

# COMMODITISATION OF IP PROFESSIONAL SERVICES

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## The key questions

- What is commoditisation and what is the evidence that it is occurring?
- Why is it happening and should you be concerned?
- Examples and lessons from other professional service sectors
- How should you respond?

*"Lawyers tend to fear commoditisation for two reasons. First, the very term seems to devalue the practice of law, reducing it to a mere commonplace. The second is a fear of the economics of information commodity markets. An on-line legal service is an information commodity, and competition amongst those who sell information commodities tends to move the price towards the marginal cost of reproducing and distributing the information, i.e. to the cost of producing one new copy. Because this cost is negligible, the prices of information products, where there is competition, tend rapidly towards zero. Lawyers fear services whose price is zero." Richard Susskind 'The End of Lawyers?' Oxford University Press 2008*

## My thesis in brief

In the eyes of an increasing number of clients all professional service firms look alike. Their services are viewed particularly by sophisticated clients as a means of achieving a number of well-defined *outcomes* that are available from a wide range of firms. As such they are increasingly willing to use cheaper and often internet based suppliers for instance to achieve those outcomes or through RFP<sup>1</sup> type processes seek the lowest price supplier who can produce those outcomes for it.

This attitude has been fuelled by service providers not updating their offering to meet or sufficiently understanding the evolving needs of their clients and by their reluctance or inability to communicate their unique value to such clients. The value of a soundly drafted patent speaks for itself, doesn't it...?

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<sup>1</sup> Request for Proposal/Tender

The perceived value of patents and other forms of IP have been devalued by the perceived drop in standards of acceptance by many IP agencies. Additionally moves to simplify and standardise processes and reduce national legal differences also leads to a lack in need for professional advice or guidance.

Patents themselves are being treated and traded as commodities with more emphasis perhaps on quantity rather than quality, the perception being that only very few companies with exceptionally deep pockets can afford to test their real worth.

Then there is the profession itself. Historically, high profitability, poor business practices, lack of partner accountability and focus and under investment in innovation in services offered and service delivery have only compounded the problem and attracted competitors.

To avoid this commodity trap, firms must become far more adept at diagnosing their clients' business needs, developing innovative targeted and cost effective solutions, and above all communicating this value to the client in terms relevant to the client's business.

In short an attorney must become a trusted advisor to the client, partnering with the client to deliver perceived and tangible value to their business operations.

In the absence of such a relationship, clients will view low-cost as the only discernible 'value' delivered by their commodity provider and purchase accordingly.

This approach must be matched by a far greater attention to the patent attorney firm's strategy and its supporting business model which commoditization fundamentally threatens.

The key concept is then one of communicating sufficient 'value' in the client's mind and being able to deliver on that promise. This boils down to making strategic decisions about where you can credibly offer such value and ensuring that you have a business model which can deliver it.

**Key points I'll attempt to cover:**

- There is clear evidence that commoditisation is occurring and it is not likely to be a transient phase – it is a very common phenomenon across all sectors including goods and now more frequently services. It is *not* simply an outcome of the GFC and the understandable desire of clients to reduce their costs – this trend has been evident in most service sectors since the 1970s – now greatly accelerated by ICT enabled business models
- It is driven by broader economic and technology enabled trends and forces outside the profession, but the profession, because of its dominant business model and the vagueness of the strategy it is meant to support, makes many firms particularly vulnerable - some more than others
- It's not that *all* the services attorneys offer will become commodities but that some of the currently most profitable ones may well be and some firms may not be able to survive with their current strategies and business models on what remains or at least face painful adjustments
- There are a wealth of examples which can be drawn upon to assist you to understand, respond, manage and even take advantage of the situation

- There is no 'silver bullet' however. The answers will lie in a combination of your strategy and the business model that supports it - and the need to recognise the implementation of those concepts within the context of your own firm and client base
- Finally - The profession as a whole needs to develop a collective response which assists firms respond including better data an increased profile and developing better business skills.

### What is commoditisation?

When we talk of commodities we usually think of goods like wheat, iron ore, bread, milk and the like. Think also of services such as air travel, courier services, internet service providers, on line brokerage.

