Investor Perspective: the Value of IP Management

Can a patent make you rich?

Introduction

Too many entrepreneurs and researchers believe that having a patent issued is like having your own private goldmine. Nothing is more wrong. The only thing which is 100 % sure, if a person wants to patent an invention, is that it costs a lot of money and that the patent description will disclose detailed information about the invention to the outside world. Only few patents are very valuable per se and generate a substantial revenue stream. However, a patent can be a powerful tool to protect a product and business, and the patent process in itself gives an insight in the technology world the company is working in, and an overview of the IPR protection others might have achieved.

In other words, a patent is an important ***protection of the value which can be created*** by the technology and products covered by the patent. However, in a world where the commercial lifetime of many technologies and products spans over only few years – the value of patent protection might be close to nil, as the IPR process normally is rather lengthy, and patent injunction activity cannot be commenced before the patent has finally been granted. However, the patenting process in itself provides an overview of areas, where others IPR might prevent a company from entering, and it might also be a strong bargaining tool, if there is a need to get access to other IPR protected technologies via e.g. a license.

All in all a decision to protect a technology or business via patents or other type of IPR is primarily a strategic decision, rather than a technical or financial decision. It is necessary to closely examine the degree and values of the protection achieved, and mirror this value against all the cost of obtaining, maintaining and policing the protection. Experiences have demonstrated, that many of the entrepreneurs who are looking for financing want to get "world class technology" financed – but have not fully analyzed if the technology can also lead to a "world class business".

Good technology is only a small (but important) part of a successful business. Production capabilities, sales and marketing skills, a large market and experienced management skills is often more important if business success is to be achieved.

Strategic Analysis

In many situations it is very difficult to assess the strategic value of a patent protection. However, as the cost of the initial filing of a patent is not very high, it is often advisable to proceed with a filing in order to obtain an early priority date. The filing provides a period, where the strategic situation can be better assessed and where measurement of the value of the protection, which might be achieved, can be analyzed. The Value of other strategic advantages may be likewise identified. These Values shall then be mirrored against the IPR cost.

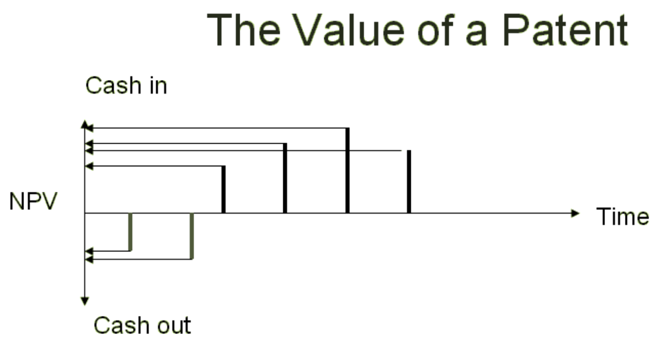
The cost analysis shall include

- Initial cost of advice on patentability and patent filing strategies.
- Cost of filing and achieving the patent or other type of IPR protection, including the cost of securing adequate geographical coverage of the protection achieved.
- Cost and possibility of policing the IPR.
- Cost and possibility of defending the IPR.

The strategy considerations shall also include how to get and pay for qualified and international experienced advisors after the IPR protection has been granted to assist in e.g.

- litigation strategies including cross-border injunctions
- National and multi-national patent litigation including revocation actions
- Drafting commercial agreements including development, joint venture, manufacturing, distribution and licensing agreements

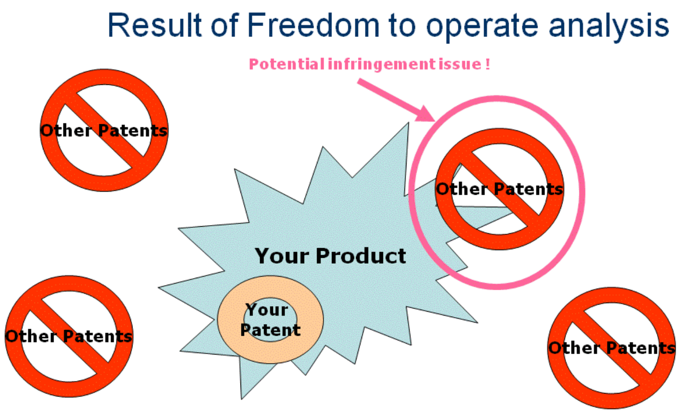
In today's world of international competition it shall not be assumed that competing products or technologies will automatically respect other parties IPR. Your IPR needs to be actively policed and defended. Hence, without taking all these foreseeable and potential costs into consideration it is not possible to estimate, if the potential value of the protection actions justifies all the effort and costs.



