TRANSACTIONS POWERED BY INTELLECTUAL ASSETS

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Combine technology, brands and operational excellence with the right people to power value, says Juergen Graner at a Globalator in a book inspired by the EPO's and LESI's High Growth Enterprise Taskforce

When business decision-makers enter into strategic transactions, such as alliances, licensing, spin-offs, acquisitions and divestments, the overall goal is to generate the highest value possible. Such transactions are based on a fundamental asset or a group of assets that the source company controls. The goal is to increase the intrinsic financial value by adding a strategic value component, which comes from combining the asset package from the source company with an asset package controlled by an external transaction partner. For example, a company that has developed a new product could see a tremendous increase in value by co-operating with another company that has an established global market access to the intended customer base. In most strategic transactions the ultimate drivers of strategic value are intellectual assets, which see the best returns when intellectual property is in the hands of the right team.

Intellectual assets

The following three intellectual assets have been proven to be the ultimate value generators in business practice: technology, brands and operational excellence.

Technology and team know-how

Technology companies in particular rely on generating and owning IP rights. A lot of money is directed towards the creation and protection of patents, trade secrets and related rights, which provide the foundation for a technology intellectual asset. However, unless an organization is able to create an environment where its engineers and scientists can flourish and are motivated to continuously invent and create, as well as improve, the underlying technology will either not reach its full potential or eventually become obsolete. Technology IP only becomes an intellectual asset if combined with team know-how. Once the complexity of a transaction with an external partner is added, the challenge to manage ongoing innovation projects usually increases exponentially.

Brands and customer mindshare

The brand is almost always an important factor in any type of company. Most decision-makers understand that in order for a brand to be strong, it needs not only to be promoted, but also to be protected through a trade mark in the jurisdictions where business is conducted. Similar to technology IP, the brand IP needs to be combined with the human factor in order to become a brand intellectual asset. Different from technology though, the human factor is not within the control of the company. A brand is basically the ownership of customer mindshare, which is a manifestation within the customer's mind, created through their own experience with associated products and/or services, combined with information absorbed from others and from perceived marketing messages. A brand intellectual asset is fragile since it takes a long time to build, but, especially in today's interconnected world, it can easily be damaged. In an acquisition situation, for example, the association of the brand of the source company with the brand of the target company after a transaction needs to be managed proactively, since there is an important impact on both brand intellectual assets.

Operational excellence and implementation skills

One of the most undervalued intellectual assets for transaction value generation is operational excellence. A business has operational excellence if it is able to do something better and/or more efficiently than others on a continuous basis, with the ability to adjust to a changing environment. This could be related to any part of the value chain within the organization. Examples include a company that may have the best way to manufacture certain products, the best way to develop new products or the best way to provide certain services to their customers. The ability to possess operational excellence in a company as an intellectual asset is strongly linked to its employees and the culture that has been created internally. Many businesses write down the ways operational processes are conducted in manuals and standard operating procedures to create systems that form the IP base. However, the real value of these systems actually comes from the implementation skills embedded in the team. Generally, these team skills are not only dependent on individual team members, but are even more dependent on the culture of the organization. They are difficult to transfer and need to be managed diligently after a transaction has been completed, since they may be lost if certain key employees leave or become demotivated.

Transactions and value creation

The three intellectual assets discussed can be used to power the five most important strategic transactions: alliances, licensing, spin-offs, acquisitions and divestments. When engaging in any of these transactions, the following three phases have to be managed diligently, with a special focus on seamless management continuity from one phase to the next.

During the initial development phase, the source business is developing the assets that are required for a potential transaction. Generally, the highest value generation takes place during the development phase. Unfortunately, most companies handle transactions in an opportunistic, instead of a proactive, manner without the proper strategic focus, planning and development before they enter into a transaction.

The actual transaction phase is there to properly prepare the deal and enter into a legal contract. Although this is usually the phase with the lowest value generation, a lot can be lost if parties are not able to agree to win-win oriented terms and fail to cover implementation requirements. While involvement of lawyers is a prerequisite, the general consensus amongst experienced decision-makers is that they should not drive the deal. As a general rule, whoever will lead the final implementation phase should also lead the transaction phase.

