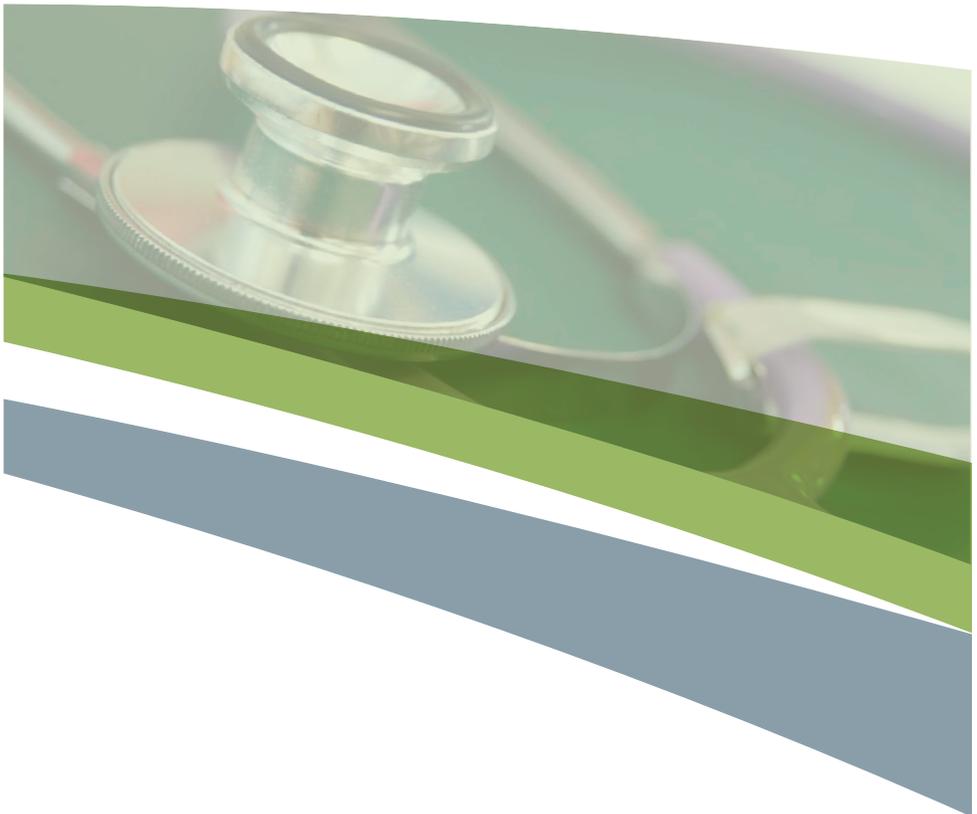




Intellectual
Property
Office

Agreeing a price for IP rights

IP Health Check 2



1



2



3



4



5



IP Health Check booklets

This booklet forms part of our IP Health Check series, a suite of booklets and online tools for business which have been developed to help you identify your intellectual assets and advise you how best to exploit and protect them.

There are five IP Health Check booklets in this series:

1. Licensing intellectual property;
2. Agreeing a price for intellectual property rights;
3. Non-disclosure agreements;
4. Choosing the right IP adviser;
5. Resolving IP disputes.

Online IP Health Check

The online IP Health Check is free for any business to use and takes you through a simple questionnaire which creates a tailored confidential report setting out an action plan.

There are seven online IP Health Checks:

1. Trade Marks for branding of goods and services;
2. Patents for technology in products and processes;
3. Registered designs for the way products look;
4. Copyright for literature or artistic work;
5. Licensing your intellectual property for exploiting your IP;
6. Confidential information to keep your IP secure;
7. Protecting trade marks overseas.

The online IP Health Check is available at:
www.ipo.gov.uk/iphealthcheck.





About this booklet

This booklet is designed to help businesses conducting transactions involving Intellectual Property Rights (IPRs)¹ to arrive at the valuation for the IPRs. It:

- will help you understand whether you are charging or paying too much;
- describes the common methods of valuing IPR;
- provides an easy-to-complete checklist, in scorecard form, which you can use to assess the value of IPRs in your transaction; and
- lists other useful resources.

There is no easy or foolproof way to value IPR, and it can become complicated. This booklet will take a little time to read through, but it will take you a long way towards being able to take an informed decision about the value of IPR. It will also help you to see whether you need to call on an expert professional, and if so it should enable you to make best use of his or her time. We encourage you to read on – it will be well worth it in the long run!

