

LESI IP Valuation And Standards Committee Report On IP Valuation Survey Of LES National Societies Global Technology Impact Forum—Geneva, Switzerland

By Dwight Olson and David Drews

The IP Valuation Committee of the Licensing Executives Society International (LESI) was tasked with educating the members of the LES national societies on the best practices used in performing IP valuation analyses. This effort is in conjunction with the production of a basic valuation primer for use by the stakeholders and constituencies served by the World Intellectual Property Organization (WIPO). The primer is being produced by Ocean Tomo with considerable input by the members of the LESI IP Valuation Committee and WIPO personnel.

In order to provide the most effective guidance on the construction of the primer, and to provide the basis for a uniform education on IP valuation best practices throughout the LES national societies, the LESI IP Valuation Committee felt it was necessary to understand the IP valuation practices currently employed by members of the various LES societies.

In order to identify these current practices, a survey was constructed in January 2011.

The survey consisted of seven broad categories of written questions, along with a matrix with rows representing different IP asset categories and columns indicating different contexts under which a valuation of IP may be necessary or considered. The initial set of survey questions is presented in Figure 1 and a representation of the matrix is presented in Figure 2. The respondents were instructed to provide written answers to the survey questions and to record the various methods employed in the cells corresponding to each of the asset category/context junctures.

The valuation methodologies included in the survey matrix are a broad cross-section of IP valuation techniques. They have the following characteristics:

- **Market Approach:** The IP is valued using recent transactions for comparable assets.
- **Income Approach:** The IP is valued using the cash flows that are attributable to the IP, whether in the form of income or cost savings.
- **Cost Approach:** The IP is valued by ascertaining the expenditures necessary to replicate the subject IP or IP with similar utility under the current circumstances.
- **Excess Profits:** The IP is valued by measuring the portion of profits associated with products featuring the IP that are beyond the profits of similar products without the IP. These can be in the form of higher profit margins, increased market share, or both.

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Figure 1. Initial Survey Questions

Q1: How often do you value IP?
Q2: Why do you value IP?
Q3: How many different methodologies have you heard of?
Q3.a: How many different methodologies have you used?
Q4: What methodologies do you use for Patents?
Q4.a: What methodologies do you use for Trademarks?
Q4.b: What methodologies do you use for Copyrights?
Q4.c: What methodologies do you use for Trade Secrets?
Q5: What issues affect valuation of a license or other deal?
Q6: Is there a government body or other organization in your county that sets standards for IP valuation?
Q7: Who typically performs the valuation?

Figure 2. Survey Matrix Sent to LES National Societies

Assets Valued	Context									
	License	Sale	Joint Venture	Merger	Collateral	Internal Transfer	Tax Issue	Portfolio Management	Bankruptcy	Litigation
Patents										
Trade Secrets										
Copyrights										
Trademarks										
Software										
Other IP/ Intangibles										

Methodologies: Market Approach, Income Approach, Cost Approach, Excess Profits, Premium Pricing, Cost Savings, Relief From Royalty/Royalty Savings, Other.

- **Premium Pricing:** The IP is valued by analyzing the price characteristics of products featuring the IP as compared to those of similar products without the IP.
- **Cost Savings:** The IP is valued by analyzing the expenses associated with utilizing the IP versus expenses associated with similar processes or functions without the IP.
- **Relief From Royalty/Royalty Savings:** The IP is valued by assessing the value of the royalty payments avoided due to ownership of the IP. This method utilizes a hypothetical license for the use of the IP.

The survey and matrix were initially sent to the presidents of the 33 LES societies and sub-chapters in January 2011. A follow-up email reminder was sent to those societies that had not yet provided any response in March 2011. Dwight Olson presented the survey and the results then in place at the LESI meeting in London in June 2011, and a team from the IP Valuation Committee presented updated results at the LES USA/Canada Annual Meeting held in San Diego in October 2011. Additional responses were obtained from attendees at those meetings, as well as important feedback on the nature and construct of the survey questions. This feedback resulted in the inclusion of five supplemental questions. The updated survey and matrix were then sent to the new LES society presidents in November 2011.

By the time of the presentation to the Global Technology Impact Forum in January 2012, roughly 70 percent of the LES societies had responded, with the vast majority of those providing answers to both the questions and the asset category/context valuation methodology matrix. The results from those responses are summarized below.