Once the deal is signed, the transaction enters the implementation phase where both parties will need to live with the deal that they have just made. This is normally the phase with the second highest potential for value generation. Unfortunately, most companies do not have a continuous function for managing the deal from start to finish in place, and therefore often struggle with its implementation due to this discontinuity.

Alliances and strategic partnerships

An alliance, also often called a strategic partnership, is formed if each party is willing to provide assets that complement each other. Both parties commit resources for the duration of the alliance and each party remains independent. There are many different types of alliances, such as those for research and development, manufacturing, procurement, servicing, co-branding, co-promotion, referrals and sustainability.

As an example, an outbound distribution alliance is something almost any company will embark on at some point in its life when expanding internationally. The most important intellectual asset is usually the brand from the source party. The key challenge is that there is often an inherent misalignment of incentives that neither party is addressing with the other proactively before a transaction is entered into.

The distribution partner generally is only motivated to provide performance that is simply good enough. If it is bad, then the distribution partner knows that it will be replaced by another distributor. If on the other hand the performance is excellent, then the distribution partner knows that it may be replaced by the source party establishing its own footprint in the target market.

The most viable solution is to tackle this problem head on in the development phase and finding a joint solution. If the intent is to eventually take over the new target market, the source party could offer the distribution partner a more significant financial upside tied to the success after the handover or find some other alignment solution. This openness and understanding combined with a proactive management of the relationship during implementation will both grow and protect the brand as an intellectual asset.

Licensing

A licensing transaction is usually formed if a protected brand or technology asset can be useful to another party. Each remains independent and the target party will generally commit significant resources for the duration of the licence. Such a licensing transaction may be incoming (in-licensing), outgoing (out-licensing) or bi-directional (cross-licensing).

For brands, the intellectual asset is secured through trade marks in the target regions. Such brand licensing transactions are often used to expand to new markets with new product categories building on a certain, already well-established brand positioning in the target market. The key challenge is that allowing another party to utilize a brand seems like an easy way to make more money without increasing operational challenges. However, if the transaction partner does not manage the customer mindshare carefully during implementation, any backlash could have a dramatic impact on the brand.

For technology, the intellectual asset is secured through patents, trade secrets and related rights. Generally, a technology licensing relationship is entered into if the target party has the ability to use the technology in an area that the source party cannot itself evolve to the fullest possible extent. The key challenge is often not so much the transfer of the technology and the related know-how, but ensuring that the partners will really do their best during implementation, turning that technology into something

that can and will be sold in the market at a peak performance level. While a solid, well-negotiated contract during the transaction phase might provide the source party with some steering elements, such as minimum royalties, the only true formula for success is a functioning and stable win-win relationship with the partner for the entire life of the licensing relationship. It is therefore advisable to take sufficient time during the development phase in selecting the right partners and early on establish a long-term oriented relationship that is built to last.

Spin-offs

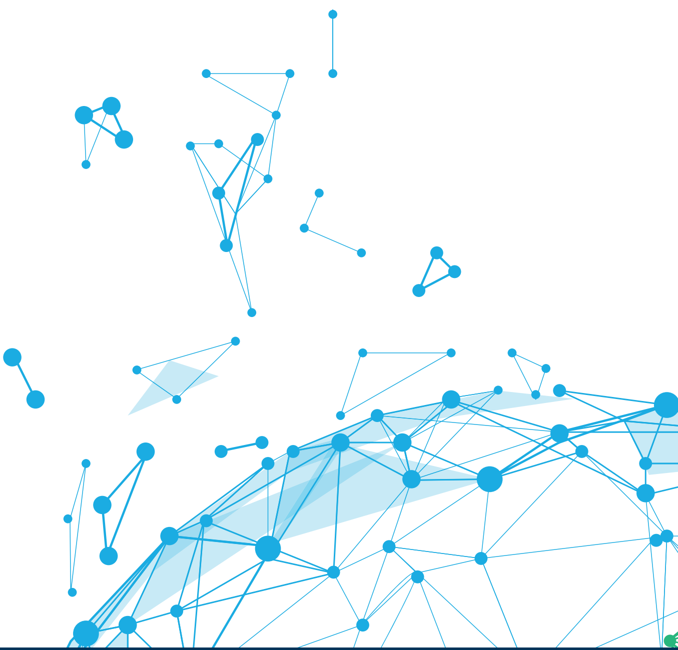
A spin-off usually gets created if either the potential of a technology intellectual asset could be enhanced through a separate entity (spin-off venture) or if a business unit no longer fits the current focus defined by the business strategy and could evolve better as a separate entity (unit spin-off). A spin-off venture is mostly based on technology IP, whereas a unit spin-off generally includes a whole team. In either case, a separate entity is created, but a strategic relationship between the two parties remains. In many cases spin-offs are created together with one or more other partners in a joint venture.