The common characteristics are usually that:

- there is a large and wide, often world-wide demand and sources for such goods or services
- the goods are undifferentiated i.e. subject to basic quality requirements you can't tell where they come from or who supplied them
- pricing is usually set by very open and competitive means driven primarily by supply/demand dynamics rather than a willingness to pay for some actual or perceived value or added features
- Those companies who compete in these markets are usually required to be large, well-funded, efficient, and be prepared to exist on razor thin margins - except of course when the commodity is in short supply or demand is very high or they are protected monopolies or, in the case of oil, a cartel.

So why is commoditisation feared? Don't big players in the commodity market make big profits e.g. BHP? Why wouldn't you want to get into that business or a business that has those characteristics?

In essence my approach here is that there is nothing to be feared from being in the 'commodity' business no matter what product or service it is **providing your strategy and business model in all its characteristics is set up to suit that type of business**. And it's not just about pricing, it's about every element of your business model. If your strategy is to do such work then make sure your business model supports and can sustain it over time and the firm's other activities are not compromised directly or indirectly by such commodity style services.

Think briefly of the demise of the typical city based newspaper. Its business model has been fatally compromised when the 'cash cow' of classifieds and then all print ads was attacked by on-line competitors like Craigs List in the US – estimated to have wiped off \$25 billion in ad revenues from the print media since 2005<sup>2</sup>.

Such newspapers eventually found that their news coverage and journalists could simply not be supported merely by the cover charge for the paper alone or by revenues generated by their slow entry into competition in digital distribution and advertising. Similarly witness the music business, where Apple's strategy and business model and the iTunes 'portal' has completely supplanted that of the once all powerful record companies. Amazon's impact on the book business is readily apparent. In both Apple's and Amazon's case it is highly significant that the content they offer is not generated by them but is sourced from 'traditional' content creators, artists and authors

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<sup>2</sup> 'Reflections of a Newsosaur' – Alan D. Mutter - <http://newsosaur.blogspot.com.au>

and software developers through the 'App' phenomena. The portals take a very heavy share of the profits and also dictate the low prices at which content producers can sell via their sites to attract customers in high volumes.