Initial Survey Questions

Question 1: How often do you value IP? This question was intended to provide insight as to the level of experience the respondent had with using IP valuation techniques. It also gauges the relative importance of valuation to the member's licensing operation. The responses to this question ranged from rarely or never to every day, with very few responses indicating any sort of middle ground. Therefore, it was apparent that the respondents fell into two broad categories: those who were IP valuation professionals (IPVP) and those who were not (Non-IPVP).

This particular dichotomy of respondents was responsible for significant variability in the responses associated with almost every question. In general, the IPVP responses indicated familiarity with most valuation methods and contexts while the Non-IPVP responses indicated some familiarity with certain techniques in specific contexts, but not a comprehensive awareness or experience with all techniques and/or contexts. In addition, there was evidence of geographic variability. IP valuation appears to be more ubiquitous in the United States than in other parts of the world. For example, it was estimated by one respondent that no more than 50 material IP valuations are conducted in his LES Society on an annual basis.

Question 2: Why do you value IP? There were several suggestions provided with this question, including licensing, merger, financing/securitization, sale, internal transfer, tax or financial reporting issue, and portfolio management. The numerous options were provided to help the member think about a relevant answer to this question. The question is really trying to gauge the different contexts in which a member feels it is necessary to gain an understanding of the value of the subject IP. A response may be one, several or all of the listed reasons, or may

even include reasons that were not listed.

Once LESI has an understanding of the situations that members claim give rise to a need for valuation, it will help to establish the valuation best practices, standards and program content needed to address each of these specific valuation contexts and map out the next steps for the LESI IP valuation committee. It may also be possible to streamline the best practice elements so that every context utilizes a similar platform instead of one set of best practices being applicable to a tax-related valuation need and a separate set being applicable to a litigation-related valuation need.

The primary responses to Question 2 were those related to transactions: licensing, sale, merger, franchising, etc. Financial reporting and government needs were also important drivers. For example, the retail trade law in the Philippines mandates that foreign retailers wanting to operate in that country must meet a minimum per-store capitalization requirement. As a result, many applicants submit a valuation of the brand name / trademarks as part of their capitalization measurement. Finally, even though it was not listed as one of the prompts, litigation was listed as a reason for performing an IP valuation on a significant number of responses.

Question 3: How many different methodologies have you heard of? Have you used? These questions sought to gain an understanding of the methodologies that are currently in use by LESI members. The instructions for these questions expressed a preference for a listing and/or explanation of the methodologies rather than simply providing a numerical response. It was thought that any dif-

ferential between answers on the two questions may help portray preferences or higher levels of utility/applicability that may be important.

In general, respondents had heard of roughly twice as many valuation methodologies as they claimed to use. This was the case whether the list of familiar methodologies consisted of the three general valuation methods (market, cost, income) or a more comprehensive list. The exception to this general rule were the IPVPs, who consistently used almost all of the various techniques with which they were familiar, depending on the particular aspects of a specific project.

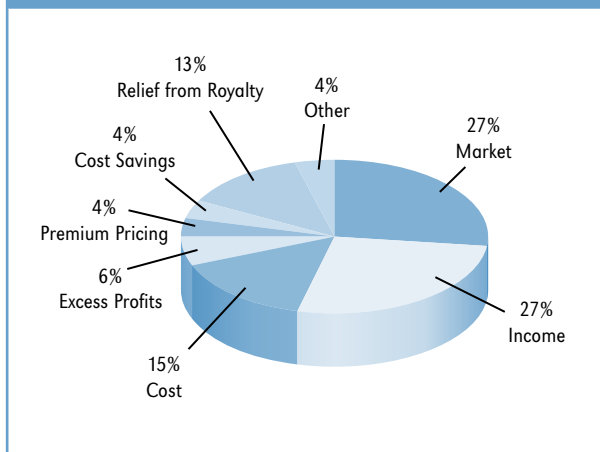
Question 4: What methodologies do you use for Patents? Trademarks? Copyrights? Trade Secrets?

The instructions for this set of questions requested that the member utilize the matrix portrayed in Figure 2 when providing their answers. The matrix asks for a more targeted response than that provided for Question #3. Answers to Question #4 hopefully allow LESI to gauge which methodologies are used for each asset class. While the methodology used may be more closely tied to the information available rather than the asset class, it is illustrative to see how members respond to this question, which will make LESI's efforts at establishing best practices, standards and useful program content more fruitful.