¹ The main intellectual property rights include: copyright, patents, trade marks and designs. Know-how (trade secrets) may also be an important element of an intellectual property portfolio. These are explained in more detail in 'My IP: Intellectual Property explained' <http://www.ipo.gov.uk/myip.pdf>. The management and licensing of the different forms of intellectual property can be important to business success. See 'Licensing Intellectual Property'. <http://www.ipo.gov.uk/licensingbooklet.pdf>



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Buyers and sellers, and licensors and licensees, usually negotiate and reach some sort of compromise on the price to be paid for IPRs.

Why valuing IPRs can help your business

You will need to know whether you are charging or paying too much (and how any differences of opinion can be resolved) when you are:

- selling or buying any Intellectual Property Rights (IPRs);
- selling or buying any asset protected by IPRs;
- selling or buying any business in which IPRs are significant assets;
- granting or taking a licence of any IPR; or
- appointing a franchisee, distributor or reseller.

This booklet is designed to help you in those circumstances.

Given the amount of time, effort and money spent in creating and protecting IPRs, they must have a value, but where do you start when you want to put a price on any IPR?

Buyers and sellers, and licensors and licensees, usually negotiate and reach some sort of compromise on the price to be paid for IPRs or on-going payments or royalties. You will reach a reasonable compromise more easily if you understand your own position and the position of the other party.

IPRs are worth only as much as the buyer or licensee is willing to pay for them.

You are more likely to be successful in your negotiations if you have a good idea of what might be a reasonable price to charge or pay, and how you can justify the amount you want to charge or are offering to pay.

Valuing IPRs

IPRs are worth only as much as the buyer or licensee is willing to pay for them. The only time you know exactly how much any IPR is worth is when someone has just paid for it.

Valuing IPRs can seem difficult and complicated because:

- there is no easily-understood set of valuation rules which can be applied in every circumstance;
- no one knows what benefits owning or using the IPRs will bring in future; and
- when you value IPRs, the unique qualities which give them their competitive edge mean that you cannot easily obtain information about sales or licences of similar IPR.



Value may be more if the seller is willing to provide other benefits, such as technical assistance.

Important factors for buyers and licensees

Many factors determine whether there is a buyer for any IPR, and how much that buyer is willing to pay.

For buyers and licensees, the value of IPRs will depend on factors such as whether the IPR allows them to:

- increase sales;
- price their products at a premium;
- reduce production costs;
- increase the speed of production;
- improve the quality of their products;
- create customer following;
- avoid or reduce development costs; or
- erect a barrier against competition.

That value may be more if the seller is willing to provide other benefits, such as technical assistance, marketing assistance, help with quality control or providing know-how.

If you are selling or buying a car, it is easy to look at a guide to motor vehicle values and to find a figure based on sales of cars of the same make and model and the same age and condition; but it is difficult to find similar comparables for IPRs.

As well as the financial side of things, look at what other contribution(s) the licensee will make to your business.

Valuing IPR is not a hypothetical exercise

The value of IPRs to the seller and to the buyer depends on the circumstances at that time and in that place.

It is important to look at:

- the nature of the IPRs;
- the purpose for which they will be used;
- the potential market for them;
- the business of the seller and the buyer;
- their competitors;
- all the details of the transaction between the buyer and the seller; and
- why each of them wants to do the deal.

It's not just about the money

It is important to look at the deal as a whole and your relationship with the other party in the round. As well as the financial side of things, look at what other contribution(s) the licensee will make to your business.

One buyer or licensee may be prepared to pay a higher royalty rate, but another licensee may be able to generate more sales. That may be because it has a product which is complementary to the licensor's product or because it is more experienced or has better geographical coverage. Or another licensee may give the licensor access to IPR which increases the attractiveness of the seller's product.



There is no point in trying to value a trade mark which does not differentiate your products or services.

A royalty which is too high is not always a good thing in the longer term; it could lead to the licensee trying to increase its return by charging a higher price to customers, and that might mean that fewer products are sold.

Not all IPRs are valuable

Unless IPRs help to create, maintain or increase cash flow, they may have no real value.

There is no point in trying to value a trade mark which does not differentiate your products or services, or which others are not interested in using, or for which they are not prepared to pay. You may have to accept that your trade mark has no commercial value at present.

