KPMG ANALYSIS

Companies Sharing Profits From Research Labs

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Companies that have depended on innovation are now sharing information with partners more frequently, often with basic research that's unrelated to their primary areas of business.

Executives from technology and health care companies in particular say a company's collective knowledge can be harnessed to create new sources of revenue, such as patent and licensing fees, that were once considered ancillary income.

"We license [products] regularly as part of our business," said David Kuttler, vice president of information architecture for Johnson & Johnson, at an intellectual property (IP) conference organized by the Executive Council of New York.

"If 40 percent of our manufacturing is done by third parties, we need to share knowledge and they need to know what IP has to be protected," Kuttler said.

With innovation being central to their business model, developing and protecting IP has long been a core competency for tech companies. According to the U.S. Patent and Trademark Office, the top 10 patent recipients in 2005 were all enterprise and consumer technology companies, with the top five being (in order) IBM, Canon, HP, Matsushita and Samsung.

Marshall Phelps, corporate vice president and deputy general counsel at Microsoft Corp., said collaboration is increasing as companies try to leverage other firms' expertise. For instance, Microsoft spent $1.4 billion in 2006 buying software code developed by other organizations.

"The shelf life of products and services has shortened dramatically, so it's incumbent upon us to work together to swap technologies," Phelps said.

Companies in numerous industries are recognizing that intellectual property can contribute to revenue. For instance, in its 2006 annual report, IBM reported $900 million in revenue from sales and transfers of intellectual property, licensing fees and royalties, and custom software development.

"Corporate America is beginning to understand that knowledge and IP are highly visible components of their corporate assets and their strategy," said Jack Nelson, senior vice president and chief information officer for Mount Sinai Medical Center in New York. "Knowledge has become a competitive differentiator and a weapon."

Microsoft spends about $8 billion annually on basic research, most of which won't be integrated into its software products. "Microsoft researchers are almost free to do what they want to do, and they develop a lot of things that would never find their way into the latest version of Windows," Phelps said.

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In 2006, Microsoft also provided venture funding for 20 companies in the United States and China to commercialize technologies developed in the firm's research labs.

In late March, Microsoft announced the spin-off of ZenZui, a company that has done research on improving access to Web content on mobile phone screens. Microsoft will retain a stake in the new company, which also received investments from two venture capital firms.

Other technology being offered on Microsoft's IP Ventures Web site includes wireless roaming between telecommunications providers, face detection and tracking, audio correction algorithms, automatic photo cropping, building material estimations and river flow modeling.

Contract manufacturing and product licensing are taking place globally. Phelps cited the example of an airplane whose wings are built in Japan while the fuselage is built in Italy, the engines are built in the United States and the United Kingdom, and the various sections are flown to the United States for final assembly and integration.

"There is a lot of intellectual property that has to be shared at the front end of this process," Phelps said.

Cooperation is also increasing between companies in putatively different industries. The importance of supercomputing in pharmaceutical research, for example, is prompting computer and drug companies to collaborate on supercomputer technology and design.

Collaborating on IP can also help reduce patent disputes between companies with similar technologies. Phelps said cooperation can often take less time and expense than litigating intellectual property battles in court.

"Most people think of patents and intellectual property as a 'negative right' -- as the right to stop people from doing something," he said. "Most times, this is a false hope. Very few patents can stop someone from doing something because if it's worthwhile, they can find away around [legal defenses]."

Despite the increased collaboration, however, the value of patents means they are likely to remain a fertile source for litigation. A federal court in San Diego in February awarded a $1.52 billion judgment to Alcatel-Lucent against Microsoft in a dispute involving MP3 audio technology. For its part, Microsoft, which is appealing the MP3 jury award, has filed claims against Alcatel-Lucent with the U.S. International Trade Commission over the use of unified communications technology.

A number of health-related intellectual property challenges are also looming on the horizon. For example, companies conducting genomic research, insurance companies and consumers are likely to have disputes about who owns specific patients' genetic profiles and how that information is used, Johnson & Johnson's Kuttler said.

Similarly, according to Mount Sinai's Nelson, business process patents could hinder collaboration if they are applied to health-care procedures.

Because medical research often builds on previous discoveries, Nelson said institutions may have problems obtaining research grants or could be reluctant to take advantage of new developments if they have to deal with patent or licensing issues associated with new treatments or techniques.

"I'm very scared that the altruistic traditions in medicine could be diluted if someone gets a patent for a new way to repair someone's aorta," Nelson said. "I hope that never happens."

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