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Snow White shows the way

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In today's dynamic, and uncertain business environment, doing things faster and better than your competition is no longer a sustainable form of competitive advantage. Our competitors have access to the same information technology and network tools to speed design around solutions or reasonable imitations. In fact, having a few strong patent claims may not be enough to build competitive advantage that survives the ravages of time. Patents after all do expire.

How is it than that some firms continually manage to hold dominant positions in markets that are extremely competitive? How is it that Disney (media), Searle (foods/pharmaceuticals), Intel (integrated circuits), Microsoft (software) and others maintain such powerful market positions in the face of so much competition?

We think (and most readers of *MIP* would probably agree) that one answer to this rather loaded question is related to the management of intellectual properties. We further submit that staying power and long-term market dominance can be achieved by combining the advantages of multiple forms of intellectual property protection, a technique that can be simply illustrated with a handy tool known as the intellectual property continuum of protection. In this article, we explore the relationship between ideas, innovations/creations, intellectual properties and their all-important role in sustaining competitive advantage in dynamic markets. We then draw some analogies between financial securitization and IP securitization. Finally we examine these ideas in the light of a number of contemporary examples.

The economics of wealth creation

As many of us involved with intellectual property either as inventors, asset managers or legal advocates are aware, the percentage of market valuation for companies in information rich industries that are associated with intangible assets has grown substantially during the past 15 years. In fact, this trend is not limited to information rich industries, but instead related to almost all industries. Over the past decade even traditional smokestack industries have witnessed increasing market value to book value ratios. Investors are beginning to place increasing value in the intangible assets of corporations.

Most of these intangible assets can be described as intellectual capital, a broad term that builds on an important idea put forth by 20th century economist Joseph Schumpeter. Schumpeter observed that in the long term, the only source of real value creation is innovation. Those firms or economies that innovate and can sustain innovation have a long-term engine for wealth creation.

Economist Lester Thurow put a more contemporary spin on the significance of innovation when he said: "Skills and knowledge have become the only source of sustainable competitive advantage." Competitive advantage is an important element of corporate strategy for all our collaborators and clients because it usually translates into higher margins and profits, the very tangible form of capital that allows one to sustain innovation. In a recent *Harvard Business Review* article, Michael Porter, the muse behind the classical five forces framework for evaluating and analyzing competitive advantage in an industry, re-emphasized the importance of product/service differentiation in building competitive advantage.

However, in an era of efficient markets, enhanced information transparency and reduced information asymmetry, competitive advantage for many firms has become a bit of a Holy Grail. Charles Fine capitalizes on this point when in his book *Clockspeed* he observes that the increasing ability of firms to design around or reengineer products in rapid succession has reduced the life cycle earnings potential of new products and services. He therefore puts forth that we are entering a period of temporary competitive advantage.

We, like many, were troubled by these and other reports that warned of an era of decreasing margins brought on by the information efficiencies inherent in the internet. All of this was clouding my mind until a recent visit to the video store. I had been dutifully and urgently dispatched by my wife who asked me to purchase no less than three copies of the 1937 animation classic *Snow White.* I did not fully understand her urgency until I actually found myself in a special queue at this store to purchase the videos. The queue was rather long. I found myself asking, why was a children's movie created in the last millennium creating such contemporary demand?

The answer of course is the careful, purposeful management of copyrights and trade marked character rights that derive from this classic animation. The Disney firm knows how to maximize the economic life of its copyrighted animation classics and transfer the corresponding value into trade marks (the Disney Brand) and character rights. Timely merchandising of the characters helps to periodically ramp up demand for a new release of the same classic animation. Hence I queue up in 2001 to pay $14.99 for the video version of Snow White, the same film I paid 25 cents to view at the matinee in 1966. Could it be that this intellectual property asset is actually appreciating with time?

In our work with clients and other academic scholars, we have investigated the sources of competitive advantage in today's most robust companies, ie those firms that seem to be surviving despite the uncertainties of the public markets. The significant issue that we have explored however is not the sources of competitive advantage but rather the methods for sustaining advantage, ie extracting real value from intellectual assets for a long period of time. This is where the securitization of ideas and innovations by way of the intellectual properties is playing an increasingly significant role.