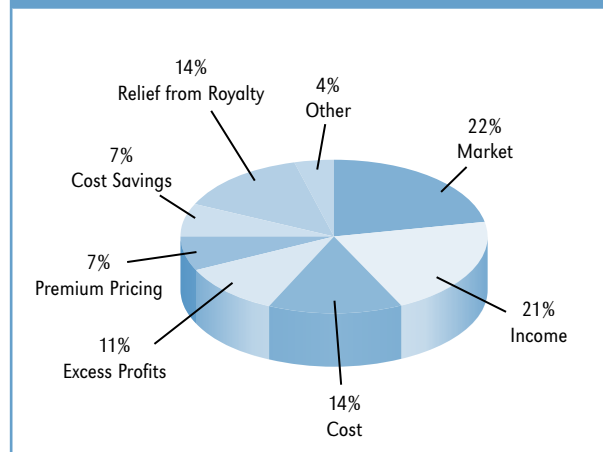
Perhaps unsurprisingly, the primary methods used across all asset categories were the market, income and cost approaches to IP valuation. However, many other techniques were mentioned by respondents as well, as is illustrated by the following charts.

Charts 1–5 indicate the percentage of the total mentions that each method represented. During

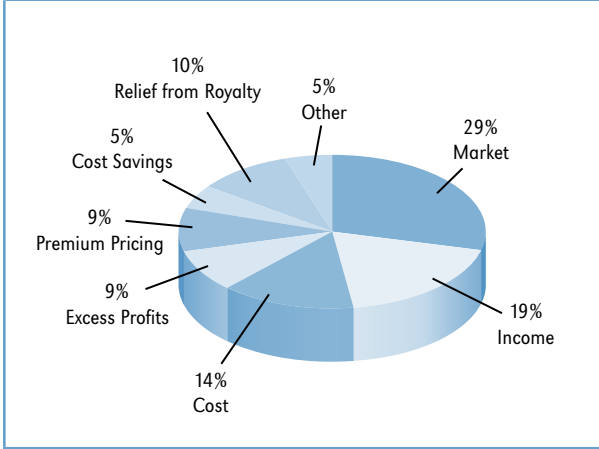
**Chart 1. Patent Valuation Methods
LES Society Relative Mentions**



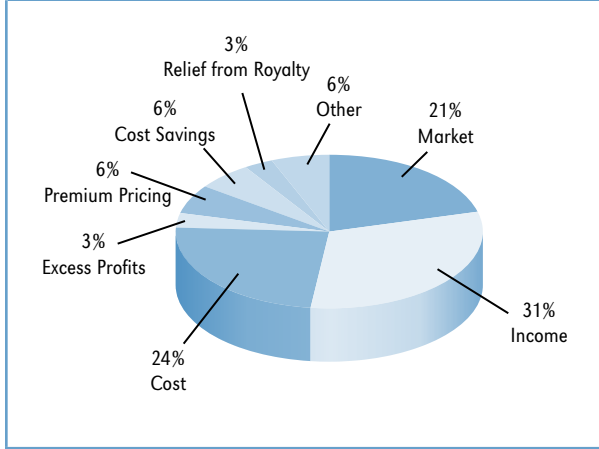
**Chart 2. Trademark Valuation Methods
LES Society Relative Mentions**



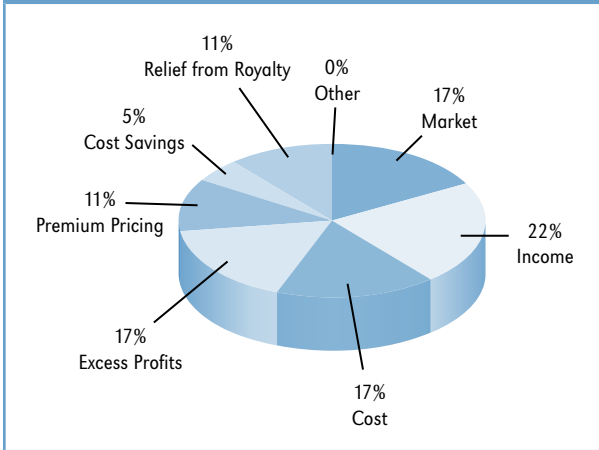
**Chart 3. Copyright Valuation Methods
LES Society Relative Mentions**