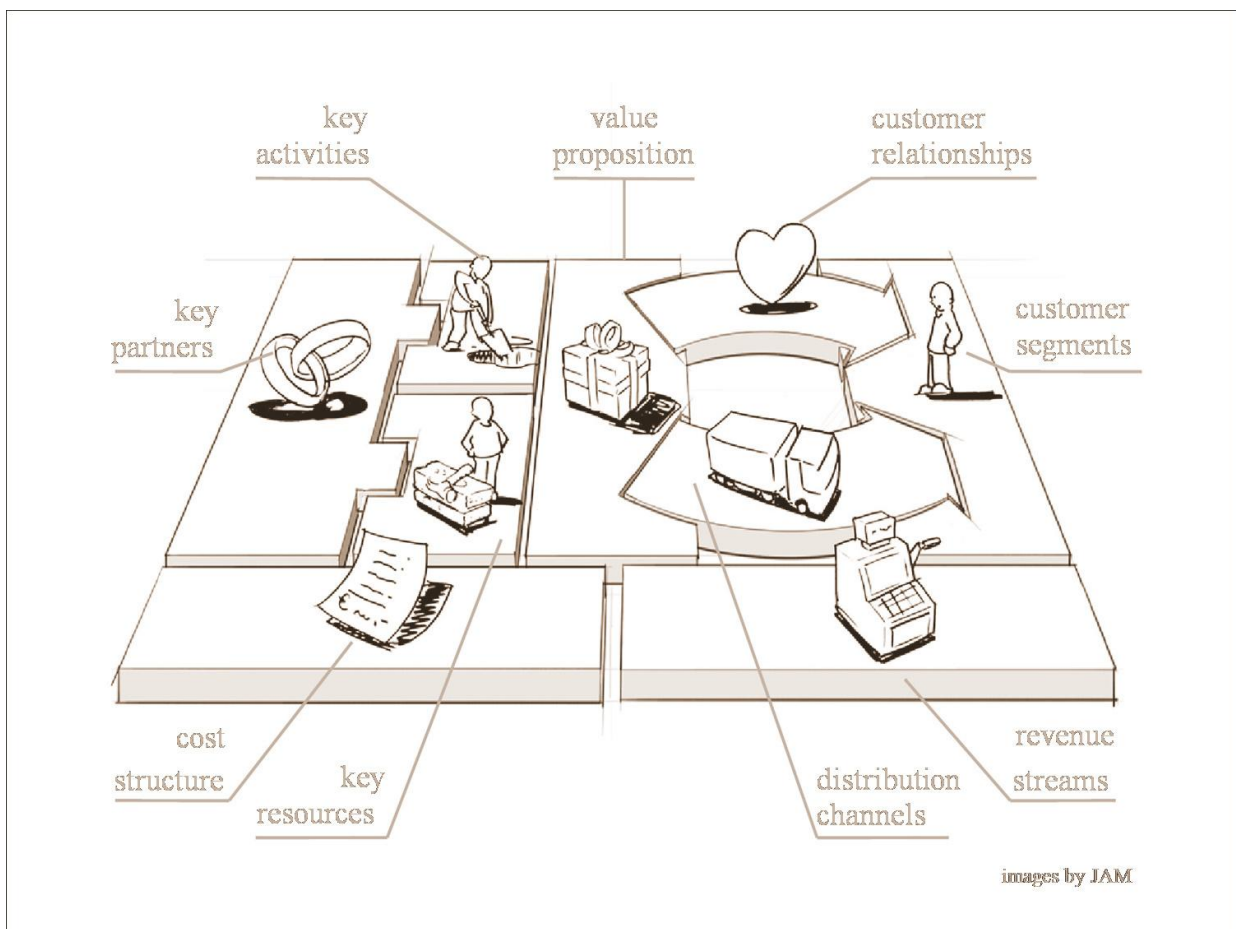
Witness also IBM getting entirely out of the booming PC manufacturing business when PCs became a commodity, selling to China's Lenovo, to focus on services which it sees itself as far better suited to create, deliver and differentiate. There are also several examples in the legal sphere as well which I'll discuss later.

### The 'classic' case

Consider briefly the classic ingredients of our capitalist model.

Firms *compete* to supply clients with services that they *value* at a *price* they are prepared to pay and at a *cost* to the firm which will enable it to make a sufficient *profit* to continue to supply such services at a profit level that sustains the business model over time.

Here is a simple but powerful representation of the key elements of a business model created by Alex Osterwalder & Yves Pigneur.



(Alex Osterwalder - [www.businessmodelgeneration.com](http://www.businessmodelgeneration.com))

## So how does the 'usual' attorney business model firm read onto this generic model?

Patent attorney firms often offer a wide range of services, targeted at ill-defined and often quite diverse clients and markets, at prices which are commonly sufficiently high to generate between 25-50% profits for the owners. Costs are relatively high, particularly wages, rent and IT. Profit expectations are also very high. There is little serious attempt to 'brand' or differentiate services. It's long been seen as a 'relationship' based business protected by high barriers to entry through academic requirements and protection by statute.

Critically however not all services or specialties offered by such firms are equally profitable and depending on the nature of the expertise being offered there is a great deal of cross subsidisation between partners and in respect of different types of services.

This is often not obvious and masked by:

- equal and some would say, uncritical profit distribution
- lack of any firm wide strategy or direction
- poor internal analysis of costs and where and how profits are made
- lack of leverage in who and how the work is done
- lack of discrimination or focus in deciding what work they will do let alone how that work is to be performed

In effect a typical firm is perhaps best considered as a cluster of often quite different 'businesses' operating under the same roof or name. There is commonly no guiding strategy to direct or inform partners which services, what markets or clients they should focus upon nor what pricing, staffing or resources might be required to maintain or drive profitability. In short the strategy and supporting business model is not clear at all. On analysis therefore it could be argued there are *several* models and strategies in play at any one time if only it should be said by default rather than as a result of any deliberate decision. This is often quite wasteful of resources, brand and weakens the collective strengths that should be developed in a firm environment. In many cases the 'whole' is much *less* than the sum of its parts!

