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How Purchasing can use Intellectual Property to Improve Results

AT A GLANCE

- For technology-intensive companies, intellectual property (IP) is a key component in many supplier relationships, and its importance is growing for most industries with increasing digitization.
- If the purchasing organization knows when and how to use IP, it can make a big difference on the bottom line – affecting price levels, ownership of or access to critical IP, and business risk.
- IP can be important for selection of suppliers in strategic areas, when negotiating rights to results, when securing background in joint or custom development arrangements, and as leverage in price negotiations.
- A key to success is often a strong partnership between the IP and purchasing organizations. The IP organization can provide the purchasing organization with IP intelligence and business-anchored guidance on which IP to secure and how to leverage IP in arrangements with suppliers, as well as IP expertise for managing challenging situations.
- Although management of IP in supplier relationships holds large untapped potential for many companies, this capability is often underdeveloped.

HOW PURCHASING CAN USE INTELLECTUAL PROPERTY TO IMPROVE RESULTS

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For technology-intensive companies, intellectual property (IP) is a key component in many supplier relationships. IP can have large impact on e.g. cost of goods sold, market shares, as well as business risk. Information about the IP of third parties can also provide valuable intelligence regarding which suppliers to engage with, and which to avoid.

A purchasing organization, supported by a business-driven IP strategy, that understands how IP can support the business and systematically applies this knowledge can make a big difference on the bottom line.

The digitization trend which is rapidly evolving in most industries and driving a need to insource IP-intensive digital technology, is increasing the relevance of this capability. Still, it is lacking in many technology-intensive companies.

SITUATIONS WHEN IP MATTERS TO PURCHASING

IP is important in all areas where innovation and further development takes place, either in-house or externally. In these areas, IP becomes important in all stages of the purchasing process.

Key situations include:

1. SELECTING SUPPLIERS

When selecting suppliers for development, production, or off-the-shelf goods in strategic areas, IP intelligence can provide decisive input. For example, it can be used to evaluate the relative innovation capabilities of competing suppliers, or to assess business risks associated with potential IP-related conflicts.

2. NEGOTIATING RIGHTS TO RESULTS

When a supplier provides a component, system or service, which is customized to the company, and is developed or specified in some degree of cooperation or co-development, it is critical to secure ownership of, or access to, results (i.e. know-how and IP expected to come out of the agreement) that will support the business, while not paying extra for rights to results that are of no business use to the company.

3. SECURING BACKGROUND

When an agreement with a supplier is negotiated that involves some degree of cooperation or co-development, it may be critical to secure background (i.e. know-how and IP belonging to the company prior to the execution of the agreement) to avoid that business-relevant background ends up unprotected or with the supplier, who could use this background in other business relationships with for example competitors, or to create lock-in situations.

4. NEGOTIATING PRICES

When a company owns IP that is of business relevance to a supplier (e.g. IP the supplier needs to be able to sell a component, which otherwise would infringe on the company's rights), IP becomes valuable currency in the negotiation and can be used to reduce costs.

THE IMPACT OF DIGITIZATION

If an IP purchasing area represents a large share of cost of goods sold, the financial impact of IP is naturally bigger and needs more attention. The introduction of IP-intensive digital technologies in almost all industries means that for most companies an increasingly larger share of cost of goods sold will come from IP-dense purchasing areas.

In these areas, new types of technology will have to be sourced from new types of suppliers that are experienced in leveraging IP in business situations. This means that purchasing organizations will need to consider and address an increasing scale and new types of IP issues than in the past.

Areas where IP can be disregarded

If you are buying standard components available from multiple sources in purchasing areas where limited development is taking place, there is often little leverage potential, or risk, related to IP.

If you cannot get the component from one source you can get if from somewhere else, and the evaluation and selection of suppliers will be based on other criteria than IP. For some industries, a large part of the supplier base belongs to this category. In other industries, suppliers are key innovators and most insourced items are customized and co-developed to fit the buyers' solutions and needs.