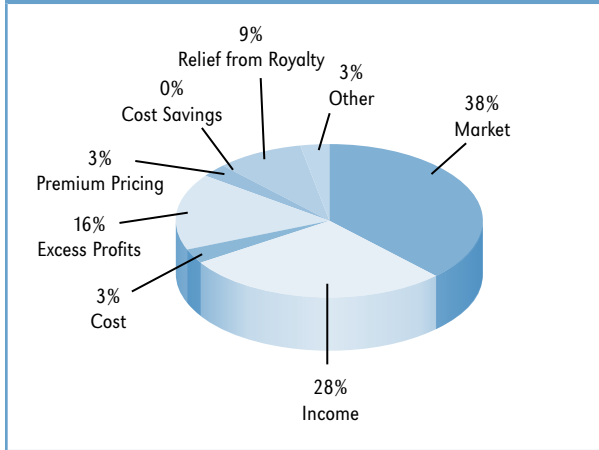
**Chart 4. Trade Secret Valuation Methods
LES Society Relative Mentions**



**Chart 5. Software Valuation Methods
LES Society Relative Mentions**



**Chart 6. OECD Tax Authority Valuation
Methods, Relative Mentions**



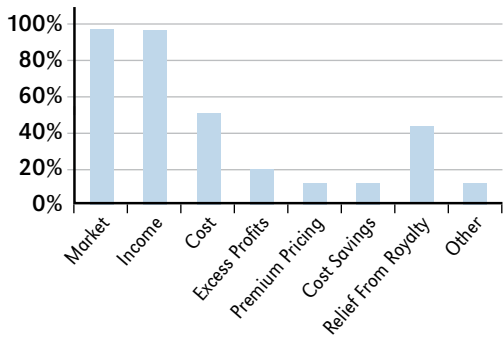
our research, we uncovered results from a similar survey conducted among the various tax authorities in the Organisation for Economic Co-operation and Development (OECD) nations, which are illustrated in Chart 6 (<http://www.bna.com/Transfer-Pricing-Oecd-p7745/>). Despite the focus on taxation, this survey was thought to be a good check against our results since the OECD covers many of the same geographies. Interestingly, the cost approach is a minor fraction of the required or preferred methods listed among the OECD respondents, whereas it was a much more frequent response among the LES society respondents. The results for the other methods were similar in scope to those found in the LESI survey.

While these charts depict the relative “market share” captured by each of the methodologies when discussing the various asset categories, they do

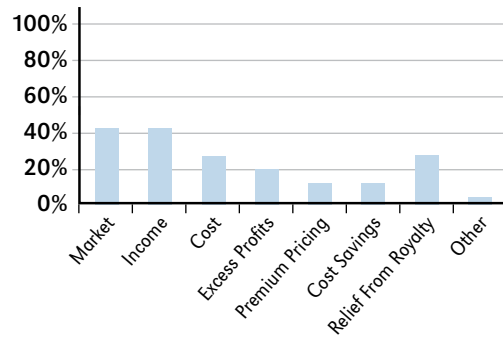
not provide complete information on the “relative strength” each method enjoys among the respondents, or how often each method is used. The bar charts (Charts 7–11) illustrate the percentage of respondents that included the listed methodologies in their responses.

As can be seen, the market and income approaches were mentioned by 100 percent of respondents when discussing the patent valuation methods used. The income and cost approaches used for trade secret valuation were the only other asset category / methodology junctures mentioned by a majority of respondents. Of course, there are no wrong answers to the survey, but these results do indicate that increased education efforts, such as the above-mentioned primer and the LESI valuation workshop series, may provide members and others interested in IP valuation with

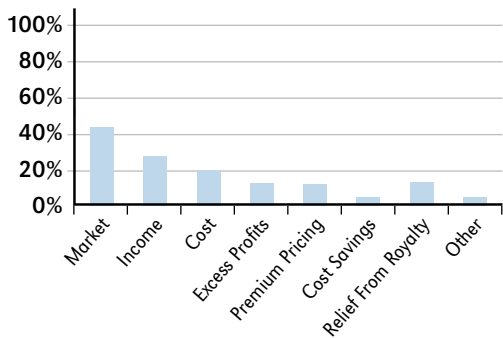
**Chart 7. Patent Valuation Methods
LES Society Utilization**