In short the strategy the business model supports is often loose and vague....'we take on all work from all sources and we permit wide variation in how that work is performed, priced and costed'. Historically profits have been high enough to support such a loose model and 'strategy'. The question is how long will that continue to be the case when faced with a rising number of more focused, better funded and more efficient competitors?

How does commoditisation threaten that model?

### A clear example...the attack of the 'portals'

I'll take the most obvious and perhaps the most critical current service that is being commoditised as an example. I'll describe as the 'portal' strategy.

Many firms derive substantial profits from national phase filings carried out on behalf of often international companies and their attorneys. This has been highly profitable work which has often required little professional advice and is largely carried out or managed by what amounts to para-legals within the firm overseen by attorneys.

The price for such services has often been 'agreed' as between agents with the patentee having little choice or say in what is to be paid for this phase of the work. Renewals and assignments also fall into this arena.

This type of work is contrasted with what is often referred to as 'local work' where advice is provided and patent specifications are drafted for primarily locally based clients. Much professional time and expertise is often devoted to finding and performing such work and charges are often low or discounted and seldom reflect the hoped for 'hourly' rate. Fees are often designed to encourage the patentee to continue a broader patenting program when charges for subsequent work (often the less demanding work) increase on a 'flag fall' basis and more substantial profits made. In many cases however those hopes are not realised. In marketing parlance this type of work is seen as a 'loss leader'.

So what's wrong with this? In several firms I have seen the *profits* of the firm are almost entirely derived from what I've described as national phase work originating largely from overseas. It is that work, which, because of its profitability, cross subsidises the rest of the work the firm carries out, particularly its local work.

Even if that national phase work comprises only 30% of the firms gross *revenue* it may be responsible for 50% plus of the firm's *profits*. A reduction therefore of say 50% in the profits derived from such work will cut the whole firms profitability by a similar amount, despite it only comprising a third of the revenue the firm generates. In many firms almost none of the 'local work' generates any profitability at all if costs associated with it were properly allocated - if the partners stopped doing such work altogether overall profitability would probably increase! That not surprisingly is not seen as an attractive option though in the past I am aware some firms actively discouraged the pursuit of such work preferring not unnaturally to focus on securing as much national phase work as they could.

Any attack on that 'national phase' type of work therefore will have, and has had a marked effect on many firm's overall profitability and may eventually put the firm's whole business model in question. I have heard figures of charges for such work being reduced by 50% for instance.

Can the firm in those circumstances afford to pay the partners the same historic levels of income, the juniors the same wages, pay the same rent or indulge some partners in continuing to work in unprofitable sectors or in an 'inefficient' fashion or for obviously unprofitable clients? What effect does it have on the likely appointment or retirement prospects of partners? And what about the way local work is sourced, priced and performed? These are serious and continuing issues.

This then is precisely the area that inovia and others have targeted. Not surprisingly this has resulted in either loss of such work or firms being required to reduce their fees to compete with the lower prices being offered by such groups and the firms that support them. Similar activity is also obvious in the trade mark area. Those offering such services through aggressive internet portal based sales strategies, selectivity about what they offer and whom they target and direct approaches to more significant users of such services, have effectively stepped between the attorney and their usual source of work. Having done so they have then induced a frenzied price war between firms as they try and outcompete their rivals by offering lower and lower prices for the outcomes they promise. Low price is the number one 'value proposition' they offer their

clients. The only 'doorway' to such clients from the attorney perspective is increasingly seen as being via such 'portals'.

This is a classic commoditisation strategy on the part of such a 'disruptive'<sup>3</sup> competitor. They have correctly identified that there is a large worldwide market for such services, it is relatively cheap to provide and does not require the same level of investment, close personal contact, client knowledge and professional service as other services provided by patent attorneys might. In short they are targeting and eating the 'cream on your cake' and there is every reason they may start finding the rest of the cake pretty attractive as well!