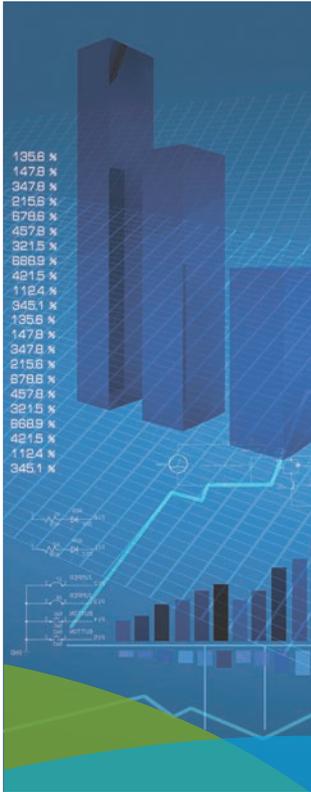
The fact that there is no commercial use now for a patent does not always mean that the patent has no value. Its value will depend on its ability to generate revenue in future, or its ability to help the owner or licensee to increase or maintain market share by acting as a barrier to competition.

The value of the IPR will change over time.

The economic climate will affect the value of IPRs, but so will other factors.

A patentable invention in the early stages of development will be worth less than a strong, patented invention which is close to market or which is on the market and generating revenue.

A patent which is generating healthy revenues now will be worth less if it is soon to expire.



The availability of information, and the aims of the parties have a bearing on the method to be used.

Some common methods of valuing intellectual property

There are many different approaches to valuing IPRs. They all have their limitations and no method is appropriate in every case.

The stage of development of the IPRs, the availability of information, and the aims of the parties have a bearing on the method to be used.

It may be useful to start with one approach and then to use one or more others as a cross-check. But using different tools may result in different valuations of the same IPRs.

Valuing IPRs is an art and there is no obviously right or wrong answer.

The cost method

This involves looking at:

- the costs incurred in developing or creating the IPR; or
- what it might cost to recreate the IPR or to develop a similar product or service.

'The cost method appeals to sellers because it seems fair to them that they should receive at least as much as they have spent.'

These costs usually include the cost of:

- labour;
- materials and equipment,
- R&D;
- creating of a prototype;
- testing and trials;
- regulatory approval and certification;
- registering the IPR and associated professional fees;
- and overheads for utilities, accommodation and support staff.

This method assumes that a potential buyer can avoid these costs by buying the IPRs. The seller will try to convince the buyer that, by buying the IPRs, the buyer will avoid:

- spending at least as much to develop similar IPRs;
- the risk that it might not be successful in developing similar IPRs; and
- the risk that the similar IPR might not be protected.

This method appeals to sellers because it seems fair to them that they should receive at least as much as they have spent.

And it is easier than other methods which involve finding comparative information on which to base a market valuation of the IPRs; or estimating the income which might be received from exploiting the IPRs.



The cost method may be appropriate when valuing IPRs which are in the early stages of development.

It is an unsatisfactory method for the buyer. The costs incurred in the creation of the IPRs have no bearing on the income which the IPRs might generate in future or the amount which the buyer will have to spend to get the product to market.

This method may produce the wrong answer for the seller. It may give an under-valuation if the IPRs give the owner an important advantage in the market, but the development costs have been low.

But if the development of the IPR has been inefficient or especially long-drawn-out and expensive, this method may result in an over-valuation.

This method is sometimes used to apportion the purchase price of a business among its assets where the IPRs are a small part of its total assets.

It may be appropriate when valuing IPRs which are in the early stages of development or when equivalent IPRs may easily be developed.

The market value method

Estate agents use many methods to value properties; one is by looking at the price of other properties in the same area sold during the last few months. In theory, you should be able to value IPRs by looking at sales or licences of similar IPRs.

The market value method is objective and fair to both parties, but is unlikely to be used to value patents, as the value of a patent depends on its novelty.

You need to look at several very recent (ideally contemporaneous) sales or licences of similar IPRs for similar products in the same industry sector.

In practice, it is often difficult to use this method because:

- It is difficult to obtain information about other transactions – they are often kept confidential;
- There are sources of transaction data for various sectors, but they tend to give a wide range of figures for sales and licences which are only broadly comparable;
- Few transactions are sufficiently similar to allow a valid comparison. Your arrangements might differ from other arrangements in terms of: exclusivity; the payment structure; whether any technical or other support is provided; the territory; the economic climate and market conditions;
- You are unlikely to know whether, for instance, a lower royalty rate was agreed because the buyer/licensee brought some other advantage to the seller/licensor; and
- No two deals are really the same. You have to take into account unknowns such as the position of the parties, the characters of the people involved in the negotiations and the economic climate.

