



# Information- and rivalry-based perspectives on reactive patent litigation strategy <sup>☆</sup>



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## ABSTRACT

Patent litigation is a common form of legal, economic and strategic behaviors that arise in a variety of business domains. Using information-based and rivalry-based theories, this study explores how asymmetric information, competitive rivalry in a strategic group and market positions influence companies' reactions to patent litigation. By applying an experimental design method to develop scenarios for top executives of small and medium-sized enterprises, the results show that a theoretical framework of asymmetric information, competitive rivalry in a strategic group and market positions affect a firm's reactive patent litigation strategy. These findings not only broaden information- and rivalry-based theories' explanations of reactive patent litigation decisions, but also enable us to formulate the codes of conduct for the managerial capability in regard to legal astuteness in patent litigation.

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## 1. Introduction

Patent litigation is a common form of legal, economic and strategic behaviors that arise in a variety of business domains. While top management teams strive to identify the importance of patent litigation (Siedel, 2002; Somaya, 2003), how to manage the legal aspects of business becomes one of the most critical capabilities to achieving a successful corporate strategy (Shanley & Peteraf, 2004). The existing literature on patent litigation focuses on the legitimizing aspects of intellectual property law (Bagley & Clarkson, 2003; O'Connor, 2014; Suchman, 1995), the political aspects of intellectual property law (Hillman & Hitt, 1999), as well as other "non-market strategies" that firms pursue to help in shaping the external regulatory environment within which they do business (Pathak, Xavier-Oliveira, & Laplume, 2013; Siedel, 2002; Somaya & McDaniel, 2012). However, scholars devote little attention to the importance of managing the legal dimensions of businesses (Ring, Bigley, D'Aunno, & Khanna, 2005). Bagley (2008) postulates that "legal astuteness" is a valuable managerial capability that can communicate effectively with legal counsel and work together to solve complex problems. Thus, this study seeks to develop a theoretical

framework for the managerial capability of legal astuteness on patent litigation from a business strategy perspective.

This study employs two broad categories to explore the companies' reactions to patent litigation complaints: (1) information-based theories, where patent litigants follow others that have superior information (Fleming & Sorenson, 2004; Powell, Koput, & Smith-Doerr, 1996), and (2) rivalry-based theories (Somaya, 2003; Somaya & McDaniel, 2012), where firms litigate against others to maintain competitive advantage. While the competitors' strategy and market position in a strategic group have impacts on a firm's decision-making based on the rivalry theories (Fiegenbaum & Thomas, 1995; Mas-Ruiz & Ruiz-Moreno, 2011; McGee & Thomas, 1986), asymmetric information among competitors also influences the manager's decision making (Brodbeck, Kerschreiter, Mojzisch, & Schulz-Hardt, 2007; Mas-Ruiz, Ruiz-Moreno, & Ladrón de Guevara Martínez, 2014; Özer & Wei, 2006).

When a patent owner learns that a third party may be infringing his right in a particular country and brings an action of patent infringement, the accused must quickly decide how to fight back based on the best information that the accused can obtain (Harriss & Newiss, 2001). In many legal environments, litigation processes are subject to uncertainty or ambiguity, and only a few decisions have outcomes that are fully predictable (Grundfest & Huang, 2006). Litigation associates with strategies. For example, to protect the value of patents, both Apple Inc. and Samsung Electronics Co. file patent lawsuits against each other by focusing on countries where each other's intellectual property is weaker or less enforceable. During a high-profile case in a California court in August 2012, the federal court jury in San Jose finds that Samsung copied ideas from Apple and infringed six out of seven Apple patents, while Apple did not violate any of Samsung's patents.

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Just a week before the U.S. federal court decision, Samsung asked the South Korean court for permission to use industry standard-essential patents to counter patents that other companies kept for their own use, and the court decides that Samsung is not an abuser of rights. On the other hand, Samsung's attempt to wield standard-essential patents prompts the European Commission to start an investigation into whether Samsung tries to stifle competition because the European Commission opines that industry standard-essential patents should be available to any company on a fair and reasonable basis. Thus, the different legal outcomes initiated by the U.S. federal court, the South Korean court, and by the European Commission demonstrate that the legal criteria of patent law is not universally applied under the same rules around the world. Overall, environmental uncertainty based on information and rivalry theories raises the likelihood of undesirable outcomes. Therefore, this study uses a contingency perspective to specify the conditions, such as strategic group, market position and asymmetric information, under which each type of patent litigant is most likely to occur.

This study offers three contributions. First, the research builds on two theoretical foundations: the information-based theory and the rivalry-based theory. While the information-based theory highlights the importance of asymmetric information to strategic decision-making, the rivalry-based theory emphasizes the importance of a firm's market position and strategic group to the decision environment. Second, this study integrates the above theoretical foundations to develop a framework and demonstrates the validity of the framework from our experimental research on small and medium-sized enterprises' (SMEs') top executives. Third, this study also explores the components of managerial capability with a particular focus on legal astuteness in regard to patent litigation by linking legal and strategic studies with a rich agenda that examines the interaction between a firm's strategy and the institutional foundations of legal work.