Their strategy is clear and they have built a business model to support such a strategy and in the process devalued the worth of the very 'product' they are selling.

Internet portal companies have selected and 'unbundled' the most profitable section of the work performed by patent attorneys in much the same way the classifieds have been lost to the daily newspapers. Many firms have taken the view that if you can't beat them you might as well join them and prices and arguably standards have fallen accordingly as sales teams from such 'portals' scour the globe offering ever discounted packages to potential clients.

The threat to many firms is obvious as their 'cash cow' looks not only a little sickly but is no longer producing any cream!

### **Trends in professional services**

Such types of activity, particularly where such large savings are proffered is often client driven or at least they are receptive to it. They are prepared to consider such alternatives and are prepared to experiment with such new providers even at a cost to established relationships they may have with their existing patent attorneys. They are comforted of course by being assured all such work is nevertheless being performed either by their usual attorney or by what they perceive as an undifferentiated similar provider. Quality at an often 'fixed price' suffers accordingly.

Clients in these cost conscious times are increasingly managing costs through their own in house departments or through external 'cost management consultants' and see the potential for great savings to be made. Previous 'cosy' arrangements between firms who swapped work of such nature internationally have been disrupted as clients are 'sold' or become aware of cheaper alternatives, which in the absence of arguments to the contrary offer similar or at least indistinguishable 'value' propositions. Clients see little to differentiate the services supplied by such 'disrupters' from those supplied by their existing attorneys and are quite happy to see portions of their work 'unbundled' in this fashion. There is little sympathy after all, for the firm now doing the same work for a fraction of the cost which the client may have been paying for many years previously.

National phase filing is but one example. Trade mark profitability has already been dramatically curtailed and the message is that any service your firm might provide, particularly if it is capable of generating high profitability with a modified business model is likely to be attacked - most likely perhaps by people whom you would not consider to be your competitors.

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<sup>3</sup> See Clayton Christensen and Michael E. Raynor 'The Innovator's Dilemma' and 'The Innovators Solution' Harvard Business School Press 2003

## The legal business

To take a legal analogy - when I went to my first legal business conference in the early '80s a collective P&L disclosure by each of the participating firms showed that all but one firm derived in excess of 50% of its profit from conveyancing! Nowadays that would be less than 1% in the more profitable firms. Such work is now conducted largely by small firms who either do nothing else, (and make very much less of an income), or it is performed by licensed brokers who charge a fraction of what lawyers used to charge. A similar situation now exists with respect to wills, tax returns, incorporation etc. Much of this documentation is now also available on-line or delivered to clients via the same 'portal' based strategies now intruding into the patent arena.

Law firms were deriving 'super profits' from such services and were overly dependent and exposed thereby. This encouraged 'bad habits' such as pursuit of unprofitable work or clients, cross subsidisation, (often not acknowledged or understood), poor business practices, overly generous partner and staff remuneration. Pre-computerised accounting systems this was understandable, if not wise but such 'willful blindness' is now tantamount to financial suicide.

New strategies and business models were required if firms previously heavily dependent on conveyancing were to survive. These were aggressively pursued. They included increasing use of professional management techniques, mergers, fresh services, leverage, better business practices, training and a close eye on profitable clients and services and greater partner accountability. Incorporation, even public listing is now a reality as firms seek capital to compete, tap new markets and to innovate and differentiate their services. In the area of personal injuries the firms concerned have gone to a revenue model where the client only pays on a successful outcome and all costs and risk are carried by the firm.

To return to the patent attorney situation one can for see therefore that in the future much of this 'unbundled' work will be performed through or by portal type organisations or by small firms whose cost structures and profit expectations are geared to perform that type of work. In short their strategy and their business model is adapted to do this type of work.

This is not to say that all such work will be lost or become unprofitable. Strong client relationships, opposition work and the need for particular expertise will remain important differentiators but the question will be how often is that going to be a determining factor in a client's mind and how much will they be prepared to pay for it? Even more concerning in the long run will be the close nexus the portals and their ilk will have established, particularly with the larger clients. They will, through their 'portal' strategy progressively offer an ever wider range of services and be increasingly in a position to dictate prices to firms.