This method is objective and it is fair to both parties.



The thinking behind the income or economic benefit method is that IPRs are only worth what they will generate in future....

But it is unlikely to be used to value patents. That is because the value of a patent depends on its novelty; and that novelty means that you are unlikely to be able to find truly comparable information.

If you are in a niche market you will have difficulty finding comparative information.

If you are involved in negotiating the sale or licence of a package of IPRs, you are less likely to be able to find information about similar deals.

The income or economic benefit method

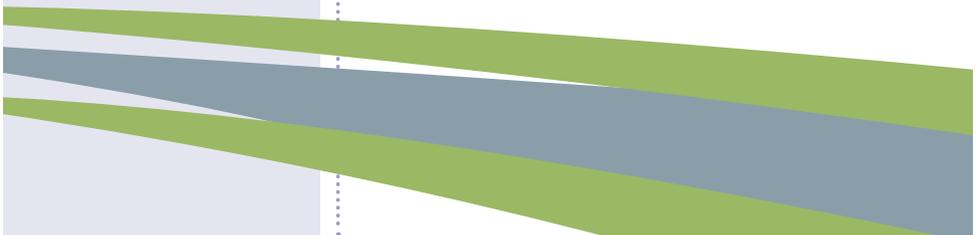
The thinking behind this method is that IPRs are only worth what they will generate in future. It involves looking at:

- future income which the IPRs might generate; and
- the costs of generating that income;

over the economic life of the IPR.

Then the result is discounted to allow for risk and the cost of money. The end result is the net present value or NPV.

If the NPV value is positive, a buyer using this method will probably proceed; if the NPV is negative, the buyer will probably withdraw.



The market value method is objective and fair to both parties, but is unlikely to be used to value patents, as the value of a patent depends on its novelty.

Difficulties with this method include:

- It is difficult to estimate the economic life of the IPRs;
- It is difficult to estimate the income over several years;
- Factors such as the strength of the IPR, the size of the potential market, the nature of the competition, changes in the economic climate, and the costs of registering and defending the IPR need to be taken into account; and
- There is no generally accepted view about the amount of the discount to be applied.

The way in which the IPR is exploited, the costs involved, the time it will take to get to market, and the risks involved along the way will vary from business to business.

To make matters more complicated, income may be generated by other factors, e.g. the skill of the seller's staff.

Uncertainties about the future mean that it is unrealistic to project income for more than 4 or 5 years.

Trying to estimate the income for early-stage technology is very difficult.

The **relief from royalty** method is a sub-method of the income method. The thinking behind this is that if the buyer did not own the IPR, it would need to buy or take a licence of it. Therefore, the value of the IPR should be equal to the present value of the royalties which the owner does not have to pay to use the IPR.

Industry norms

It is tempting to rely on anecdotes about standard royalty rates in different sectors and on surveys or databases of licensing rates in different sectors.

This sort of information may be out of date and it is likely to give a wide range of rates.

Industry norms do not take account of: the strength of the IPRs; the potential market; the competition; the position of the parties; or their relative bargaining power. They ignore the current economic climate; the specifics of the sale or licence; and the characters and skills of the negotiators.

Rules of thumb

The 25% rule

In many negotiations the royalty rate actually agreed for a patent turns out to be somewhere between 25% and 33.3% of the licensee's anticipated gross profits (before tax) on sales of products which use the patent. For a trade mark the royalty rate is more likely to be between 10% and 15%.

Calculating gross profits usually involves taking into account manufacturing costs, such as raw materials, labour and utilities, but operating expenses (e.g. costs of sales and general overheads), are usually ignored.

This is the case even though the value of the IPR to the licensee will be affected by its operating

expenses. The more the licensee has to spend on things such as marketing, selling and customer support, the less valuable the IPR will be to it. A royalty rate which ignores this is unrealistic.

Most royalties are on net sales, so the 25% rule is adapted to give a rate on net sales. In sectors where profit margins are usually high (e.g. the software industry), the royalty rate will be correspondingly high; where profit margins are traditionally low, royalty rates will also be low.

Some negotiators will automatically challenge you if you depart from this rule of thumb, but you may have good reason for not sticking to it. You will only be able to counter a rule of thumb valuation or industry norm if you can justify your figures.

The 5% rule

In many sectors the average royalty rate based on net sales turns out to be in the region of 5%. This is an average and the figures which underlie it vary widely.

