Constructing the “Price” of the Technology in IP Licensing Negotiations
Topics

- What is Valuation
- Value and Price
- Key Terms of a Licensing Agreement
- Constructing the “Price”
IP Valuation

- Valuation – The process of identifying and measuring financial benefit of an asset.
- Valuation of Intangibles – The process of identifying and measuring financial benefit and risk of an asset, in a particular context.
- Risk
  - Time – What is the time needed to bring technology on the market? Sometimes even breakthrough technology can be « too early » for the market.
  - Money – How much more do we need to invest?
- Risk is a particularly important element in the valuation of early stage technologies – more time and money needed to bring technology on the market – less value.
Risk and Money?

Closer to the market, with and without financial partner – the value of IP will be different for the same asset.
Intangibles
What is so Different than Valuating Tangibles?

• Most intangibles are capable to generate more than one value stream simultaneously.
• In certain contexts the value is determinate by the authority, relevant laws (tax laws) or empirical experiences.
• It is important to define approach to value:
  – Understand actual value of an asset in use for actor,
  – Potential value in use,
  – Value construction – for negotiation purposes.
Intangibles
Value and Price

• The value of an intangible is the financial benefit that an asset can generate in a particular context, taking fully into account the risk that the investment in the development of the asset may be higher than realized value.

• The potential value of intangibles depends on the context in which that value will be realized.

• The price is not the value of an intangible asset, while the price of a tangible asset is usually the expression of the real value.

• The price is what is proposed to the other side of the deal and it depends on how « thirsty » is the other side for that particular technology.
Challenge 1. - Identifying Potential Asset

- **Potential Asset**
  - IP that can generate a value in particular context;
  - Collaboration – non exclusive license providing access to other parties;
  - Sponsored research – usually providing access and right for non-profit use;
  - Licensing to industrial partner to commercialize technology;
  - Spin-off, Start up.
  - Entity has a control over the future generated benefits – ownership or legal contract providing control – licensing.
R&D Context - Examples of Scoring Criteria

- Internally developed ranking criteria, such as “8 leading factors”:
  - Suitability for Suggested Application
  - Cost
  - Development Status
  - Exploitation Rights
  - Degree of Novelty
  - Marketing Interest of Partner
  - Quality of Technology Information
  - Sociability of Technology Provider

- Or
  - Patentability
  - Patent Strength
  - Status of Invention
  - Market Situation
  - Inventor’s History – Supportive or not in the process of transfer?
  - Additional Services for the Partner (potential for continuation of collaboration)
  - To whom shall invention be licensed
Elements of Ranking – IP Valuation, Wroclaw 2013, Team I

Each element has fixed weight, from 0,6 to 1,4

<table>
<thead>
<tr>
<th>Element</th>
<th>Weight</th>
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<tbody>
<tr>
<td>Ease of collection</td>
<td>1</td>
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<tr>
<td>Market potential</td>
<td>1,4</td>
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<tr>
<td>Barriers of entry</td>
<td>1,2</td>
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<tr>
<td>Technology development</td>
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<td>Legal protectability</td>
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<td>Relative technical experience</td>
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</tr>
<tr>
<td>Communication skills of researches</td>
<td>1</td>
</tr>
<tr>
<td>Experience with business and industry</td>
<td>1</td>
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<tr>
<td>Interdisciplinary potential of technology</td>
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Challenge 2. Potential Value of IP for Licensee

- Context is essential
  - Collaboration – value for project result;
  - Spin off – attracting venture capitalist;
  - Licensing

- Does this IP correspond to licensee business objectives and business plan?
  1. Reduce the investment needed to access the marketplace;
  2. Accelerate market introduction;
  3. Minimize potential liability;
  5. Limit time commitment;
  6. Access markets otherwise inaccessible due to shipping restrictions or lack of a distribution system; or
  7. Acquire specific capabilities such as manufacturing, sales and distribution or business management

- Technical characteristics
- IP quality
  - scope of protection – “freedom of operation”;
  - can patents and trade secrets be easily circumvented; and
  - the projected cost to enforce patents and trade secrets