When a technology-driven spin-off venture is created, usually a new team is formed around some core technology intellectual asset that has either been transferred or licensed to the spin-off. Often separate funding is raised for such an endeavour, and the new team in the new entity starts building its own intellectual assets in technology and operational excellence around the technology provided.

The key challenge in spin-off ventures is what to do when the spin-off team finds out after the transaction that additional technological capabilities are needed from the source business. This is especially difficult if there is a joint venture partner that has provided the technology foundation for the new entity and now sees a chance for renegotiating the transaction terms. In order to avoid such a scenario, significant effort needs to be put into the development phase, creating a detailed and realistic operational business plan (not to be confused with a sales-pitch-driven business plan for investors) ahead of time. It would also be advisable to negotiate a long-term alliance relationship between the source company and the spin-off to be able to close any potential future technology gaps early on with clearly defined parameters. Although as a sole owner, this problem is likely easier to resolve, it is still advisable to be just as careful in the development phase as if a joint venture partner was part of the transaction; otherwise any change in plans at a later point might still result in an unexpected interruption of the source business as well as in the spin-off.

When a unit spin-off is created, a whole existing team from the source business serves as the foundation for the new entity, generally combined with some technology intellectual asset. By definition, the source party usually loses some of its technological capabilities and sometimes also certain commercial capabilities. Also in this case, the transaction might be accompanied by including external investors. A unit spin-off is not to be confused with a management buy-out (MBO) of a part of the business. An MBO would be considered a divestment from the selling party perspective, since generally no strategic relationship remains between the two transaction parties after the transaction.

The key challenge in unit spin-offs is often the exact opposite of the one in spin-off ventures. In this case, the source business might discover at some later stage that certain technological or commercial capabilities that are needed have been lost to the spin-off. This gets tricky in the case of a joint venture, where one source business joint venture partner suddenly asks the spin-off to spend valuable resources to provide help. It also becomes a problem with investors who are unlikely to support resource allocation by the spin-off to help the source party. The solution is the same as with spin-off ventures: ensuring a thorough development phase with the establishment of a detailed and realistic operational business plan.



Acquisitions

An acquisition happens if a selling party is monetizing its entire business (equity deal) or certain assets (asset deal) by selling them to a buying party. The buyer takes ownership of the business or the assets, and the seller generally ceases to exist. Also, a management buy-out or a management buy-in would be considered a special kind of acquisition from the buying party perspective, since they also result in a change of ownership.

Depending on the target company, an acquisition can be brand driven, technology driven, operational-excellence driven or a combination between them. Generally, technology and operational-excellence acquisitions are much more difficult to get right than brand acquisitions.

In a brand acquisition, the focus during the development and transaction phase is to understand how it was built and how it can be stretched or expanded. The advantage is that, since, as an intellectual asset, a brand does not rely on an internal team, but on existing customer mindshare, the implementation phase is less dependent on the employees staying on board. It gets slightly more complicated when the owner is personally part of the brand. If that is the case, the owner needs to stay on board for a considerable time to allow for a transition period. The key challenge for brand acquisitions is for the new marketing team to have a clear strategy and implementation plan early on. Fortunately, the buying party generally has some time to get this right.

A technology or an operational-excellence acquisition is more fragile from a management perspective. A technology intellectual asset usually consists of patent-protected technology paired with the scientific and technical know-how of the team. Similarly, operational excellence consists of well-documented systems coupled with the implementation skills of the team. Unless the technology is acquired simply to establish a freedom to operate position, and the buyer already has all the required capabilities in-house, the focus here is on securing and motivating the key employees that provide the buyer with a continuous flow of innovation and consistent operational excellence.

