INTELLECTUAL PROPERTY DECISION MAKING

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Sectors of industry where intellectual property [IP] is important are pondering the rumors that the value of IP may change drastically over the next twenty something years. Currently 5-10% of the value of most corporations, postulations place it as high as 90% in the long term in certain sectors. At the least, it is surely to double or triple in importance from the current 5-10%. Intellectual property generally consists of patents, trademarks, servicemarks, copyrights, trade secrets, and other less-used categorizations. The first four are registerable, within the US and in most cases globally. Trade secrets are purposely not disclosed and/or registered, although value may be assigned to them (e.g. the formula for Coca Cola). Brands, also high value IP, typically fall in the trademark and servicemark categories.

A Changing Environment

Goodwill, which is the amount paid over the book value of a corporation or business when the asset is purchased, reflects the collective value of IP across all valued and non-valued categories. The non-valued value of market share positions, hard to tap distribution channels, access to select customer groups, the location of R&D centers and/or plants, and other intangible non-valued IP all contribute to purchase premiums paid in acquisitions. It is an accounting nightmare to accurately distribute and apportion the various premiums paid as a lump sum across the valued and non-valued assets subsequent to an acquisition to create the post-acquisition financial statements. As the accounting profession seeks to recognize this evolution in principles and practices, each category of IP will become more unique with a more specific *valuation definition* and therefore *valuation amount*. One should then expect new categories of IP to emerge as industry discovers its *intangible assets with real value that can be valued that do not fall under the few categories that currently exist*.

The changes in legislation and accounting principles will take years to improve and adopt for categories that currently exist and will be further muddied as smart corporations begin to lobby for classifications that reflect their own intrinsic values that cannot yet be seen as "standard and common." If the accounting profession stays consistent with past precedent changes, it will seek to maximize the amount of premiums that can be attributed to specific line item categories and establish line item valuations. It will try to minimize the amount of unattributable goodwill. Future corporate balance sheets will probably have an IP Sub-Ledger that looks much like a Capital Asset/PP&E Sub-Ledger, even if it remains in the intangible assets section of a balance sheet.

Increased Decision Making Complexity

The costs of managing IP are already significant and are likely to grow as the registerable categories will not be regulated by the competitive marketplace, but by governments. A patent in the United States often costs more than one-hundred thousand dollars and some overhead annually to maintain it. A global patent can easily reach eight-hundred thousand dollars today. Companies have a lot of work to do to decide if any given piece of IP is worth the cost to register it today in what has been a “steady-state of valuation” world. Decisions will become even more complicated in an “increasing and changing valuation” world. The life cycle of the IP will need to be netted against projected rising valuations and rising costs of evaluation, registration, and maintenance. The decision complexity will approach that of product selection and portfolio management processes where projections over the life cycle of product prices, costs, and volumes must be netted against competitive factors and market share position as the life cycle decreases and the IP value increases from generation to generation.

Current Decision Making Processes

Goldense Group, Inc. [GGI], Needham, Massachusetts, believes the rumors regarding the transformation of IP valuation in industry cannot be ignored. While the change is sure to be slow, it is sure to be real. In GGI’s biennial “2004 Product Development Metrics Survey,” we researched several emerging areas of change in IP practices. The study was conducted by a combination of e-mail and mailer questionnaires, with a small number of handouts. Net total pieces distributed was 4050. A total of 208 completed surveys were received. One survey was determined to be invalid and was eliminated. Five duplicate responses were eliminated, yielding a total of 202 valid responses included in the 2004 results database. The response rate was 5.0 percent.

One question, which asked about the number of management meetings that result in a go/no go decision, yielded a good initial baseline from which to benchmark change in the coming years. GGI asked companies to state the number of steps, based on a set of defined criteria, that were used to approve IP. The categories were: 2.5 or 3 Step, 2 Step, 1 Step, No Step (where an individual makes all the decisions), and Other. In light of one-page identification forms industry often uses to capture and/or review IP ideas, like one-page forms to capture and/or review product concepts, these initial steps are often called “half-step.” In 2004, companies are fairly evenly distributed across four of five survey categories with no responses for the Other category [Figure 1, next page]. This profile is fairly typical of the decision making process that existed when product selection processes went through a step-function increase in importance. There was no generally accepted practice in industry.

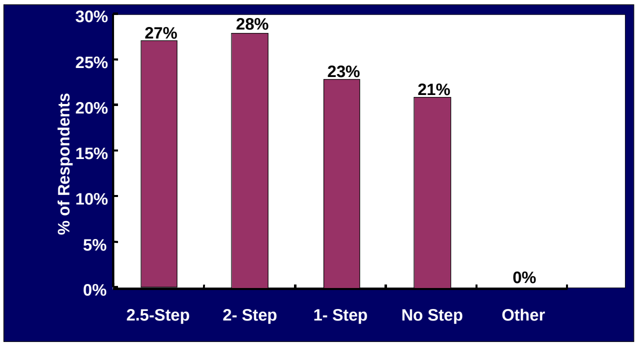

Figure 1: IP Management Decision Process

The 2004 study also enabled the creation of a profile of what this decision making process might look like in six to ten years. It is the profile of what the product selection decision process has evolved into in 2004 after many years of working to improve it [Figure 2]. While IP and Product Selection processes are not exactly the same, they are two highly analogous processes and it is not unreasonable to believe the matured business processes will be similar in years to come.

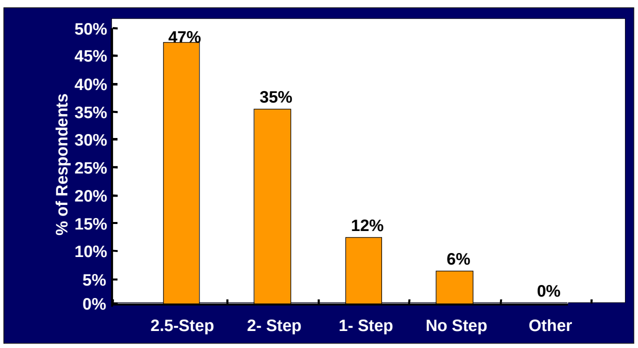

Figure 2: Product Selection Decision Process: A Predictive IP Indicator

Decision Making Lessons Learned

Below this macro-level decision process are a number of other business activities including meetings, decision agendas and criteria, personnel, required competencies, forms, documents, legalities, valuation tools, registration tools, management and tracking systems, and maintenance activities that together constitute a state-of-practice for IP management. Like product selection, if the information provided to the decision makers is not robust, the best decisions too often will not be made. The 2004 research also showed that the fewer the number of steps a company had in its decision process, the less formal the process. Conversely, the greater the number of steps involved, the greater was the degree of formality at each step and in the process as a whole. Practically speaking, if several informal meetings are held there is a better chance of a making good decision than if a single informal meeting is held. A more formal process can be

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built in the future from this basis. Companies in industry sectors where IP is expected to change in importance in the coming years have an opportunity to apply many of their lessons learned from their advances in product selection processes and techniques.$^{K}{}_{R}$