The costs are perhaps the easiest elements to estimate, much more difficult is it to estimate the value of the IPR protection, which might be high – however its "net present value" (NPV) is often lower than expected, when the time dimension is taking into account. When estimating the value of the protection it is important to take into account that the cost are to be paid first, while the revenues is something "out in the future", and as such associated with much more uncertainty than the cost. AND, if proper financing is not obtained to cover all cost before revenues are pouring in, the protection might be totally lost in the meantime.

Freedom to operate

Whether a company is embarking on implementing an aggressive IPR strategy, or has decided, also based on commercial strategy considerations not to follow the IPR route, it is always wise to conduct a « ***Freedom to operate*** **»** analysis. The « Freedom to operate » analysis will tell the company if its product or technology faces the risk of infringing someone's IPR. Remember that most products, even products based on a solid IPR, includes many other elements than the IPR protected element, or uses production processes which might be covered by a third party patent.



Many young companies have been faced with patent infringement claims after having launched their new product, which was "all invented by themselves". The cost of obtaining a license to use a third party IPR is normally much higher, when the third party can see how it hurts to be delayed in a sales process or a fundraising process, than if you are a small "new comer", which might never succeed in the venture. It is also worth mentioning that in some countries e.g. USA, it is possible to protect a "business concept" (e.g. "an on-line reservation system for using certain attractions in an amusement park combined with a queuing system in the park").

It is also important, when evaluating the value of an IPR protection for a young and small company which often only has few patents, that larger international corporations have hundreds or thousands patents. Hence the IPR strategy of a small company and that of a large company differs in several aspects. The young and small company primarily uses its IPR to "protect" its technology and products. The larger company not only achieve a technology and product protection, it also builds a whole bank of IPR's, which can be used as bargaining chips to get access to other companies IPR, often via the exchange of mutual royalty free licensing agreements. Hence, for larger companies an IPR achieved, which even do not lead to a commercial product might still have a large commercial value in the inter-company IPR game. A small company will in most cases need to take a much more narrow view on the strategic value of a patent.

Financing

Before entering into the full and costly patent process, it is important to analyze the whole strategic situation, including how the new business is to be financed. Once the IPR process is started the "clock starts", and funding is required to pay for each of the many steps in the IPR protection process. A general advice is to select an internationally experienced advisor with a track record in the particular field of IPR protection – even if he is costly. In the IPR game the old saying applies: "if you feed peanuts you get monkeys". Remember that it is often not the biggest challenge to obtain an IPR protection, what distinguishes a good IPR protection from a mediocre protection, is if also how well it can be policed and defended.

If venture capital is one of the sources of funding, the value of the patent protection can also be seen from a different angle, namely that of the investor. Investors in general love patent protection, but often for different reasons than the inventor. Issued patents, shows the investor that the area of technology has been searched, and that it is unlikely that a third party patent suddenly will prevent the sales of products protected under the patent. Issued patents, also provides the investment target with bargaining power to get access to licenses regarding other IPR. And last but not least, if the company (and not the inventor) owns the patent, it prevents the entrepreneur/inventor to leave the company and start producing the products himself. Thus some of the risks which an investor always fears are reduced.

Only in a few cases is it the patent protection in itself, which gives value to a company. Normally the value comes from the products the company is producing and selling, not to mention from the size of the market. But in order to attract the right investors and obtain the right valuation of a company prior to a Venture Capital investment, a well structured patent protection might be powerful tool, if, at the same time it is proven, that the products or the company has a large market, and that a reasonable profit can be made by selling products/services into that market.

Only few entrepreneurs with an idea or technology which merit patent protection can on their own complete the required strategic analysis in a professional way. They will need advices from experts with business insight and experience before they decide in the IPR route.

Universities which embark on the "patent route" for a number of there researchers, shall also have in mind these considerations, and have a realistic view on when revenues from sold licenses are going to materialize. In many cases it may take longer than expected. So substantial funding, and 'staying power' from these Universities is also required.

Despite these words of caution, active patenting of new technology is important if the competitiveness of Europe shall be strengthened. But the patenting activity shall not go on 'blindfolded' and with an eye only on patent achievability. It is equally important that the strategic business situation is put under microscope, and that the cost to be spent is carefully weighed against the potential benefit from having the patent issued.

