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Late to the race, not the victory

Buying late and paying a premium for the patents that a company needs is no longer just a viable IP strategy; it is a surprisingly lucrative one

The recent moves of companies like Google, Facebook and Microsoft that have been relative latecomers to patents, and are being forced to play catch-up, are an illustration that they have learned from their early miscalculations.

Once laggards, these businesses are benefiting from a late start, quickly amassing fully-embodied patent families that they can rely on now, as opposed to gambling their fate on R&D and patents yet to issue.

Balancing the right amount and type of research and patent filings with rights that are in-licensed or otherwise acquired is a strategy that more businesses are learning to employ. For those that are cash rich and creditworthy, it can make sense to buy patents after an industry starts to mature if it means securing the rights that they and others need. Overpaying rarely enters into the equation.

In 1996, when I was putting together my first book, *Hidden Value,* Microsoft had just six issued patents. It is hard to believe that an explosive software services company with billions in revenues could fall into this trap. Companies such as Microsoft, Cisco and Apple believed at the time that they could succeed on the strength of their market share, brand recognition and ability to invalidate patents and settle disputes. They have come to realise that this strategy will only take a business so far.

What some businesses might consider reckless abandon to others is prudent IP management. Microsoft's annual R&D spend is about US$9 billion - more than four times that of Apple. Although that might be a relatively small R and a very big D, it raises a very real question: what is Microsoft getting in return for its investment that Apple is not? Large numbers of patents mean something, but not much if they don't read on the right products. Patents that a business needs to prevent or win litigation, or to influence industry direction, are priceless. Unfortunately, they are only occasionally generated internally.

Microsoft's recent acquisition of some 800 patents and applications from AOL for US$1.1 billion showed it can be decisive. While US$300 million was the generally accepted value of the portfolio, Microsoft knew the marketplace well enough to pay what seemed like a ridiculous amount and then turn around and sell parts of the portfolio to Facebook for about half that price while keeping what it needed. The fairness of the AOL sale process is not the issue. Microsoft recognised how and to whom these patents were meaningful and how they might be used to neutralise its arch rival, Google.

Patent catch-up can be an effective strategy if a business has the vision and resources to play. The creditworthiness of some companies renders their cost of capital minuscule. Historically low interest rates and an enormous cash position (Apple's is US$110 billion), coupled with the difficulty of converting costly R&D into relevant inventions rights, can make acquiring relevant patent portfolios at almost any cost more sensible than self-generating them.

With the AOL transaction, Microsoft went one step further. It effectively became a patent deal maker, competing not only with operating companies, but also with non-practising entities (NPEs) and aggregators. This is a strategy that only a handful of companies have the sophistication and resources to pull off.

To date, no NPE – not even Intellectual Ventures, with US$6 billion raised – has been able to effect an IP acquisition greater than US$200 million. I can only believe that will change as investors realise the importance of costly portfolio purchases and companies become increasingly willing to collaborate on accomplishing them. Patent management is becoming more of a market-focused enterprise, balancing risk and reward with available cash and timely opportunities.

This is not to suggest that companies can be lazy about conducting R&D and filing patents. They are learning that, like the pharmaceutical giants, it is not enough to go at it alone. Today, no company can generate internally all of the innovation and rights that it needs to compete. IP management (indeed, good company management) dictates that many businesses engage in effective R&D, patent filing and licensing, as well as be able to acquire patents and businesses intelligently as risk, cash and market conditions dictate.

Paying a premium for quality is not a unique idea. It could make the game of patent haves and have-nots (and have-maybes) even nastier than it is already. If companies can move faster and speculate more boldly on what to secure, and tap into NPEs and the capital markets to help them, IP management could get even more complex.

To those detractors who believe that this is not real innovation, but mere financial engineering, I say this: if patent transactions are what it takes to get the marketplace to recognise what is inventive and what assets businesses need to succeed, it is a healthy part of an evolutionary process. If small and medium-sized enterprises, independent inventors and investors can benefit from these moves – and I believe that the smart ones can – you can be certain that IP M&A has only just begun.

The benefits to be derived from these transactions, aside from lucrative returns for some sellers, include a new respect for good patents. Recognition that the rights to meaningful inventions can have significant value, even if they have not yet been upheld in court, reflects positively on the patent system and the growth of IP management. The cold reality of patent deal making may be too stark for some. Still, it beats the cynical game of legal cat-and-mouse that currently pervades the patent world, where important inventions and valid rights, and their holders, are too often denied the recognition they deserve.

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