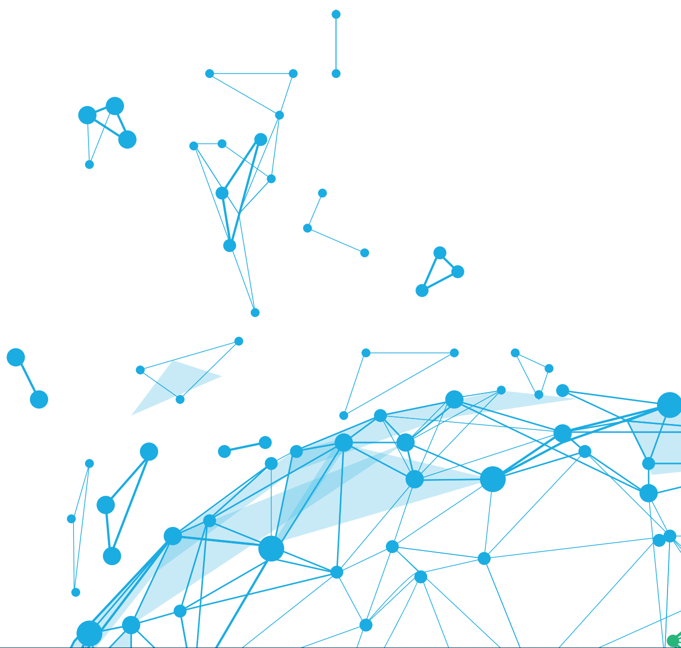
The key challenge in technology acquisitions is that the human factor is difficult to judge during the transaction phase, since it is almost impossible to get access to the full scientific or engineering team in a setting where their motivation and capabilities can really be judged. Therefore the focus has to be on the implementation phase, during which one of the key tasks is to secure and motivate that scientific and technical team. Once traction with the team is lost in the process, there is a high risk of losing some of the best scientists and engineers. In the high-tech field, many companies intend to acquire capabilities (and often also pay a premium for that) but end up having merely purchased products.

The key challenge in operational-excellence acquisitions is similar to those in technology. One difference here though is that the goal is not to ensure a continuous flow of innovation but rather to continue the status quo of that operational excellence. Since operational excellence is strongly influenced by the culture of a company, it is difficult to transfer to another entity during the implementation phase, especially to a different country.

Divestments

A divestment, also considered an exit, is essentially the other side of an acquisition. Everything mentioned above for acquisitions still holds true, but in this case the source business is on the other side of the transaction. An exit does not necessarily mean that the entire business is sold. In some cases a partial exit might be desired, where the seller only sells a certain business unit or certain assets. Moreover, several deals might be structured around a platform technology where different parts of a selling entity might be able to serve distinctly different markets with different products, in which case, a number of serial exits could be completed over time.

Generally, the biggest mistake owners make in selling their business is to consider it an end in itself during the development phase. It may be somehow counter-intuitive to associate a full divestment of a company with a growth strategy. However, this is exactly what is needed in order to create the ultimate value for the owners of the selling party, especially when the business value is driven by intellectual assets.



Most owners are torn and believe that there is a trade-off between the highest possible price for a business and the future of their employees. However, especially for technology businesses, this does not have to be the case if the business is built around strong intellectual assets. With a well-executed long-term build-to-sell strategy, starting at least two to three years before the intended sale, the focus is on how the potential future buyer of the business will be able to utilize the underlying assets in a synergistic or symbiotic way.

If the key assets are based only on technology IP without the need for the team know-how, then there is no additional strategic value for a potential buyer to keep the team in place, and the future development potential is limited. When intellectual assets combine IP with people and operational excellence in a way that someone else can build on, the seller will not only reap the ultimate exit value, but also be in a good position to secure the future of their employees. So actually securing the future of the employees in a business to be sold can increase the exit value significantly. It does not always work, but there is no downside in trying to make money from securing the future of employees — a real win-win situation.

Conclusion

Most strategic transactions, no matter if they are alliances, licensing, spin-offs, acquisitions or divestments, create the best possible value if decision-makers use intellectual assets (technology, brand and/or operational excellence) as the core drivers for value generation. Ensuring management continuity from the development phase all the way to the implementation phase is one of the key success factors.