## 2. Conceptual development and research hypotheses

### 2.1. Asymmetric information and reactive patent litigation strategy

Tversky's (1977) theory of asymmetric information between two objects can explain variations in competition between the plaintiff and the defendant. Much of the strategy research examining asymmetric information focuses on how managers perceive and categorize information regarding their organization and competitive environment (Gary & Wood, 2011; Porac, Thomas, & Baden-Fuller, 1989; Porac, Thomas, Wilson, Paton, & Kanfer, 1995). By contrast, few scholars devote attention to investigate the impact of decision makers' asymmetric information on the competitive dynamics of patent litigation and how this information affects strategic choices.

Previous studies find that asymmetric information has a negative impact on managers' decision-making (Brodbeck et al., 2007; Özer & Wei, 2006). Although information asymmetry is difficult to quantify (Özer & Wei, 2006), this study based on information sharing between firms and the exchange of information among the industries illustrates the degree of information asymmetry in the patent litigation process. In addition, a reactive patent litigation strategy is an important aspect of decision-making for firms facing patent infringement complaints (Somaya & McDaniel, 2012).

**Hypothesis 1.** The degree of asymmetric information negatively influences the companies' reactive patent litigation strategy.

### 2.2. Strategic group and reactive patent litigation strategy

A strategic group is a set of firms that use a similar strategy and emphasize similar strategic dimensions, and results in homogeneous competitive actions/reactions within an industry (Caves & Porter,

1977; Cool & Schendel, 1987). The increased set of competitive actions and competitive reactions builds up competitive behavior, and all competitor behaviors taken by all firms competing within a market are referred to as the competitive dynamics (Young, Smith, & Grimm, 1996). Thus, from the competitive dynamics perspective, competitive rivalry in a strategic group has a major effect on the firm's decision-making (Leask & Parker, 2007; Shamsie, 2003).

Increasingly, when firms constantly jockey for advantage as they launch competitive actions and respond to rivals' moves in multimarket competition (Chen, Su, & Tsai, 2007; Nair & Filer, 2003), competitive rivalry evolving from the pattern of actions and reactions intensifies in the highly competitive markets (Grimm, Lee, & Smith, 2006; Powell, 2003; Yu & Cannella, 2007). Therefore, while highlighting the competitive rivalry's effect on the firm's strategies, both the plaintiff's initial patent lawsuits and how well the firm anticipates and responds to its competitor's initial actions in a strategic group determine a reactive patent litigation strategy's success. Thus, when facing the patent infringement complaints, the higher the competitive rivalry within a strategic group, the higher the propensity for a firm to adopt a reactive patent litigation strategy. Specifically:

**Hypothesis 2.** For firms led by top executives, a high degree of competitive rivalry in a strategic group will have a positive impact on the reactive patent litigation strategy.

### 2.3. Market positions with reactive patent litigation strategy

Previous research indicates that the characteristics of a firm's external environment are crucial to a firm's market expansion (Finkelstein, Hambrick, & Cannella, 2009; Souder, Simsek, & Johnson, 2012). With respect to the market competitive position variable, Child and Rodrigues (2005) investigate whether the pattern of market expansion initiatives is institutionally embedded or reflects a strategic choice by the market leader of the firms. In addition, Rui and Yip (2008) demonstrate that the market leading firm has a greater willingness and desire than the market followers to implement a market expansion strategy. With respect to the reactive patent litigation strategy, whether the market leading firm and market followers have the same interests and perspectives becomes the main research objective of this study.

## 3. Research method

This study uses an experimental design to examine the above hypotheses. The experimental design method is a good way to clarify the specific impacts of the three variables—the degree of competitive rivalry in a strategic group, asymmetric information and market positions—on the reactive patent litigation decisions.

This study conducts a 2 (competitive rivalry degree in a strategic group: high vs. low)  $\times$  2 (asymmetric information: high vs. low)  $\times$  2 (market positions: leader vs. follower) between-subject design.

A total of 217 executive lion club members (65.0% male; with more than 60% over 40 years of age) in Taiwan serves as the subjects in our experiment, and randomly assigned to one of eight conditions. Participants first encounter the pure scenarios and then respond with their patent litigation strategies in the scenarios with conditions. In the pure scenarios, all participants read that one competitor is advancing a patent infringement complaint, as the following.

### 3.1. Pure scenario

Imagine you are an executive in a publicly-traded company named Company X which produces high-tech consumer electronics products. Company X will shortly launch a smart watch that combines the functions of a phone, office, and entertainment center, which will bring abundant profits to the company. However, the company's competitor

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