All rules of thumb ignore important factors such as the investment needed, the risks involved and the circumstances of the parties. Any rule of thumb should be no more than a starting point; it should not prevail over a more considered approach to IPR valuation, common sense and commercial acumen.

Valuation checklist

The following IPR Valuation Checklist sets out some of the factors you need to take into account when valuing IPRs.

It has been designed to help you to analyse whether you are in a strong or a weak bargaining position (i.e. if you are a seller or licensor, whether you can justify a higher price for your IPR) and to consider how you might improve your position.

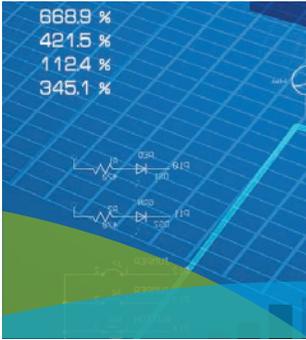
If you are a prospective buyer or licensee, you can use the checklist to help you to decide whether it is worth paying a lot for the IPR or whether there are circumstances which reduce its value to you and/or which you want the seller/licensor to sort out before you are prepared to pay for the IPR.

You will find it easier to answer the questions in the Checklist if you have read the final section of this booklet – Factors to take into account.

Feel free to add more factors to the checklist.

You should answer each question in the second column.

Some of the questions may not be relevant to you or to the IPR which you want to buy, sell or license. Just ignore those.



Column 3 (Score) is designed to give you a feel for where you stand. It allows you to assign a score depending on whether your answer suggests that you are in a very strong bargaining position (a score of 5) or in a bad bargaining position (a score of 0), or somewhere in between.

The final column is for suggestions as to how you might improve the position if you have a low score. If you take steps to improve the position you can recalculate the scores.



IPR valuation checklist

The IPRs: _____

The proposed transaction: _____

The parties:

Seller/licensor: _____

Buyer/licensee: _____

Score (on a range of 0-5 where 5 means you are in a strong position and 0 means you are in a weak position)



Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
<p>1 What benefits does the IPR bring to the buyer/licensee?</p> <p>Does the IPR allow the buyer/licensee to:</p> <ul style="list-style-type: none"> • Generate revenues in future? • Create, maintain or increase cash flow? • Increase sales? • Price their products at a premium? • Reduce production costs? • Increase the speed of production? • Improve the quality of their products? 			

IP Health Check: Agreeing a price for intellectual property rights

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
<ul style="list-style-type: none"> • Create customer following? • Avoid or reduce development costs? • Increase or maintain market share by creating a barrier to competition? 			
<ul style="list-style-type: none"> • Will the seller/licensor provide: • technical assistance? • help with quality control? • know-how? • some other benefit to the buyer/licensee? 			
<p>If there are existing licences, does the buyer want the revenue generated by the existing licences?</p>			
<p>Are the terms of those licences commercially sound?</p>			
<p>Is there some other benefit to the buyer/licensor?</p>			

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
2 What benefits does the buyer/licensee bring to the seller's/licensor's business?			
<p>Does the buyer/ licensor bring:</p> <ul style="list-style-type: none"> • A complementary product? • Sales and marketing experience? • Good geographical coverage? • IPR which increases the attractiveness of the product? • Other benefits? 			
3 The nature and strength of the IPR			
Is the IPR in the early stages of development/close to market/ on the market?			
Does the IPR give the owner a monopoly, (as with patents, trade marks and registered designs) rather than just a right to prevent copying?			

IP Health Check: Agreeing a price for intellectual property rights

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
Does the IPR give the owner a wide monopoly?			
Is the IPR new, or a modification of existing IPR?			
If it is a modification, is it vital to the operation of the product?			
Is the IPR dependent on earlier IPR?			Seller/licensor should obtain alicence under the earlier IPR
Has the IPR been kept confidential?			Seller/licensor should obtain non-disclosure undertakings
Does the seller/licensor own the IPR?			Seller/licensor should take an assignment of the IPR from the owner
Does the seller/licensor have the right to license the IPR?			Seller/licensor should acquire the right to license the IPR
Have all contributors to copyright works waived their moral rights?			Seller/licensor should obtain waivers if the moral rights affect the value of the IPR
If the IPR can be registered, has it been registered? (Ask this question for each relevant territory)			Seller/licensor should submit application for registration
If the IPR is registered, will it expire soon?			Seller/licensor should submit renewal application if possible
If it is about to expire, can it be renewed?			Seller/licensor should investigate whether it can be renewed

