

Intellectual Asset Management and Harvesting

By Andrew J. Sherman

CEO's and business leaders of many small and growing companies are committing the strategic sin of failing to properly protect, mine, and harvest intellectual property because they often do not understand intellectual property generally and fail to assess their intellectual properties appropriately. Although intellectual capital embraces almost every aspect of a business's core assets and potential revenue stream, its significance has not been sufficiently understood. For example, from 1997 to 2001, billions of dollars were invested in venture capital and private equity markets, which were in turn used by entrepreneurs to create intellectual property and other intangible assets. Five years later, many emerging growth and middle market companies have failed to leverage such intellectual capital into new revenue streams, profit centers, or market opportunities. It is thus important to understand intellectual property within the context of a company's capital.

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Understanding Strategic Categories of Intellectual Capital

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advisors are discovering that intellectual capital, while often hard to quantify, is essential for survival. Intellectual capital typically falls into one of three categories:

- 1 **Human Capital.** This category encompasses the skills, experience and ability of the employees. Creativity, innovation and forward thinking drive a company forward and allow it to compete in an environment that is constantly becoming more complex and idea-dependant. Although it is difficult to measure human capital, it is usually viewed in terms such as turnover and employee satisfaction.
- 2 **Organizational Capital.** This category includes things owned only by the company, such as patents, trademarks, copyrights, formulas and databases. Converting human capital into organizational capital is difficult because it requires collecting and retaining employee ability so that such ability belongs to the company.
- 3 **Relationship Capital.** Putting an emphasis on the customer can be extended to any outside party that creates value for a company. Some organizations have been keeping tabs on this information as it relates to its revenue base. Many are now recognizing the relationship between customer loyalty and increased profits.

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As more and more new intellectual properties are developed and the significance of its strategic management is recognized, it is also important that one understands how intellectual property laws may be utilized to protect such valuable assets. Because these assets cannot be touched or felt, today's entrepreneurs must protect them by relying on the tools and weapons offered by the various branches of IP law. The key is to match the intangible asset a company is trying to protect and/or leverage with the most effective legal and strategic tools available. This requires a basic understanding of the laws that protect intellectual property as well as the strategies that are most effective to leveraging it.

A lawyer's role, as legal and strategic advisor to companies that have grown through the process of leveraging their intellectual property, in this critical process is to:

- Work with clients to find their intellectual property and hidden intangible assets (IP protection and leveraging audits, etc.);
- Protect the intellectual property (through registration strategies, confidential agreements, etc.);

- Develop strategies to leverage the intellectual property (through joint ventures, alliances, licensing, etc.); and
- Look at these strategies in comparison to other growth strategies as alternatives.

A lawyer's strategic analysis may include questions such as:

- What competitive advantages has the company developed?
- Is that competitive advantage protectable?
- What IP law strategies can be used to protect ownership/use?
- How can this intellectual property be leveraged into revenue/profit streams?
- How can a company use intellectual property to create substantial competitive advantages with durable revenue streams?

An entrepreneur's ability to grow a business and achieve success depends on his or her ability to: invent and exploit new products and services, open up new distribution channels, foster new production and training techniques, implement new promotional and marketing campaigns, establish new pricing methods, and adapt to changes in competition, consumer preferences or demographic trends. The ability to help the client identify, develop and protect IP rights is critical. Being an effective advisor in this area can help one's clients to do the following:

- Improve the overall value and rate of growth by increasing intangible assets;
- Create competitive advantages and barriers for competitors intending to enter the marketplace;
- Understand the IP rights of other firms;
- Create licensing opportunities and additional revenue sources;

Figure A. Intellectual Assets Drive Growth Strategies and Generate Revenues

Protectable Intellectual Property

- Patents
- Trademarks
- Copyrights
- Trade dress & trade secrets
- Distribution channels
- Show-how & know-how
- Databases & customer information
- Software & proprietary algorithms
- Customer & partnerships
- Proprietary processes & systems
- Knowledge & technical workers
- Exclusive licenses/access to technology



Possible Market Opportunities and Revenue Sources

- Spin-off new companies
- Joint ventures, strategic partnerships & alliances
- Technology & software licensing
- Outright sale of new technology
- Co-branding
- Franchising
- Enter new markets
- Develop new products
- Brand-extension licensing
- Technology transfer
- Cooperatives, consortiums, federations
- Training & consulting services
- International expansion
- Government contracts



- Build consumer goodwill and brand loyalty; and
- Provide maximum control over the development and ownership of the ideas and invention of employees.

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Failure to Leverage Intellectual Capital

The failure to leverage intellectual capital into new revenue streams, profit centers, or market opportunities is due to either a singular focus on the company's core business, or the lack of a strategic vision in identifying other applications or distribution channels. Part of the reason for this may be that entrepreneurs and growing company leaders may lack the proper tools to understand and analyze the value of the company's intellectual assets. For example, a recent study by Professor Baruch Lev of New York University revealed that only 15% of the "true value" of an S&P 500 company is captured in its financial statements.