CATEGORIZING PURCHASING AREAS BASED ON IP RELEVANCE

Assessing and categorizing purchasing areas from an IP perspective can help focus a company's resources toward the areas where IP matters for the bottom line.

It can help to achieve optimal outcomes in regards to:

1. Selection of suppliers;
2. Relationships, agreements, and price arrangements with suppliers; and
3. Contribution to the IP portfolio and its value creation for the rest of the business.

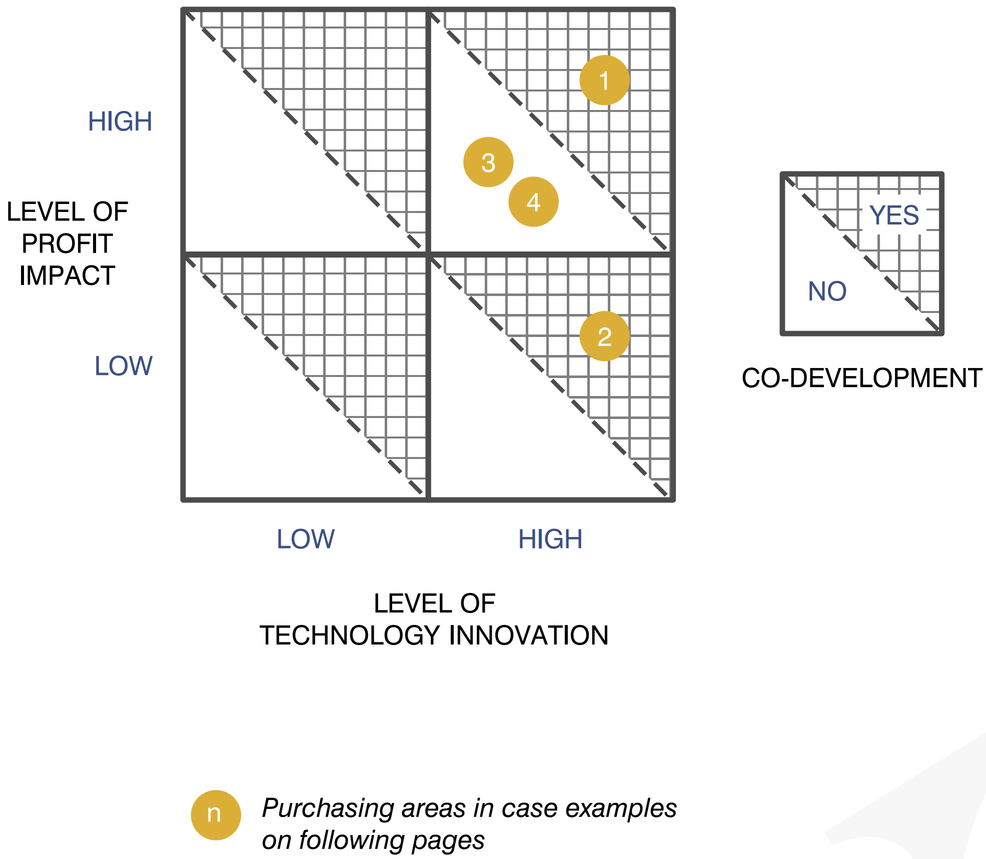
One way to categorize areas to help determine when IP is relevant to consider for purchasing, is to use three parameters:

1. Level of profit impact, i.e. the degree to which the area is of strategic importance in terms of added value that drives revenue and the effect of its costs on the company's profitability;
2. Level of technology innovation, i.e. the degree to which the area will be subject to new technological, potentially patentable, developments; and
3. Co-development, i.e. whether or not joint development with suppliers or other types of partners will take place in the area.

In general, the higher a purchasing area scores on each parameter, the more relevant IP becomes for the area. There are of course exceptions to this rule of thumb and each categorization has to be interpreted. To fully leverage IP in purchasing situations, by for example using IP as currency in supplier negotiations, this categorization must also be complemented with assessments of the strength of the company's IP portfolio relative to its suppliers. Nevertheless, the categorization can help companies to determine where and how IP is important today and tomorrow, and to prioritize resources and efforts to maximize business results.