There will be a need therefore for firms to ensure their overall strategy is not too dependent on such work continuing at historic high margins. Firms must look for ways to replace or accept the lost profits from such work and ensure their business model and strategy in their other activities is not compromised by loss or reduction of such work. It is a vain hope to expect the fees for such work to return to 'pre-portal' rates, that genie is well and truly out of the bottle. The challenge to firms is to grapple with such reduced profitability and to adapt their strategies and business models to ensure their services cannot be further commoditised in this way.



## How do other sectors cope?

Firms outside the professional services environment spend vast sums on advertising and branding in order to distinguish their goods and services from those of their competitors even when there is no realistic difference. The supermarkets (being in effect 'bricks and mortar portals') respond by offering generic branded products such as flour, sugar, milk and an ever increasing range of 'home brands' as customers become aware of the lack of any 'real' added value provided by the 'branded' alternatives. They also relentlessly drive down the prices the manufacturers are able to charge to sell their goods on their shelves. ALDI's whole business model for instance is based on offering no branded goods which takes even that avenue away from the manufacturer who is left in the role of being a generic supplier.

The rise of the generic drug market is another sector in the news. Initially a drug is protected and differentiated by its patent and then faces commoditisation when that protection expires. How do the patentees respond? As you know they use every possible argument to extend the term, filing thickets of patents, going into the generics business themselves, attacking 'imitators' and seeking legislative protection and of course lobbying such legislators. Recently it is alleged competing generic manufacturers have even been paid to keep their product off the market. It is a point of concern however that without the profits previously enjoyed the substantial R&D and approval process required to bring new drugs to market the development of new products will be substantially eroded.

So how does that read onto the patent attorney sector? As previously observed it is not just about price. The impact of lowered prices and profitability impacts the whole way in which the firm does business and organises and resources itself. It is quite possible to make profits in a commodity market but NOT with the same strategy (or lack thereof) and business model as you may previously have operated with.

A lesser cost structure would be essential, cross subsidisation of unprofitable sectors and services would have to be reviewed as would pricing of other services and capital, hiring and partnership structures would require close scrutiny. None of this is easy or necessarily pleasant but wider economic trends are driving such restructuring across a wide range of industries.

Look at the media and music industries in particular, think about the wholesale relocation of manufacturing to low cost destinations such as China, Vietnam and the like. Consider the impact of low cost providers in the airline industry, the impact of Japanese manufacturing techniques and organisations in the car and electronics industries and the impact of Indian based outsourcing in the IT sphere. A whole new suite of skills have been developed to manage long logistical support supply lines, foreign sub-contractors and 24/7 research and development in order to enable firms to continue in these markets.

Professional and other services comprise 70% of almost every advanced economy, and Australia is no exception. It attracts considerable attention from legislators and increasingly figures in trade agreements as you know only too well. If mature economies are to improve their productivity (and services have been slow to demonstrate much if any such improvement), then legislative intervention to provide an even freer markets is inevitable. Driving costs down is a mantra shared across the political spectrum.

Profits in the professional service sector have been very high and the size and economic impact of accounting, legal and other professional service firms is increasingly obvious. Such attention attracts entrepreneurs and invites attack and these attacks will only continue particularly as IP increases in importance and profile. IP is seen as a key 'differentiator' in practically any market despite its 'devalued' basis as earlier discussed. The investment of private equity giants such as Criven in funding such firms as CPA Global is a case in point<sup>4</sup>.