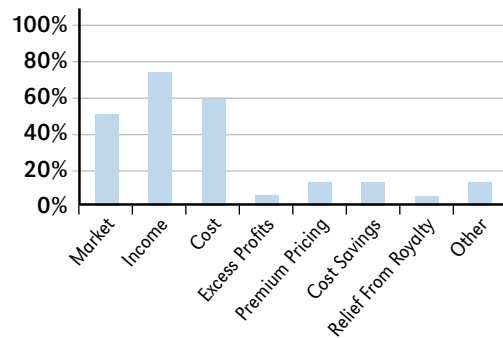
**Chart 8. Trademark Valuation Methods
LES Society Utilization**



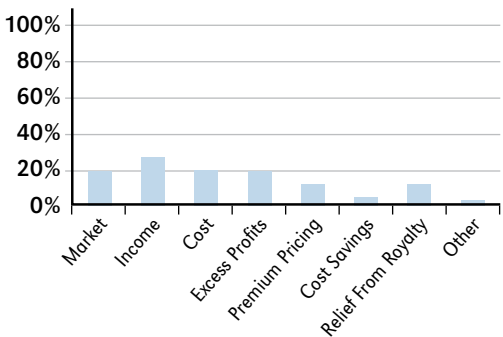
**Chart 9. Copyright Valuation Methods
LES Society Utilization**



**Chart 10. Trade Secret Valuation Methods
LES Society Utilization**



**Chart 11. Software Valuation Methods
LES Society Utilization**



additional resources and/or tools.

Question #5: What issues affect valuation of a license or other IP deal? This question was explained as a request for more detailed information on the context issues identified in Question #2. Specifically, this question was concerned with how the different context parameters impact the valuation exercise (method used, value standard used, etc.) and sought knowledge on the relative occurrence of the context parameters.

The responses to this question were typically in the form of one of three categories: general comments, valuation parameters and licensing parameters. General comments included mentions that a litigation context had a different set of factors or issues than a commercial deal. There was also discussion surround-

ing whether the valuation was mandatory or not. The valuation-specific parameters included items such as macroeconomic factors (GDP, inflation, interest rates, etc.); industry-specific factors (growth trends, competitive environment, etc.); company-specific factors (sales, margins, historical growth, product life cycles, marketing efforts, etc.) and asset-specific factors (remaining life, patent quality, comparable royalty rates, etc.). The licensing-specific responses (although many of these are also valuation parameters and vice versa) mentioned parameters such as stage of technology, exclusivity, R&D funding, payment configuration, other IP required/licensed, payment of maintenance fees, etc. These responses are useful in helping to identify the full extent of parameters that must be considered when valuing IP in many different contexts.

Question #6: Is there a government body or other organization in your country that sets standards for IP valuation? The extent that government entities or other authorities have addressed these issues is an important element. Similar to how the United States changed its patent expiration protocols to better match those used internationally, existing frameworks and regulations may provide guidance in establishing system-wide standards and best practice guidelines. The instructions for this question indicated that it covered governmental regulations, accounting regulations, tax regulations, professional association guidelines, etc.

Roughly two-thirds of the respondents indicated that there were organizations, either governmental or some other entity, that set standards for IP valuation. Some standards were more restrictive than others. For example, in the Czech Republic, firms and individuals must receive permission from the courts in order to perform valuations for third parties. This applies to everyone from small consulting firms to big accounting firms. Also, the Czech Republic is in the process of adopting IP valuation standards, an initiative started by a group of professional appraisers in conjunction with the University of Economics in that country.

Among those who claimed to have some form of standard in place, many of those standards were established by non-governmental entities, such as the IFRS Interpretations Committee and the International Accounting Standards Board. Others were established by governmental entities, such as the Taiwan Valuation Standard Committee and the National Center of Intellectual Property in Russia. Many respondents also pointed toward case law

precedents as being an important factor.

Question #7: Who typically performs the valuation? This question sought to understand who is actually undertaking the valuation exercise when it is needed. This was asked to help LESI target its communications more effectively so that all relevant voices are heard during the discussion of best practice guidelines, standards and program content. It will also help to identify potentially under-represented members of the licensing community who may benefit from a closer relationship with LESI and its member societies. Responses generally mentioned outside consultants and internal teams, with a few mentioning IP law firms. As is reported on SQ4 below, it was apparent that many companies do some analyses in-house and outsource other analyses for specific purposes like litigation, financial reporting or tax compliance.

