8
Valuing Intellectual Property

Focus and structure

This chapter focuses on the valuation of IP, and covers four main themes. First, it shows how people from different backgrounds can perceive value very differently. Second – the most important theme of this chapter – is the evaluation of the market, cost and income approaches, the three most-frequently used and widely accepted valuation methods for measuring IP assets. Third, some less-frequently used methods are outlined. Finally, the significance of valuation is discussed to examine how IP valuation can serve different purposes in business.

The opener, closer and the IP facts sections present further discussions relevant to the chapter themes. The opener emphasizes how doing homework thoroughly is the first step to generating IP value for the IP owner. The closer examines how Dr. Seuss’s IP assets were valued for inheritance purpose when he died in 1991, and how his creative legacy lives on in the form of IP assets he has left for lovers of his work. The IP facts section shows how royalties vary across businesses.

Opener: An intellectual property deal starts with homework

Without doing their homework thoroughly, IP owners cannot be certain about the commercial value of a particular IP product, and as a result may fail to gain the income they deserve. Poltorak and Lerner (2004) recount the (true) story of ‘My wife’s diamond ring’. An inventor has decided to sell his patented invention to a multinational experienced in IP. When the company asks him how much he is looking for, instead of negotiating step by step to make the most of his patent, he tells them he wants US$20,000 as an up-front payment – because he has never been able to afford a diamond ring for his wife before, and would like to do so
now – plus one per cent running royalty (i.e. one per cent of the net sales of the products). He is very happy when the company offers him twice as much as an up-front payment: but does the deal he has made represent the true commercial value of his invention? How can he know? This example reveals two lessons. First, the inventor has not investigated the true market potential of his invention, and has not done any homework as to the value of his patent. Second, he lacks basic negotiating skills, and has revealed his ‘trump card’ at the very beginning, putting the multinational into a powerful position in the deal-making.

To do their homework thoroughly, IP owners must understand the three-step Value–Valuation Decision Chain (Figure 8.1). When an invention is born, the IP owner must assess its patentability, its manufacturability and its commercializability. The first step – after an invention has been created which looks as if it might be marketable – is to conduct a search to ensure there is no other identical or similar invention. This step also involves the assessment of the patentable criteria – novelty, inventiveness and utility (see Chapter 2). Moreover, an IP owner should also consider the claims – the scope of protection – to make, so that IPP can be clearly defined. The misconception is that the owner can leave all the work to the IP attorney. However, an owner who is clear about what should be protected will be able to help the attorney to accelerate the process of application for patent grant.

Figure 8.1 Value–valuation decision chain. Created by the author.