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
Is the IPR likely to be challenged?			Consider contacting the IPO to make a freedom to operate search (providing information to help establish whether a product or process may infringe somebody else's patent) and obtaining information about a rival company's patent activity (competitive intelligence)
If it is likely to be challenged, can it be easily defended?			Consider filing a new patent to strengthen the existing patent
Does the owner have sufficient resources to resist any challenge?			
Can competitors design around the IPR?			
Is the IPR the subject of a legal dispute?			
If the IPR is infringed, will it be difficult or expensive to stop the infringement?			Consider obtaining insurance cover
Will the licensee pay a royalty for a licence to avoid a dispute?			

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
Will the licensee have exclusive rights?			
Will the licence be long enough to allow the licensee to recoup its costs?			
May the licensee grant sub-licences?			
4 The potential market			
Is there a market for the products protected by the IPRs?			
What is the nature of that market?			
What is the size of that market?			
What is the value of that market?			
Where is that market?			
How much are customers prepared to pay?			
What is the potential market share?			

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
5 The competition			
Does the IPR create a barrier for competitors?			
Can competitors easily work round the IPR?			
How long will it take to work round the IPR?			
How much might it cost to work round the IPR?			
6 Further development and investment			
How much will the buyer/licensee have to spend before the product is ready for market and attracting customers?			
How long will it take to be ready for market and to attract customers?			
What are the risks of the development not being successful?			

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
<p>What are the risks of competitors getting to market first?</p>			
7 The economic life of the IPRs			
How likely is technological change which will make the product obsolete?			
How likely are changes in legislation which will make the product obsolete?			
Are production costs likely to increase substantially?			
For how long might market share increase?			
How long is the economic life of the IPR?			
8 The position of the parties			
Does the buyer/licensee have skills, technology, geographic or market presence or financial resources which help it to get the IPRs to market more quickly, to exploit them more successfully and to see off competitors and challengers?			

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
Will the buyer/licensee have to buy-in expertise or other IPR in order to be able to exploit the IPRs?			
Does the seller/licensor need money quickly?			
Does the buyer/licensee need a quick deal?			
Is the seller in liquidation?			
Does the buyer/licensee have access to funding?			
Does the buyer/licensee want to exploit the IPRs as widely as possible to generate income?			
Does the buyer/licensee want to stop its competitors using the IPR?			
If there are existing licences, does the buyer see the existing licensees as a threat to its own operations?			

Question	Answer	0 = weak 5 = strong	Possible steps to be taken to improve the position
9 The payment structure			
Is the seller/licensor insisting on an up-front payment?			
Is the seller/licensor prepared to share the risks in the form of success payments?			
		Total Score:	

Factors to take into account

The nature and strength of the IPRs

You need to understand the type of IPR, what it protects, and the benefits it might bring to the business of the buyer or licensee.

A patent is a registered IPR and it gives the owner a monopoly; only the owner has the right to use the invention. Copyright does not create a monopoly, but it stops competitors copying the protected work. Both are limited in time. On the other hand, a trade mark is not limited in time and may be renewed indefinitely.

IPRs to be sold or licensed will consist of more than one kind of IPR. A product may be protected by patent but the brand name may be as important, and sometimes more important, than the patent. In some cases it may be impossible to manufacture under a licensed patent without access to confidential know-how.

Novelty: If a new technology can be exploited without having to buy a licence to use existing technology or if it fills a gap in the market, it will be worth more. But it may be more difficult and more expensive to create a market for something which is completely new.

Confidentiality: If you disclose a patentable invention before you have applied for a patent

you may not be able to obtain a patent and your invention may be worthless. Know-how which has not been kept confidential and which is available from other sources will not be as valuable as know-how which you have kept confidential.

Ownership: Does the seller or the licensor have the right to sell or license the IPR? If it does not, it has nothing to sell or license.

Anyone who has commissioned someone else to develop IPR or who has worked with someone else to develop IPR, may not own the IPR or may only be a joint owner and unable to exploit the IPR without the other owner's consent.

Moral rights: Where the IPR is a copyright work, the individual creators may have moral rights which restrict the exploitation of the work.

Registration:

Registering IPRs gives people confidence. If the IPR is capable of registration (e.g. it is a patentable invention, trade mark or design), a buyer or licensee may be willing to pay more if the IPR is registered at a national Intellectual Property Office or if an application to register has been made.