Successful decision makers understand that IP rights, such as patents, trade secrets, trade marks and operational systems, serve as qualifiers, without which a company will not even be able to participate in the ultimate generation of value from strategic transactions. However, winning outcomes rely on a human factor that is closely in sync with the IP, whether it is people within an organization (team know-how, implementation skills) or outside in the marketplace (customer mindshare).

Unfortunately in business today, transaction management focuses too much on pure financial valuation, underestimating the people factor. This does not mean that valuations are not important, but the difference between a worst-case scenario, base-case scenario and best-case scenario is in the people. People make the numbers and not the other way around, which is especially true for transactions powered by intellectual assets.

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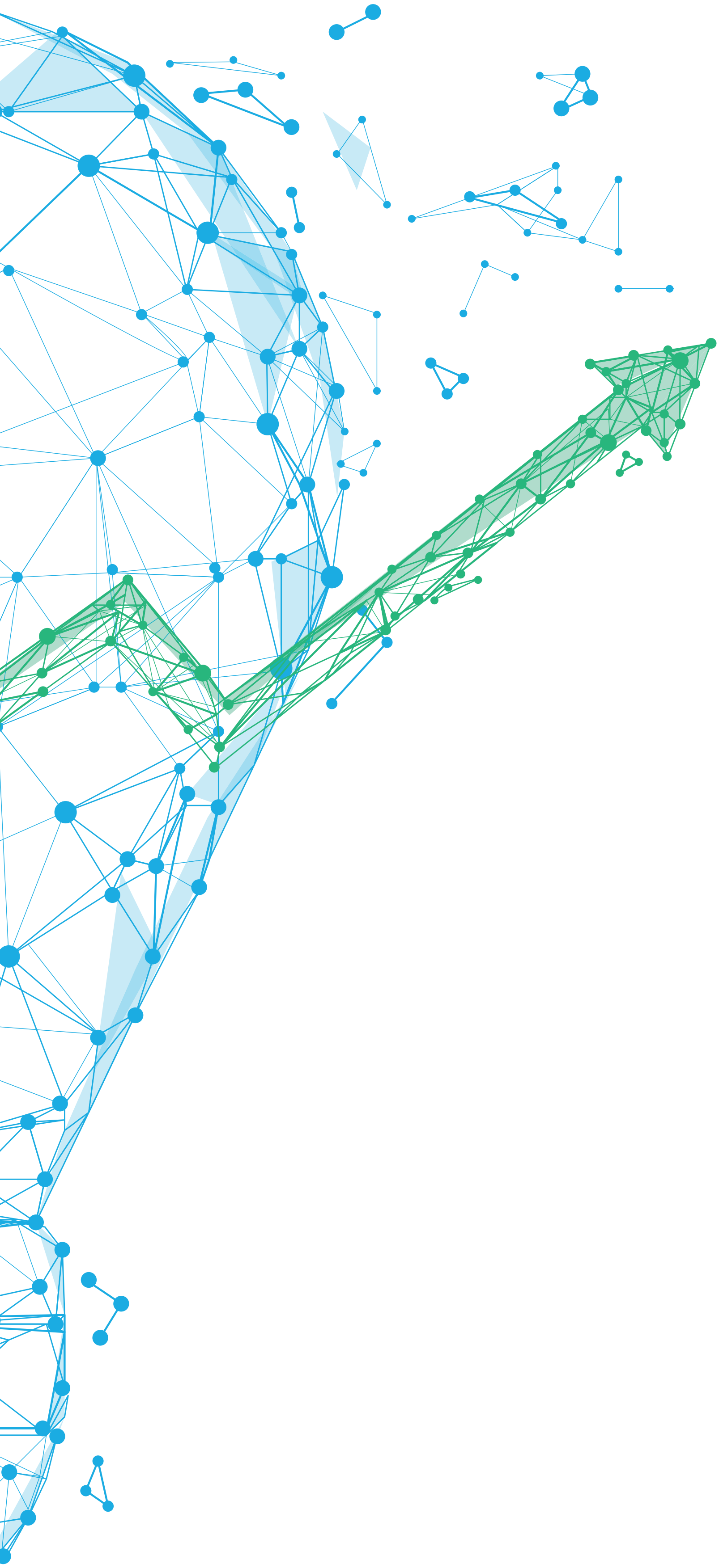

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