CASE EXAMPLES WHERE IP HAS MADE A DIFFERENCE

The following pages are briefly telling the stories of four cases where IP has made considerable difference to the companies concerned. For clarity and overview they are plotted below using the three categorization parameters.

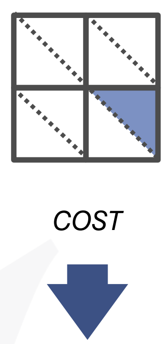


1 CASE: INSUFFICIENT BACKGROUND PROTECTION

A company set up a joint project with a supplier to co-develop a key component, without appropriately securing and pricing background IP and expected results. In the exchange between the parties, key technology ended up with the supplier who filed patents on the jointly developed component, making the company locked-in to the supplier. The supplier also made the component available on the market to competitors at very competitive price levels enabled by the R&D investments made by the company to develop the background.

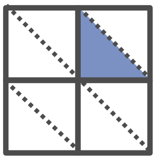
2 CASE: USING IP AS CURRENCY

A company had negotiated prices based on expected purchasing volumes. When the company did not meet the volumes, the supplier required a higher price per component as compensation. Instead of paying additional fees, the company provided a license to its IP, which had prevented the supplier from selling to others, allowing the supplier to offset the lost volumes through additional sales.



3 CASE: LEVERAGING IP IN NEGOTIATIONS

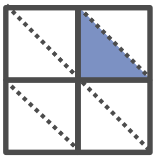
A company was going into a new market and needed to in-source a sub-system, which was heavily patent protected by the supplier. Aware of this, the company had prepared the new market move for several years and built a patent portfolio with direct relevance to the business of the supplier (unrelated to the sub-system in question). In the following negotiations, these patents where used to achieve a cross-license, which substantially lowered the cost for the sub-system, and ultimately created cost advantages in relation to competitors.



COST

4 CASE: IP AS PARAMETER FOR SUPPLIER SELECTION

A purchasing manager in a company changed supplier in the last minute after seeing an IP intelligence report. The report showed that another competing supplier had a rapidly growing patent portfolio which was quickly increasing in relative strength, while the originally selected supplier was unsuccessfully trying to build its future portfolio. This was a strong indication of the second supplier’s innovation capabilities and its expected stronger future position in a critical area.



REVENUE POTENTIAL

RISK

BUILDING INTERFACES WITH THE IP ORGANIZATION

As indicated in the case examples, substantial cost savings and decreased business risk can be achieved by actively managing IP in the purchasing process.

However, since IP is cross-functional by nature, it is normally not enough to have IP-savvy purchasing managers to secure and exploit the benefits of IP. Rather, the purchasing and IP organizations must form an effective partnership.

In this partnership, the IP organization should be able to provide purchasing with:

- A business-aligned IP strategy that provides guidance to make the right decisions;
- Support in categorizing purchasing areas from an IP perspective, i.e. where and how IP is important today and tomorrow;
- Intelligence reports informing purchasing managers on the relative strengths of the company's IP portfolio and how it can be used in arrangements with suppliers;
- Assessments of the profile and strength of suppliers' IP portfolios and alerts on changes in suppliers' IP-behavior; and
- IP expertise for managing challenging situations.

On the other hand, the purchasing organization must accept that they share responsibility in managing the company's IP. Purchasing is an important contributor to the company's IP strategy, and should provide relevant strategic input on e.g. changes in vertical integration, upcoming strategic negotiations, or purchasing areas with high impact on cost of goods sold.

CONCLUSION

For technology-intensive companies, IP is a key component in many supplier relationships. Management of IP in purchasing is growing in importance with broader needs for technology in general and with digitization in particular. It affects cost of goods sold and business risk within purchasing, and ownership of, or access, to IP of business-critical importance for other functions in the company.

Successful management typically requires a partnership between the IP and purchasing organizations to ensure business alignment, informed decision-making and appropriate expertise. Although management of IP in supplier relationships can significantly impact business results, it is underdeveloped in many technology-intensive companies and holds large untapped potential.

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