Registration is not the end of the story; it is important that the registration is renewed when necessary.

Registered IPRs which are coming to the end of their registration period and which cannot be renewed will be worth less than IPR whose registration can be renewed. In those circumstances the buyer or licensee has less

chance to recoup its investment in the IPRs.

Challenge: The fact that IPR has been registered does not mean that it is not open to challenge. Whether or not the IPR is able to withstand any challenge will affect its value.

A patent owner who has sufficient resources to litigate may be able to use a weak patent to deter its competitors.

On the other hand, the holder of a strong patent who has few financial resources may not be able to withstand a challenge.

Breadth of patent

claims: This refers to patents which give the owner broad rights which may cover (and block) later inventions made by other people. A broad claim gives a wide

monopoly to the owner or exclusive licensee. As a result, the patent may be more valuable.

A narrow patent claim may be more easily defended against challenge.

If competitors can design around a narrow patent, the patent will be less valuable.

A new patent may help strengthen an existing one and make it more difficult to challenge it, even if the new patent has little value in itself.

If a later patent is dependent on an earlier patent belonging to a third party, it may not be possible to exploit the later patent.

But a patent for a small improvement may be valuable if it is vital to the operation of a product.

Infringement and litigation:

Buyers and licensees avoid IPR which is the subject of a legal dispute.

If IPR is infringed, the cost and difficulty of stopping the infringement will affect its value.

But a business may be prepared to pay or accept a modest royalty for a licence in order to avoid a dispute over IPRs.

The nature of the licensee's rights:

A licensee who has exclusive rights may pay more than a licensee with non-exclusive rights. This is because an exclusive licensee has no competition from other licensees in its field or territory. Therefore it has a better chance of recouping its investment.

A longer licence may be worth more to the licensee because the

licensee is more likely to have time to recoup its costs.

A licensee who has the right to grant sub-licences may be willing to pay more because the licensee will be able to exploit the IPR more easily and more widely.

Existing licences

If licences have already been granted, the buyer of the IPR will want to pay less if it sees the existing licensees as a threat to its own operations. But it may be willing to pay more if it wants the revenue generated by the existing licences (provided their terms are commercially sound).

The potential market

Whether or not there is a potential market affects the value of IPRs. If there is a market, the nature of that market, its size and value, its location, the amount customers are willing to pay and the

potential market share will affect the value of IPRs.

The competition

Do the IPRs create a barrier for competitors or can they easily work round them? If they can work round the IPRs, the length of time it will take to do this, and how much it will cost, will affect the value of the IPRs.

The need for further development and investment

A buyer or licensee may have to spend large amounts before a product is ready for market.

Sellers and licensors often underestimate the investment needed, the time it will take to be ready for market and to attract customers. And they often overlook the fact that the buyer is taking the risk that the development may not be successful.

Buyers and licensees will take the costs of development, IPR protection, production and advertising into account. The higher those costs, the less they will pay for the IPR.

The longer it takes to get to market, the greater the risk that competitors will get to market first.

But if the product is ready or almost ready for market, the costs and the risks to the buyer or the licensee are reduced and competitors may have to spend a lot of time and money to catch up.

The economic life of the IPR

The economic life of IPRs is the period during which they generate income. The economic life of IPR is rarely the same as its 'legal life',

i.e. the length of time for which the IPR exists.

The situation is different in different sectors. The economic life of a software program will be shorter than the duration of copyright in the software. In the pharmaceuticals industry generic competitors enter the market when patent protection comes to an end.

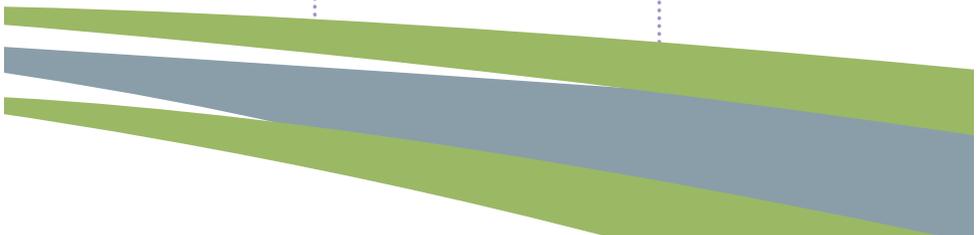
The likelihood of technological change and the costs associated with it, how quickly and easily competitors are able to produce something which is as good as (or better), changes in legislation, unforeseen developments in technology, market shifts, challenges to the validity of the IPR and increases in production costs all have a bearing

on the economic life of IPRs.