Supplemental Questions

As stated above, the initial set of questions was supplemented with five additional questions based on feedback received after the preliminary London presentation. Those supplemental questions are presented in Figure 3.

Supplemental Question #1: How has your IP valuation experience compared to actual results? Were the valuations performed in-house or by outside consultants? These questions were designed to elicit responses on how someone's valuation efforts have corresponded with the reality of the marketplace. The answers will help LESI to understand which methodologies have been most effective at anticipating real-world results.

Several respondents indicated that the valuation exercise influenced the outcome of the negotiation, so it was a self-fulfilling prophecy to some extent. Others indicated that the profit split and other income approaches had proved to be more accurate than the cost approach. Several also indicated that the compa-

Figure 3. Supplemental Questions

SQ1: Accuracy - How has your IP valuation experience compared to actual results? Were the valuations performed in-house or by outside consultants?
SQ2: Date Sources - What sources of information do you use? What information is difficult to obtain?
SQ3: Methodology - For the same IP, are different methods used in different contexts/for different purposes?
SQ4: Outside Experts - Have you ever used outside experts? What is the threshold for doing so? (context, importance, etc.)
SQ5: Sector - What sector do you represent?

able transaction data used in the market approach carried more weight in negotiations than other approaches. Among those who answered the second part of the question, the results apparently were not materially different between the in-house efforts and those of the outside experts, although the outside experts were utilized in larger transactions and/or for external audiences.

Supplemental Question #2: What sources of information do you use? What information is difficult to obtain? These questions were designed to help LESI understand how members perform valuations and identify areas where relevant information is missing or not easily acquired. This will help LESI to target research in these areas so that the relevant information will be more readily available.

The sources used ranged from commercial transaction databases and market research firms to LESI survey data and government economic agencies. Many also cited internal research efforts as being an important element. As for data that was difficult to obtain, comparable transaction data was a uniform response. Many respondents also mentioned that information on technology life cycles would be helpful.

Supplemental Question #3: For the same IP, are different methods used in different contexts or for different purposes? Many respondents indicated that the same methods were used across all contexts and for all purposes. Others were more specific. For example, “To value developed technology for sale or licensing, I use relief from royalty a lot; however, I often use Excess Earnings Method for the purpose of purchase price allocation” was a typical response. Here again, these results indicate that increased education efforts may provide those interested in IP valuation with additional resources and/or tools.

Supplemental Question #4: Has your company/organization ever paid outside experts for valuations? What is the threshold for engaging outside experts (context, importance of IP, etc.)? Some respondents indicated that outside experts are required in certain situations. For example, in Taiwan, it is required to use third parties to value assets transferred between related parties when the value of the transaction exceeds \$10 million. Others stated that outside experts are only used when the transaction reaches some critical level of value/importance, or when it is important for the

valuator to be objective or unbiased. This makes sense in that the retention of an outside consultant typically requires a greater investment of resources than if internal personnel are used.

Supplemental Question #5: What sector do you represent? This question sought to understand whether certain methodologies are preferred in one sector versus a different sector. Among those respondents who indicated a specific sector, there was no discernible difference from one sector to the next. Several respondents indicated that they were IPVP and therefore worked across many different sectors.

Summary

Several conclusions arise when viewing the totality of survey responses. First, there seems to be a universal need/desire for additional information on valuation techniques and sources of relevant data. The IP Valuation and Standards Committee members are actively working to provide additional workshops/articles/webinars to address this demand. That said, there were no surprises on the methods currently being used or the contexts in which they are utilized. Also unsurprising was that the market and income approaches were the most frequently cited valuation methodologies, although the deviation between the use of the cost approach by LESI members and that mentioned by OECD tax authorities was unanticipated. The fact that some respondents employ different methods in different contexts is an indication that valuers are considering all aspects of the project before proceeding rather than simply compiling inputs for a previously-established valuation model.

Roughly two-thirds of respondents indicated that there was some sort of standard in place in their country, whether established by a government agency or some other authority. It was also apparent that Non-IPVPs only hire outside consultants for certain needs, such as external audiences or litigation. Finally, additional resources regarding transactional data are universally desired.

Because of the divergence regarding the variety of methods used by IPVP and Non-IPVP, it is evident that increased education opportunities, such as the above-mentioned primer and the LESI valuation workshop series, may provide members and others interested in IP valuation with additional resources and/or tools to use in their daily IP management efforts. ■