- Market potential
Challenge 3: Measuring the Value

Quantitative methods attempt to calculate the monetary value of the IP and include:

- Cost
- Market
- Income
- “Rule of Thumb”
- Monte Carlo
- Industrial Standard
- Real Option
- Other Methods.
Income Method
Discounted Cash Flow Approach (DCF)

- DCF is the most frequently used approach of the Income Method;
- A projection of a future net cash flow expected from the commercial use of an intangible asset under review;
- Over a period of the economic life of the IP;
- “Discounted” by the time value of the money and risk (“discounted rate”);
- Objective: determination of the Net Present Value of the IP asset.
How DCF Works

Basic Elements

- Potential Market
- Growth of the Market in the Future
- Time under Review – Economic Life of an Asset
- Penetration Rate of the New Technology
- Expected Cash Flow from the Exploitation of the New Technology
- Determination of the Net Cash Flow – as a base for discounting and calculation of the Net Present Value
- Discounting Rate
- NPV – Sum of calculated discounted Net Cash Flow for each year under review!
How DCF Calculation Work

\[ PV = \sum_{t=1}^{n} \frac{CF(t)}{(1+r)^t} \]
Challenge 4: Constructing the Price

Once we “projected” the value - question to be asked – what is the percent of potential operational profit of licensee that you think you “deserve” as a generator of technology?

Rule of Thumb”?

25 – 30 % of licensee operational profit?

30% of NPV?

Subjective

Experience is essential!
Elements of the Price of License

- Value of Technology
- Benefit and Risk - NPV
- Key Terms of Licensing Agreement
- Premium
The key terms of a licensing agreement are the vital elements in the structure of the licensing agreement.
Key Terms and Business Objectives of Licensing Parties

- Key Terms are Inter-related;
- Determined by Business Objectives of Negotiating Parties;
- What do you want to achieve with the licensing agreement will influence your options related to key terms!
Key Terms

I. Subject Matter: What is licensed?
II. Scope: What can you do with it?
III. Financial: What value is it?
IV. Upgrades and maintenance: What will happen with it in the future?
# Subject Matter of the Imaginative “Smart Turbine” Licensing Agreement

<table>
<thead>
<tr>
<th>Patent 1 (Turbine)</th>
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- **Copyright** (Software, Schematics, Documentation)
- **Trade Secrets**
- **Know-how**
- **Trademark**
I. What the Licensee Wants to License IN

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Trade Secrets
Know-how
Key Terms - Scope: What can you do with it?

- Variety of options:
- Exclusive – Non Exclusive (the price will not be the same, even for the same subject matter!!)
- Time – longer legal and economic life, higher price;
- Territory - worldwide is more valuable, if you have an adequate protection;
- Field of Use – specific field or all?
- Right to Sublicense
- Use of Know – How – very valuable.

The scope of the rights will influence significantly the price!
Key Terms – IV. Upgrades and Maintenance: What will happen with it in the future?

- “Grant back” – very important and valuable non-monetary compensation;
- Additional services – training and other support;
- Responsibilities and Guaranties of Parties – licensor that takes responsibility to enforce the IP, licensee that will monitor potential infringement of IP, guaranties for the quality of the product etc…
Key Terms – III. Financial Terms

- Forms of Payment
  - Lump Sum
  - Upfront payment
  - Installment payment
  - Royalty Rates
  - Combination
Constructing a Price

Objective Elements - influencing the price, measurable
- Value of Technology
- Key Terms Negotiated
- Financial Situation of Licensee – objective, if licensee can afford to pay!

Subjective Element
- How important this technology is for Licensee in the current context? Very Important for Price!
Constructing a Price

- Depends on your business objective
  - Creating a long term research collaboration?
  - Desperately in need for up front payment NOW!
  - Continuing royalty rates flow?
- Structure of the Payment
  - Higher upfront payment – reasonable lower royalties rate;
  - Higher instalment payments – in balance with RR.
Conclusions

- Constructing the price depends on objective and subjective elements;
- The “whole picture” has to be taken into consideration – technology, key terms, context and interest of other party, to create more or less accurate price;
- Experience is essential.
Thank you
Thank you!

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