Compared to the vast resources of S&P 500 companies, it is likely that the intangible assets of smaller companies are even more undervalued; Lev contends the number for privately-held small companies may be as low as 5%. Imagine the consequences and opportunity cost an entrepreneur preparing to sell



his business would suffer (or even preparing to structure an investment with a venture capitalist or strategic investor) if 95% of his inherent value remains on the table! Such a gap in capturing and reflecting hidden value points out the critical needs for a strategic business and legal analysis of an emerging company's intellectual property portfolio. As many kinds of investment strategies and tools for efficient financial asset management have been developed for centuries, analogous approaches need to be introduced and utilized for intellectual asset management.

Intellectual Asset Management

Intellectual Asset Management ("IAM") is a system designed to create, organize, prioritize, and extract value from a set of intellectual property assets. A growing company's intellectual capital and technical know-how are among its most valuable assets. Although they provide the greatest competitive advantages and are the principal drivers of shareholder value, companies rarely have the personnel, resources, and organizational infrastructure necessary to properly manage and leverage these assets. *IAM helps growing companies ensure that strategic growth opportunities are recognized, captured, and harvested into new revenue streams and markets.* IAM also involves monitoring certain developments within the company's marketplace by:

- Gathering intelligence on direct, indirect and potential competitors;
- Monitoring developments abroad;
- Staying ahead of a frequently changing landscape (i.e., over 20,000 new patents are issued each month in the United States alone); and
- Maintaining license agreements and streams of royalty payments on both an inbound and outbound basis (e.g., Royalty Audits—to ensure against under-reporting (outbound) and overpayments (inbound)).

Here, the questions to consider include: Are you getting paid? Is there anyone you are paying but should not be? Are performance standards being met? Have you established relationships with the right parties? What could be done to strengthen existing relationships or distribution channels?

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In reviewing a client's current IAM practices, analyze the following:

- What IAM systems, procedures and teams are currently in place?
- How and when were these systems developed?
- Who is responsible/accountable for managing these systems within the company?
- To what degree are adequate systems for internal and external communication and collaboration currently in place?
- What are the idea/technology harvesting mechanisms, filters and procedures for innovation-decisional analysis (i.e., as to whether to move forward/budget allocation/timetable, etc.) currently in place?
- Are the strategies and processes of harvesting and leveraging intellectual assets reactive or proactive?
- What are the real or perceived internal (i.e., politics, red tape, budgeting processes, organizational structure) and/or external (i.e., market conditions, technological advances, competitor's strategies, etc.) hurdles that stand in the way of better IAM practices and procedures?
- What can be done to remove or reduce identified barriers?

An IP audit is a multi-disciplinary process that gathers data and takes inventory of a franchisor's IP assets so that they can be managed and leveraged properly and profitably.

The first step in developing an effective IAM system is to conduct an intellectual property ("IP") audit. An IP audit is a multi-disciplinary process that gathers data and takes inventory of a franchisor's IP assets so that they can be managed and leveraged properly and profitably. An IP audit can also include a competitive assessment of the strength and depth of the franchisor's inventory of intellectual assets relative to its competitors. This competitive assessment is critical when anticipating either a capital formation or business combination (merger/acquisition) transaction. It can also be a useful tool to determine where future research and development dollars or branding budgets should be allocated. This is particularly important for cases in which the franchise is losing its competitive position relative to others or where its IP portfolio contains noticeable holes or dangerous weaknesses in its IP portfolio. As the franchise system matures, its inventory of intellectual assets grows larger and stronger such that it helps to protect the franchise's market position and deliver and maintain its value position in the management of its relationship with the franchisees.

The IP audit has seven primary phases, ranging from data-gathering to the development of policies and procedures as demonstrated in Figure B below. There are a wide range of issues and action items that will need to be taken during each phase, depending on the results of the audit and overall IP objectives.

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Figure B. Seven Primary Phases in the IP Audit For Growing Companies

- **Gather IP Data**
(What Intellectual Property Does the Company Have?)
- **Organize IP Assets**
(Build Database/Tracking and Organizational Systems)
- **Confirm/Clarify IP Ownership**
(Does the Company Properly Own/License All Intellectual Property Critical to its Core Business Model(s)?)
- **IP Legal Protection and Compliance**
(Is All of the Company's Intellectual Property Properly Registered and Protected under International, Federal, and State Laws?)
- **Develop IP Policies/Procedures**
(Are there Internal Systems, Policies, and Procedures in Place to Ensure Proper Protection and Usage of the Company's IP Assets?)
- **IP Leveraging Strategies**
Are There Ways to Leverage the Company's IP Assets into New Opportunities and Revenue Streams?
- **IP Enforcement Strategies**
(Are there Any Infringements of the Company's Intellectual Property and Does it Have a Litigation Strategy for Moving Forward?)

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