessed greater value than it did before its association with the Apple brand. In this respect, intangible assets demonstrate their reciprocal and geometric character, and suggest the opportunity to increase monetary value in a way that cannot be done with traditional, physical assets. With intangibles, subordinate assets are converted into brand equity without losing their respective value, and frequently with an increase in their original value.

When intellectual capital assets are deployed strategically in the natural course of business, all assets are turned to advantage under the brand to build value, provide competitive advantage and drive market capitalisation for the respective enterprise. Thus, the equity of patents, copyrights, trade secrets and trademarks is transferred into the brand while creating new value. As an example, Intel, with its "Intel Inside" branding campaign, transferred the original equity of the hundreds of microprocessors that it has created since the early 1970s, from the 4040 microprocessor chips through to the Pentium chips and on to the Itanium, Intel Core and Xeon chips, conserving the equity of each invention into the next. What was good and valuable about any one microprocessor was carried on to deliver enhanced brand valuation.

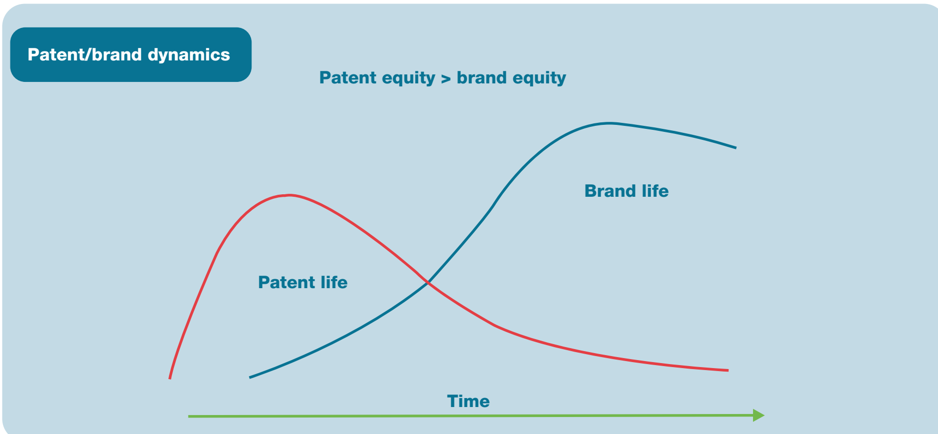
Thus, by associating a patent with a brand over a period of time, the equity of that invention becomes part of the composition of the respective brand. A patent possesses only a 20-year term and, because of the rapid march of new innovation, will reach its peak of importance and value often well before the end of its term. However, once it is merged with the brand, it possesses an indefinite life that lasts for as long as the brand remains in favourable force and in continuous use.

Well-managed brands are constantly developing and adjusting to changing market dynamics, distilling new meanings and articulating new significances for their respective enterprises. In this sense, they are ever-changing. It may be helpful to imagine brands as always 'becoming' and constantly incarnating intellectual content, for that is how they create value. Thus, when the brand is viewed as the *raison d'etre* 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 and the greatest monetary valuation.

How to optimise brand value

As intangible assets became progressively more formalised for strategic purposes, and

Figure 5. **Transferring intellectual asset equity**



Data source: **©2005, 2007 Dr Lindsay Moore and Lesley Craig. All rights reserved**

the basic theory of business valuation changed to incorporate the new asset class, a new theory of optimisation emerged among strategists.

Simply put, this theory recognises that tangible and intangible assets are different in kind and are beneficially leveraged in different ways to deliver their strategic or monetary benefit. Physical assets can be optimised through the efficient leveraging of the tangible assets which compose book value, and intangible assets can be optimised through the strategic leveraging of the intellectual assets which account for the rest of market capitalisation.

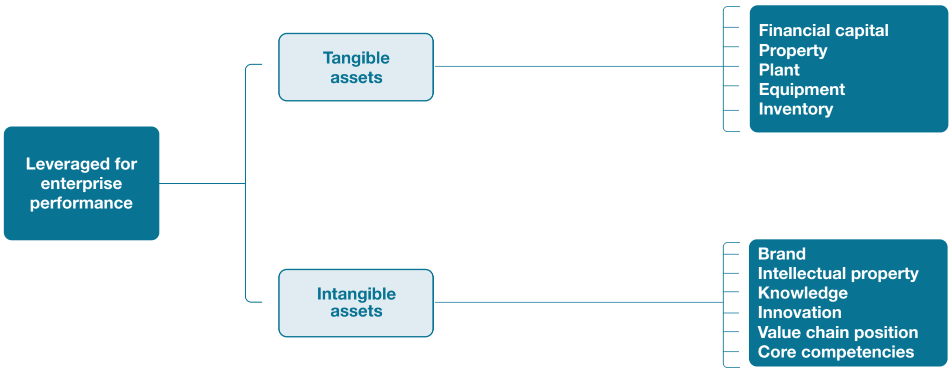
Traditional physical and financial assets are leveraged according to a kind of Newtonian financial physics that was developed throughout the industrial revolution. Because the traditional assets were wasting assets, the history of their leverage has been about optimisation in terms of scope, scale and efficiency. Under the new economy, and because intellectual assets are different in kind, the physics of the assets changed to reflect the fact that all intangible assets are knowledge-based. But being different in kind turns the fundamental rules on their heads. Instead of scarcity driving the value of Microsoft's Office software, as it does De Beers diamonds or food products, we have omnipresence driving its value. With physical assets, the economic principles is that the less there is, the more valuable it becomes. With knowledge-based assets, the economic principle becomes adoption drives value and the more there is, the more valuable it is.

