IP valuation methods in practice

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Intellectual Property (IP), protected by rights such as patents, trade marks and registered designs has the potential to create economic benefits. As with more tangible assets, realising the benefits from IP requires its conscious and appropriate management. Valuation often plays a key role here, as the ability to place a value on IP can assist the owner not only in making better management decisions but in generating income and raising finance.

The valuation of IP assets is complicated by the fact that no two IP assets are the same. This is inherently the case when IP is protected by rights such as patents and trade marks, where a requisite for obtaining such rights is that the IP does not already exist. The uniqueness of IP makes comparisons with other IP difficult, thereby limiting the usefulness of comparison-based pricing. As a result, valuations are often based on assumptions about the IP asset’s future use, what important milestones will be met and what management decisions will be taken.

Methods for valuing IP

Certainly there is a growing body of methodology used by industry and valuation practitioners. There are a number of well documented methods for valuing IP and numerous variants. One thing is for certain; there is no “one size fits all” solution.

IP valuation methods are generally divided into monetary and non-monetary approaches. Monetary approaches calculate IP value in money and include “cost”, “market” and “income” approaches. Non-monetary methods provide a value guide through the rating and scoring of IP assets based on factors that can influence IP value.

Cost-based approaches

In cost-based valuations, the cost of developing the IP asset is considered to be equivalent to its value. The historical cost of developing the IP is considered or, alternatively, the valuation will involve the analysis of the costs incurred if the

Income-based approaches

The most basic definition of IP asset “value” is based on the ability of an IP asset to generate future economic benefits. In income-based approaches these benefits (discounted for risk) are assumed to be the value of the IP. As part of the valuation, the valuation expert will need to estimate the stream of economic benefits attributed to the IP, the duration of the IP’s useful life, and an understanding of specific risk factors related to the use of the IP asset.

The principal IP valuation methods under the income approach are:

• relief-from-royalty method, sometimes referred to as royalty savings method,
• premium profits method, sometimes referred to as incremental income method,
• excess earnings method.

The key difference between these methods is the way that the income directly attributed to the IP is identified and separated from the total income attributed to a product or a process. From a practical point of view, income-based methods are the most relevant and widely used methods for valuing IP. However, the methods often involve using assumptions about the future use of the IP. Input data must be available and accurate for the valuation result to be correct.

Non-monetary value indicator based approaches

Non-monetary methods provide a value guide for an IP asset through the observation and scoring of different factors related to the IP. These factors or “value indicators” can influence
the value of the IP asset either positively or negatively. The indicators can include aspects related to the IP such as legal and IP protection background, the technology and development level, the market for products utilising the IP, financial factors and the management competencies of the organisation that will use the IP. Other types of indicators may include information about the IP asset sourced from patent or trade mark documents, such as the number of citations and the number of existing rights in similar fields.

The result of the valuation will be a descriptive analysis and/or a score for the IP asset. This can be useful for management purposes, to assist with decision making and to communicate the significance of the IP asset.

**Complexity level and quality of methods**

The methods used for the valuation of IP can be used at different levels of complexity. The valuer will use judgement to decide what level of complexity is required for each specific valuation. This will depend on the quality and type of results required to fulfil the valuation purpose, the availability and accuracy of input data, and the resources (human, financial, time) available for the valuation.

In some cases an “initial valuation”, using a scoring or rating system and focussing only on the quality aspects of IP, is sufficient for the valuation purpose. This could be for the valuation of an early stage technology development or when monitoring IP quality over a period of time.

At other times, for example when licensing IP to a partner or applying for a loan, a more in-depth monetary valuation is required. This type of higher complexity valuation is investigative in nature and will yield a higher quality of results. Valuation experts think of this as being similar in many respects to the way that a legal opinion is given.

When considering the complexity level of the valuation, there will always be a constant trade-off between the need to have the highest quality results and the data and resources available.

**Choice of methods**

The valuation of IP is an opinion, and the result is a value within a particular context and at a particular point in time. Considering that each valuation is context-specific, a valuer must be able to select the most appropriate method, combination of methods, and levels of complexity and adapt it to the specific circumstances.

The IP being valued must be clearly specified. While IP such as an individual technology can be identified and separated, in most cases it will be supported by complementary intangible assets. These complementary assets are often significant in generating benefits. If there are complementary assets these are valued together with the IP asset in an “IP bundle”. Unless a specific reason exists, the focus of an IP valuation is on a bundle of income-generating assets, with the subject IP asset at the core.

A valuation will in all cases fulfil some specific set of objectives. Usually the valuation results will provide information in order to better accomplish a specific task with the IP asset. Some examples of valuation purposes are estimating the commercial prospects for early stage technologies, making decisions related to investment into IP commercialisation, pricing an IP licence, quantifying the equity allocations in the formation of a joint venture where one party contributes IP, estimating the value of IP used as collateral, and measuring economic damages in IP infringement claims.

**Combinations of methods**

To increase the accuracy of an IP valuation, an IP asset may be valued using two or more independent valuation methods. Having more than one set of results from different methods can give a more robust range of values and can bridge some obstacles in the availability and accuracy of data. The combination of methods in an IP valuation is regarded as good practice.

**Standards**

IP valuation practitioners are assisted in their work by the development of standards in the last 5 years. IP valuation standards are related to the specific task of performing IP valuations. Valuation experts can refer to a number of standards which, although not binding, set guidelines for the valuation of different IP assets according to the context of the valuation. Standards applicable to the valuation of IP assets include international standards for valuation of intangible assets (IVS 210) and for the valuation of brands (ISO 10668) as well as country specific standards for example for the valuation of patents in Germany (DIN 77100) and in Austria (ÖNORM A6801).

**Next steps**

Those interested in finding out more about the process of IP valuation and methods in general can consult numerous general and context specific publications on IP valuation. Some of the valuation standards mentioned above are also available to download and these can give a good insight into the methods used in practice.

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