In short

So, in short, patents as such do not generate any money. They serve as insurance. Especially for products that have long times 2 market, insurance is important so that in the end of the RTD period the invention is not stolen or brought to the market earlier by another party. Since only few patents generate substantial revenue streams, strategic choices have to be made regarding patenting and licensing. IP management therefore has an important strategic value, ranging from the international coverage of the patent filing; some countries have the most important market of certain applications, or have the most key patents for certain applications making it interesting to file a patent in those countries and not in other countries. Another strategic IP managerial decision is the filing period and process. These aspects respectively give time for further studies and the opportunity to study the competitive landscape.

IP and TT Value for Investors

For investors the value of a patent lies in more than the protection or insurance. The filing shows that the whole application area has been searched, possible licenses that have to be acquired are known and the patent gives bargaining power getting access to these licenses. Very important for an investor is also the patent owner; this should be the company, and not the inventor, reducing the investor risk. This also means that the technology transfer should occur before approaching potential investors and this transfer should be completely to the company the investor might be investing in.
Another way of solving these strategic issues is by doing a “freedom to operate” analysis. This is an efficient way to avoid unnecessary costs and troubles. Such an analysis provides an overview of all patents and other IPR which relate in any way to the business of your company.

A solid and well thought business model is more important than having a patent

For many years, the equity gap or “valley of death” is referred to as the scapegoat in the innovation financing industry. This equity gap was the problem for European early stage ventures to bring innovation to the market. Eventually the problem got heard and in various Western European markets, seed financing facilities emerged (TechnoPartner in the Netherlands, HighTechGruenderFonds in Germany, Arkimedes in Belgium …). Still, the risk profiles of many of the investors remained the same as well as the quality or investor readiness of the entrepreneurial projects. Keeping the venture capitalist with cash packed wallets at the door.

Explicitly for early stage ventures starting to expand and commercialize their business, one agrees that the success is to a very large extend related to the managerial capabilities of the management team. It is the team, and more importantly the CEO of a company who needs to execute and deliver what is written in the business plan. He/she writes the business plan about a unique offering based on a bullet proof business model that he/she needs to understand and manage. And exactly these elements seem to be hard to find.

Why is the importance of a business model undervalued?

There is a widespread awareness about the importance of innovation. At the European Commission level, it is an important element of the Lisbon agenda where it has been identified as the fuel for economic growth and a necessary ingredient to make Europe's knowledge based economy more competitive. And let there be no doubt about it, innovation in all its forms, product innovation, market innovation, financial innovation, is important. Originally, innovation is more related to process and product innovation. Herewith referring to research and technology development (RTD) as the source where innovation originates. Such innovations are mostly innovations where the intellectual property can be protected. As such, innovation goes parallel with patents. Once the innovation is protected, then one starts exploiting the opportunity by transferring it to the market, building a business plan and developing a business model.

Not going against this, it is equally important to relate the many RTD projects the sooner the better with some key aspects of business life in order to reap the rewards of innovation and to be able to monetize based on a market problem or market need. This means a quicker integration of business planning activities, building of a business models and a more focused market oriented technology transfer combined with business training, mentoring, and securing investor readiness when it needs to be presented to investors.

In particularly for RTD projects reaching the commercialization phase, it is believed that too little time is put in working out a solid business model that supports the project. In general too much is expected from the technology; too much is expected from a patent.

It is true that different investors judge differently about an innovation. In particular, when corporate venture capitalists are at the supply side then patents and technologies are having an increased importance in the selection criteria because corporate venture capitalists tend to focus a bit more on the quality and the strategic importance of technologies rather than business models.

Other private investors, generalist venture capitalists or "opportunistic" venture capitalists however, which represent the bulk of the market, focus more on execution capabilities and the competences of the management team and the offered market opportunity glued to a solid (proven) business models.

Unfortunately, investors are still too little understood. As such we failed to equally appreciate the importance to understand the ability to build a solid business model that is able to position, manage and control these technologies/patents.

Investors' View on IP & TT management

- IP serves as an insurance of the business model (Therefore alignment of IPM with the business model is needed)
- IP Management as a strategic tool;
    - Complete search of the application area
    - Possible licensing needs are mapped
    - Competitive analysis
    - Interesting markets to enter are known
    - Cost – benefit analysis
- Technology transfer completely to company before investments
- Complete ownership of IP by company