Intellectual properties and securitization

Ideas and innovations are a wonderful source of competitive advantage when they are protected from imitation. The securest forms of ideas and innovation are the monopoly rights vested in the intellectual properties. The granting of exclusive property rights for innovations and creations by most governments in the industrialized world substantially increases the economic value behind the corresponding ideas. Ideas and innovation derives economic value from two concepts of securitization.

The first concept of securitization is the actual granting of exclusive rights to the inventors or authors of innovations and creations via the formation of intellectual property rights. These rights allow owners to exclude others from profiting by entering the innovation or idea space protected by the subject intellectual property. Simply put, a piece of intellectual property such as a method patent impedes competitors from using the same method to compete in the same market space. Hence the granting of the exclusionary right is quite valuable.

The second concept of securitization is the transformation of an innovation or creation from an illiquid idea to a more liquid security. Again, the granting of intellectual property rights achieves this goal. The rights vested in the intellectual property allow for the holder or assignee of the innovation or creation the ability to sell or license that property. This embedded option to sell or license the property also has significant economic value.

Disney understands that the granting of unique property rights for innovation and creations by many governments around the world substantially increases the economic value of intangible assets. Furthermore, unlike most physical assets, intellectual assets if properly managed can increase in value over time. To demonstrate how Disney and other firms create assets that increase in value over time consider that Disney understands that *securitization* generates economic value for ideas and innovation. In this context, securitization of ideas and innovation is not unlike the financial concept of securitization: the conversion of illiquid assets into more liquid assets. In the financial world, banks and other financial firms securitize illiquid loans and mortgage portfolios to extract additional economic value that result in the more liquid security. Furthermore, companies most adept at developing economic value for ideas and innovation understand the intellectual properties securitization process.

These firms understand that the granting of the exclusionary right is quite valuable and a source of competitive advantage. Furthermore, firms, like Disney, that excel at creating economic value from intellectual properties securitization understand something else. These firms understand a concept that we call the intellectual property continuum of protection.

Timing is everything

The basic relationship between functionality of protection and life of the protection among the principal forms of intellectual property (patents, copyrights, trade marks) is graphically illustrated in figure 1. At the functionally rich extreme (left) we have patents, a tool to gain monopoly rights on new methods, processes, chemistries and a raft of other highly specific inventions and innovations. A patent accommodates protection of the functional characteristics of the inventions and innovations; this is a very powerful exclusive right. The monopoly right granted in a patent however is for a limited period of time, usually 17 to 20 years depending on the jurisdiction.

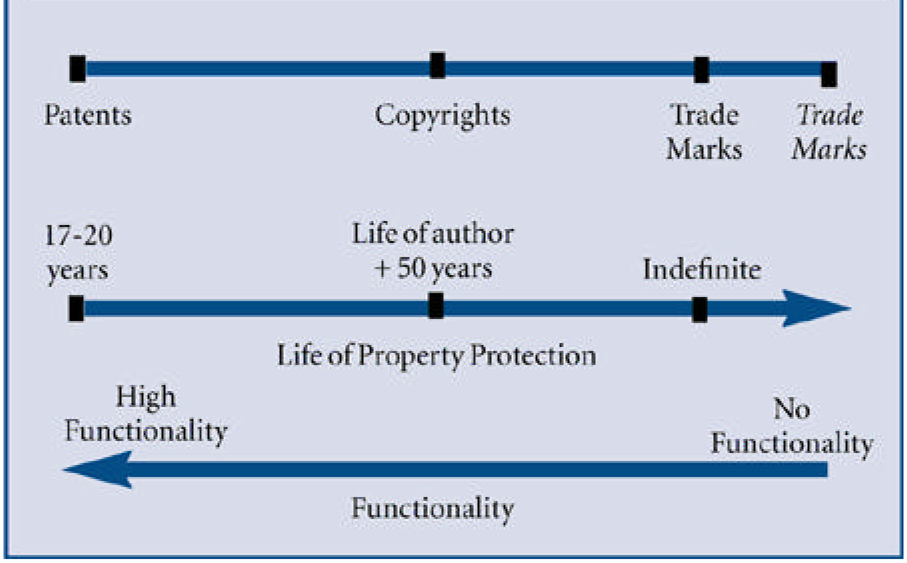
Contrast a patent's functionality and economic life with that of a trade mark or trade name. In the case of the trade mark (opposite extreme on figure 1) there is no functional protection. With a mark however, the life of the protection can possibly be infinite. Intermediate between these extremes is copyright, a less functional form than the patent, limited to the expression of an idea, but with a longer life (50 to 100 years plus). In summary, as we move from left to right across the continuum, the life of the particular exclusive right increases while functionality and breadth of protection decreases.