### Responses to commoditisation

These are all potential 'differentiators' - bear in mind these have to be clear to the client to have any value:

- deep subject matter knowledge in client relevant areas - reputation
- close relationship with client - decision makers and technical specialists
- industry knowledge - solution orientated
- client relevant knowledge, connections and skills outside traditional areas of attorney expertise
- client collaboration and risk taking
- transparent and optional pricing and payment mechanisms
- flexibility of approach and 'easy to do business with...'
- reliability and consistency - no surprises!
- innovation in services offered, packaging or bundling of services and delivery and utilisation of ICT technology
- splitting and managing, in the client's best interests, the spread of bespoke and commoditised services e.g. outsource search, bespoke drafting
- applying appropriate leverage to ensure associates and junior attorneys are utilized appropriately to reduce costs to clients

### So what's to be done?

1. The first requirement is to get commoditisation and its possible ramifications 'on the table' in your firm. In particular get the necessary data and understanding of your firm's strategy and business model appreciated by all your partners. What are the key assumptions underlying the way you do business? You need to start any 'strategic decision making process' from a shared basic understanding of where you are now. What value do you offer clients, how do you make money, what services, what clients, what industries etc.? What won't you do?
2. Where do you want to be in terms of profitability, size, structure and location(s)? What services that you offer are capable of differentiation, likely to grow, attract premium pricing? What areas should you avoid?
3. What is your cost structure and how might it be changed to ensure costs are properly allocated where they are incurred? When pricing is an issue you need to know what you can and should charge for the service you are providing. Discounting may well be an

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<sup>4</sup> [http://www.cpaglobal.com/media\\_centre/press\\_releases/5100/cinven\\_completes\\_acquisition\\_o](http://www.cpaglobal.com/media_centre/press_releases/5100/cinven_completes_acquisition_o)

acceptable option but for what purpose? Impact of a 10% 'discount' may cut profitability by 50% if your margin is only 20%!

4. What about your organisational structure and accountabilities? Does everyone pretty much 'do their own thing' with all its attendant costs and lack of focus? Would a strategic plan or at least discussion help clarify where the opportunities best lay for the firm and where you can add value sufficient to differentiate yourself, attract and retain clients and build the business? i.e. focus your resources to best effect?
5. Would merger/acquisition improve your client profile, reduce costs, increase your geographic appeal or introduce new expertise? More importantly might it enable you to make fundamental changes in your strategy and business model?
6. What about your hiring and career policies? What are your associates' understanding about what is expected of them and how they can progress? Are you rewarding the right activities and attitudes and ensuring the firm is not held hostage to an outdated model or those persisting in clearly unprofitable areas?
7. Think about where the firm is most exposed to commoditisation - are you going to compete and if so how? What added value can you offer? Can you differentiate your services to sufficiently justify your fees and just as importantly can you communicate those messages in client relevant terms?
8. What about innovation? Are there new services or bundles of services you can offer or new ways to offer or deliver those services that again will differentiate yourself from the competition?
9. Do you need to introduce or access additional capital to invest in developing your brand, range of services or geographical influence - should all the profits of the firm be paid out every year?
10. Do you want to go into the commodity business in any event? Compete with inovia and what about CPA Global? Does outsourcing for instance provide any workable alternatives?
11. What about diversification? Does the addition of say legal or other services, say valuation services, provide a differentiator that might attract clients?

#### **In summary:**

- ✓ competition is facilitated by innovative business models, new strategies and globalisation attracted by the high profits available and new internet based technologies
- ✓ you *can* compete, but not in the main by using existing strategies and business models
- ✓ client sophistication, reduced resources and clients' better understanding of patent attorney services will continue to drive changes – denial is not an option!
- ✓ fresh strategies focused on very specific client business outcomes and continual attention to every element of your strategy and business model is the only defense and will lead to new and innovative firms, strategies and business models emerging.

**Finally - The profession as a whole**

Patent attorneys rely on a legislative monopoly in the patent area - the lack of such a monopoly in say the trade mark area has been reasonably dramatic and such inroads will likely continue.

In my view the profession lacks a clear public presence and understanding of what it can contribute. A higher profile is required and a more informed debate around IP is a necessity. Think of the AMA for example.

An increased focus is also required on the *business* of being an attorney and not just the technical requirements to become one. This requires changes be introduced to encourage attorneys to seek business qualifications, utilise professional management expertise and devote training and mentoring activities to a better understanding of these types of issues.

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