Primarily, tangible assets are leveraged under the rule of efficiency; their highest leverage is thus that of total efficiency or perfect economy, or what has come to be called operational effectiveness. A company that runs a manufacturing plant 24 hours a day fully leverages the physical assets of plant, property and equipment. Even the best operations executive could not get any more time or use out of physical assets than 24 hours in a day.

Intangible assets, leveraged under the rule of achieving adoption, realise their highest leverage by having been adopted or - to use a technological euphemism from the early days of broadband - being always on. An enterprise such as Google makes the software for its search engine available to all users for free and can sell search-related advertising on its search engine because it has the greatest usage or adoption. Its free adoption is leveraged higher than other search engine players, making it the industry leader.

Thinking strategically, these new assets require a new logic that presents challenges for decision makers at all levels. As the tangible assets on the balance sheet become fully optimised, they offer less opportunity for growth and exploitation. Once a manufacturing plant is running 24 hours a day, seven days a week, every day of the year, that variable is fully optimised. However, because of their recent discovery, intangible assets are largely under-leveraged at this time. Thus, they present the greatest opportunity for growth and new deployment. Therefore, the logical thing to do from the perspective of strategic planning is to spell out each intangible asset, benchmark it, set its performance metrics and then ensure that it becomes more highly leveraged. Doing that with

Figure 6. **The primary traditional tangible and intangible assets, and the primary opportunities for leveraging them**



Data source: **2005, 2007 Dr Lindsay Moore and Lesley Craig. All rights reserved.**

tangible assets is how the industrial revolution evolved to a point of nearly complete operational effectiveness.

Yet many corporate executives are challenged learning how to create new value, build equity for their organisation and deliver growth for investors with these new intellectual assets. Of course, driving market capitalisation and increasing stock valuations ultimately means optimising and leveraging both tangible and intangible assets, but the focus of opportunity today is with intangibles.

Figure 6 presents an exploded view of the primary traditional tangible and intangible assets and thereby suggests the primary opportunities for enhancing leverage. Some of the assets in Figure 6 are discussed in this article in detail; others are not. Most modern successful enterprises have begun to leverage their intangible assets for enterprise success. Thus, we have both the opportunity and the problem of gaining expertise with this new asset class, identifying the assets, understanding their physics and how to gain adoption. Not all intellectual assets are as well developed. To date, brands and technologies have received the greatest attention and acclaim.

The opportunity for chief IP officers and IP attorneys lies in thinking strategically. In most cases these individuals are already adept at identifying and protecting intellectual content and need only increase their facility with strategy.

Talking about strategy suggests that we are in control of our destiny. It entails the realisation that failure often 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 a patent, or a brand rather than a trademark - and then to find its possibilities in that state and at that level of its totality. This does not mean that we forget the law behind the asset, because in truth it is the law that we will use to leverage it most effectively. IP law provides the structure of the asset to be leveraged. Nevertheless, we can never be in the business of leveraging patents *per se*, and move the needle on company valuation or enhance competitive advantage. Unless our business is patent trolling, it is just not enough leverage. But we can build a brand or introduce a new technological whole (eg, 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 not be able to advance the highest purposes of the enterprise. Lacking such relevance, the more tactical that they become, the more that they can be copied by other enterprises, by competition and eventually by everyone, so losing their strategic edge and thus not contributing to corporate advancement.

The role of the law with intellectual content

For many, it is hard to see how incisively the law itself has become central to enterprise strategy.

Consider the Google Books project. The Digital Millennium Copyright Act, copyright law and public policy have everything to do with Google's strategy to change the law and to create the digital Library of Alexandria. The whole strategy hangs on the law and the dynamic of ethical thinking and public policy to change the law. The Google strategy works only if policy makers can be convinced that copyright law should be changed to allow what would currently be considered copyright infringement for the greater public good – in this case, making the world's knowledge available to everyone across the Google website.

Some would argue that Google displayed the same thinking when it used patented technologies to create its Android smartphone operating system while arguing that it would reduce the cost of cellular technology by putting phones in the hands of everyone.

Or consider the fact that a patent holder can decide against whom, if anyone, to enforce – that right has everything to do with patent strategy. It has everything to do with why, in the smartphone and tablet sectors, Apple has pursued a strict exclusion policy and Microsoft has willingly licensed all comers to its patent holdings.

Today, CIPOs are rethinking company strategies in the light of intangible intellectual assets. Whether they are arguing to capitalise on 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 and their intellectual content as both the fundamental business resource.

Like Archimedes' lever, knowledge of the law as it concerns intellectual content is what propels modern intangible asset strategy. Thus, IP strategists, attorneys and strategic thinkers who understand intellectual content and knowledge-based assets *per se* are uniquely constituted to develop this kind of thinking. ***iam***

Dr Lindsay Moore is the founder and CEO of KLM Inc management Consultation, Boulder, Colorado

Action plan

In order to ensure that the value of intellectual property and other intangible assets is maximised, IP strategists should:

- Educate their constituents about intellectual assets, such as intangibles, intellectual capital, intellectual property, brand and knowledge, and explain how, on balance, brands are much more valuable than patents.
- Use intellectual assets to create competitive advantage - think strategically and use intellectual capital assets to help their companies or clients achieve important business goals and enhance competitive advantage.
- Leverage intangibles to drive market capitalisation - understand the nature of intangible assets and use the brand to position the enterprise against a highly differentiated set of meanings, build brand equity and so drive market capitalisation.
- Study how the law compels strategy and formulate thinking that either leverages the law or changes it.
- Use the law to compel intellectual asset strategy.