The relationships between functionality and life of exclusivity as expressed in figure 1 help to illustrate how a combination of patents, copyrights and trade marks can be used to build sustainable competitive advantage over long time horizons. The spectrum also illustrates why it makes very good sense to actively market innovative products under brand names protected by trade marks. In Disney's case, the same can be said for marketing and merchandising in copyrighted animations under brands protected by trade marks.

Additionally, one can superimpose the continuum on any representation of a product (innovation or idea) life-cycle. What the superimposition will tell us is that early in the product life cycle, there are numerous forms of protection including patents, copyrights and trade marks. As the product ages the value of the limited life intellectual property vehicle typically decreases unless the value is actively transferred to a longer life trade mark. If this transference is properly managed, the value associated with that idea could be extended to the life of the trade mark. Most would agree that the infinite right to exclude others from using your mark translates into a VERY long time and certainly a sustainable form of competitive advantage. Again, this is true only if it is properly managed. In those firms where portfolios of products are being managed, each product could map to a different point on the continuum.

Finally, each form of intellectual property shown in the continuum is an important source of product differentiation in the minds of consumers. Thus, monopoly rights embedded in the properties serve as protected forms of differentiation, or as Michael Porter suggests, a useful element of sustainable competitive advantage.

FIGURE 1 INTELLECTUAL PROPERTY CONTINUUM OF PROTECTION

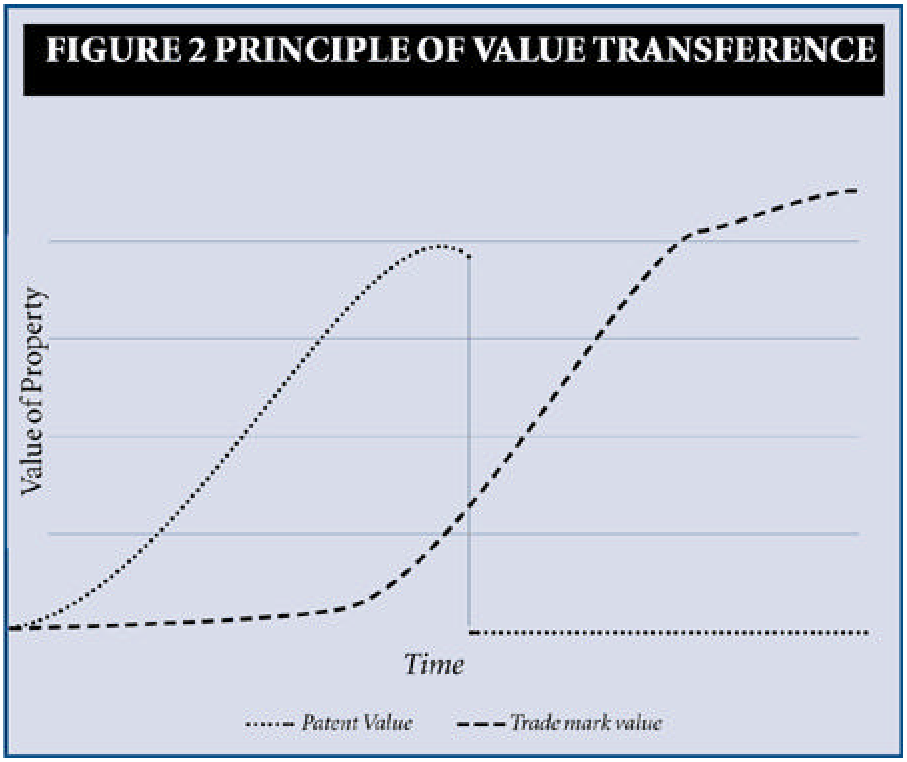


The continuum and value transference

Interestingly, the value associated with each segment of the intellectual property continuum influences (and even in some cases increases) the overall economic value secured by the holder of the securitized idea or innovation. The extension of brands and brand equity into trade marks and trade names represents a tangible example of how one can transfer value across the intellectual property continuum. Disney's management of the *Snow White* animation classic described above demonstrates our concept of transferring value from one intellectual property asset (copyrights) to another (trade marks), and in the process, dramatically increasing the value of the original animation asset.