The level of income generated by the IPR will not remain the same throughout its economic life. Income will increase as market share increases, but it may reach saturation point. Competitors may catch up or improve on the technology, or the technology may become obsolete.

The position of the parties

The buyer or licensee may have skills, technology, geographic or market presence or financial resources which help it to get the IPR to market more quickly, to exploit it more successfully and to see off competitors and challengers. In those cases, the IPR will be



more valuable in their hands.

The costs of buying-in expertise or other IPR (or both) in order to be able to exploit the IPR, will reduce the price a buyer or licensee is willing to pay.

Sellers and licensors may need money quickly. If they do, they will be prepared to accept a lower offer than if they had the time to wait for a higher offer.

A buyer's motives in acquiring the IPR and the likelihood of achieving its aims will affect the price it is prepared to pay.

A buyer or licensee may want a quick deal and be prepared to pay more if it wants the IPR before its competitors enter the market or because it needs it to obtain investment.

A buyer may want to exploit the IPRs as widely as possible to generate income. Or

it may want to acquire IPRs to prevent its competitors using the IPRs.

The economic climate

If there is less money about, it is more difficult to find a buyer or a licensee. If you can find one, the amount they are prepared to pay is likely to be less.

But if the IPR gives them a real advantage and they have the resources to exploit that advantage, the value of the IPR may not be as depressed as you might think.

A downturn means that more businesses are desperate to sell or to boost their revenues by licensing. More companies go into liquidation and are forced to sell their assets (including their IPRs). Some buyers will find opportunities which do not exist in better times.

Economic downturns do not last forever. Any

deal should not assume that the returns from the IPRs will always be as low as during the downturn. Regardless of the current economic climate, any licence should look to the future and try to take inflation into account.

Legal and regulatory matters

Compliance with the law and regulatory controls in areas such as testing, health and safety and advertising, will affect the costs of manufacture and selling, and have a bearing on the value of the IPR. (Remember that the law and regulations are different in different countries.)

A licensee will not be willing to pay a generous royalty if the licence is restricted to a country where the law affords little protection for the IPR. In those circumstances others may (unlawfully) exploit the IPR even though the licensee is granted exclusive rights.

The payment structure

Most sellers/licensors will want an up-front payment of some sort. The larger the up-front payment, the more likely it is that the royalty rates or revenue shares will be smaller.

Buyers and licensees will try to resist up-front payments because they have to pay before they receive any income from the IPRs and they bear no relation to the amount of income which the IPRs generate. Licensees may accept a higher royalty rate to avoid an up-front payment.

An up-front payment may be the only revenue which the licensor receives if the licensee is not successful in exploiting the IPR. Therefore licensors may be prepared to agree to a lower royalty rate if the licensee makes an up-front payment.

Where possible buyers want to share the risks of development and prefer to make success payments. Those are payments which depend on certain milestones being met. The buyer of a pharmaceutical patent may be prepared to make a payment when clinical trials

are completed, when authorisation to market is obtained, when certain levels of sales are achieved etc., etc. The total potential payment may be more if the seller is prepared to share these risks.

Where a licensee has exclusive rights, but the revenues generated are lower than expected, most licensors will want to be able to terminate the licence if there is a potential licensee who might be able to generate more revenues.



Sources of further information

What is IP: www.ipo.gov.uk

On-line IP Health Check: <http://www.ipo.gov.uk/whyuse/business/iphealthcheck.htm>

Advice on licensing: 'Licensing Intellectual Property': <http://www.ipo.gov.uk/licensingbooklet.pdf>

Skeleton Licence:
<http://www.ipo.gov.uk/skeletonlicence.pdf>

Valuing IP:

Valuation of Intellectual Property and Intangible Assets (Wiley, 3rd Edition), Gordon Smith and Russell Parr

Valuing Intellectual Property in Japan, Britain and the United States (Routledge Curzon, 2004), edited by Ruth Taplin

<http://www.ipfinance.blogspot.com>

History and Acknowledgements

A Review of Intellectual Property for Her Majesty's Treasury by Andrew Gowers recommended that the Intellectual Property Office should develop resources to assist small businesses in conducting Business-to-Business IP licensing. To develop this project the Intellectual Property Office set up a working group of external stakeholders with experience of, or an involvement in, IP licensing. We would like to express our sincere thanks to representatives of the following organizations for participating in this work.

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