

HOW DO TRADEMARKS AFFECT FIRMS' INCENTIVES TO INNOVATE?



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Research question

- Purpose of trademarks is not to stimulate innovation
- Yet innovating firms extensively use trademarks
 - (but so do non-innovative firms)
- Exploratory paper: How do trademarks affect firms' incentives to innovate?
 - How important are these effects?

Theoretical background

- Economic function of IPRs
 - e.g. Maskus, 2000, Landes & Posner, 2003
- Economic function of trademarks
 - e.g. Economides, 1997, Landes & Posner, 1989, Farquhar, 1994
- Economics of innovation incentives
 - E.g. Antonelli, 2003, Scotchmer, 2004
- A few studies: relationship between TMs and innovation
 - Nicholson, 2000, Mendonca *et al.*, 2004



Economic function of trademarks



- Differentiate products or services
- Signal of quality/good will
- Reduce consumer search costs

- Also signal to other firms



Patents and trademarks differ in important ways

● Patent

- Exclusive rights in return for disclosure of the details of the invention, thereby facilitating the diffusion of new knowledge

● Trademark

- Exclusive rights to a distinctive word, symbol, shape, etc.

How are trademarks linked to innovation?

- (1) Direct incentives to incremental innovation
 - Thus “innovation” can comprise product differentiation
 - Most such innovations cannot be patented

- An example:



(2) Supplements to other appropriability strategies

Means of appropriability	How trademarks can enhance appropriability
Patent	Raise imitation costs Appropriability after patent expiry
Lead time	Delay competitors from catching up Enable appropriability even if lose first position
Secrecy	Raise imitation costs Enable appropriability even if secret disclosed

To what extent do trademarks block innovation?

- Might lead to more incremental innovation at expense of basic innovation
- Barrier to entry to a more innovative firm
- Supplement to patent (which can block innovation)

How important are the effects of TMs on innovation?

- Fewer effects (both positive and negative) than patents
 - Limited monopoly power
 - Trademark-based licensing does not involve innovation
- Much depends on consumer perceptions
 - TM may signal innovativeness for a particular product, but this does not necessarily apply to other products, or the firm more generally

Trademarks most important where firms cannot appropriate returns by other means

- Design-based product differentiation



- Services

Trademarks can even help to protect "the unprotected"

- Red Hat has developed a successful business model fully based on Open Source Software applications
 - Red Hat gets Linux source code free, tests and improves the software, and distributes applications that can be downloaded without charge from the Internet
 - But most customers prefer to buy an original copy, and they are also covered by Red Hat's guarantee and offer of technical support



Concluding remarks

- More attention should be paid to the effects of trademarks on innovation
- How strong should trademark protection be?
- What types of innovation are encouraged by TMs?
- What are the effects when TMs strengthen other appropriability strategies?
- Implications for SMEs?

Further research:

(1) Innovative effect of Internet domain names

- Only one name can be registered under each top-level domain
- Dissatisfied consumers can also use DNS to subvert the company



(2) Innovative effect of geographic indications?

- Identify a good as originating in a particular place
- But how far should this protection go?
 - Some say: Producers have the right to preserve the reputation and quality of traditional goods
 - Others: Protectionism; supports inefficient production