Another example of value transference is found in Searle's purposeful branding of the patented invention of aspartame. Until 1992, Searle held the US patents on aspartame, a low calorie artificial sweetener viewed as a more healthful alternative to other artificial sweeteners. In the years immediately preceding the expiration of the patent, Searle launched an aggressive marketing campaign building up in the mind of the consumer the association between their patented aspartame and the red swirl Nutrasweet brand logo. By collaborating with their own customers, Searle successfully built value into the use of the Nutrasweet trade mark and logo as a source identifier of ingredients (Searle aspartame) in a particular food product. The advertising campaign taught the consumer to look for the Nutrasweet logo on food products where they sought the low calorie aspartame sweetener. In the mind of the consumer, the Nutrasweet trade mark and logo became synonymous with low calorie, artificial sweetener (previously covered by patent protection.)

As a result of this clever management, Searle was eventually able to license the Nutrasweet mark to many food and soft drink producers who sought to use the mark to advertise their ingredient contents on their food packaging. This proactive management of a trade mark has become what is known as "ingredient packaging" amongst marketing professionals. It is a textbook example of how the economic value of the monopoly rights vested in a patent (functional protection, short life) are actively transferred to the monopoly rights vested in a trade mark (non-functional, long life). Additionally, the profits extracted from the Nutrasweet logo licensing campaign quickly exceeded the profits associated with the economic life of the patent (figure 2).



More contemporary examples of ingredient packaging and value transference are evident on the front of nearly every laptop and or desktop computer. The "Intel inside" and or "Windows" logos on these devices assure the consumer that Intel's processors are running Microsoft's software in the subject computer. Eventually, few consumers will want to purchase a computer that does not contain these ingredient labels. As such, the value of Intel's patented processor designs and Microsoft's copyrighted software is mapped into their trade marked logos proudly displayed on the front of new machines.

We believe that the same value transference action is at play at the pharmaceutical giant AstraZenca. Their patented and very profitable Prilosec medication for gastrointestinal reflux disease (GIRD) is approaching the end of its patent protection term (April 2002). For some time the Prilosec medication has been uniquely purple in colour. Much of AstraZeneca's advertising and public domain literature features Prilosec in its unique purple packaging or as what we suspect is a trade dress protected "purple pill". It is interesting to note that the next generation AstraZeneca product for GIRD, Nexium, which is covered by a new patent is also going to be a packaged as a purple pill and hence build upon all of the consumer awareness already captured by the Prilosec purple colour.

The confluence of life cycles

Central to the idea of value transference along the intellectual property continuum is the confluence of life cycles. These can be product lifecycles, consumer life cycles, or a combination thereof. Consider again, the Disney *Snow White* example. Disney carefully studies its markets and realizes that every few years an archived film can be reissued to a new audience thus extending the life of those intellectual assets embodied within the film. With the evolution of each new demographic group (consumer life cycle) Disney has the opportunity to extend the life of its animation asset (product life cycle), thus realizing additional economic value. Disney becomes more savy and sophisticated in its marketing efforts with every reissue. The creation of additional merchandise based on the animation characters of the reissued film broadens the appeal of the movie to the intended demographic group as well as following groups and increases the economic value of the original animation characters. Hence Disney is able to capture the imagination of the new viewer and yet appeal to the previous generation of viewers. Indeed, the value of Disney's animations are increasing with time.

A source of real economic value

The management of intellectual property assets to realize sustainable competitive advantage and long term market power in dynamic industries is not something that happens by chance. When purposefully managed, multiple forms of intellectual property protection can be used to build a continuous shield of product differentiation all protected by monopoly rights. Securitization of ideas and innovations is the first step in the value creation process. The continuum heuristic described above helps illustrate and manage the change in the nature of the rights as we move from functional to non-functional protection forms. As demonstrated in a number of examples, proactive IP management can be powerful source of real economic value.

(Postscript: When I got to the front of the *Snow White* queue, the supply of videos expired. I was forced to procure them from an enterprising e-Bay auctioneer at a price substantially higher than $15 per copy. As such, Disney's cash flows from the next generation are assured.)

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