



RICS professional guidance, global

# Valuation of intellectual property rights

1st edition, May 2015



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# RICS professional guidance

## International standards

Globally recognised high level valuation principles and definitions are now embodied in the International Valuation Standards (IVS) published by the International Valuation Standards Council (IVSC). RICS has long been a supporter of the development of such universal standards, and not only fully embraces them itself, but also proactively supports their adoption by others around the world.

*RICS Valuation – Professional Standards 2014*, commonly referred to as the Red Book, formally recognises and adopts the IVS by requiring members to follow them. It also complements the IVS by providing detailed guidance and specific requirements concerning their practical implementation.

Member and firm conduct is underpinned through the application of the Rules of Conduct and the Global Professional and Ethical Standards and is assured through a well-established system of regulation. The whole ensures the positioning of RICS members and regulated firms as the leading global providers of IVS-compliant valuations.

## RICS guidance notes

This is a guidance note. Where recommendations are made for specific professional tasks, these are intended to represent 'best practice', i.e. recommendations that in the opinion of RICS meet a high standard of professional competence.

Although members are not required to follow the recommendations contained in the guidance note, they should take into account the following points.

When an allegation of professional negligence is made against a surveyor, a court or tribunal may take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the member acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this guidance note should have at least a partial defence to an allegation of negligence if they have followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance.

It is for each member to decide on the appropriate procedure to follow in any professional task. However, where members do not comply with the practice recommended in this guidance note, they should do so

only for good reason. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice. Also, if members have not followed this guidance, and their actions are questioned in an RICS disciplinary case, they will be asked to explain the actions they did take and this may be taken into account by the Panel.

In some cases there may be existing national standards which may take precedence over this guidance note. National standards can be defined as professional standards that are either prescribed in law or federal/local legislation, or developed in collaboration with other relevant bodies.

In addition, guidance notes are relevant to professional competence in that each member should be up to date and should have knowledge of guidance notes within a reasonable time of their coming into effect.

This guidance note is believed to be consistent with case law and legislation of general application at the date of publication. It is nevertheless the member's responsibility, in relation to the particular jurisdiction in which their valuation is undertaken, to establish and have due regard to:

- (a) any new or altered case law or legislation after the publication date and
- (b) any relevant national standards – see Red Book PS 1 paragraphs 4 and 5 – to the extent that they take precedence.

## Document status defined

RICS produces a range of professional guidance and standards documents. These have been defined in the table below. This document is a guidance note.

Type of document	Definition	Status
<b>Standard</b>		
International standard	An international high-level principle-based standard developed in collaboration with other relevant bodies.	<b>Mandatory</b>
<b>Professional statement</b>		
RICS professional statement	A document that provides members with mandatory requirements or a rule that a member or firm is expected to adhere to. This term encompasses practice statements, Red Book professional standards, global valuation practice statements, regulatory rules, RICS Rules of Conduct and government codes of practice.	<b>Mandatory</b>
<b>Guidance</b>		
RICS code of practice	Document approved by RICS, and endorsed by another professional body/stakeholder, that provides users with recommendations for accepted good practice as followed by conscientious practitioners.	Mandatory or recommended good practice [will be confirmed in the document itself].
RICS guidance note [GN]	Document that provides users with recommendations or approach for accepted good practice as followed by competent and conscientious practitioners.	Recommended best practice. Usual principles apply in cases of negligence if best practice is not followed.
RICS information paper	Practice-based document that provides users with the latest technical information, knowledge or common findings from regulatory reviews.	Information and/or recommended good practice. Usual principles apply in cases of negligence if technical information is known in the market.

# 1 Introduction and scope of this guidance note

**1.1** This guidance note is restricted to the valuation of intellectual property (IP), a subset of intangible assets. Its purpose is to expand on the International Valuation Standards 2013 and *RICS Valuation – Professional Standards 2014* (the ‘Red Book’) in order to clarify the legal, functional and economic characteristics of IP that should be considered and reported on in an IP valuation.

**1.2** This guidance note is built upon, and should be read in conjunction with, the following documents released by the International Valuation Standards Council and RICS:

- International Valuation Standards 2013:
  - Framework
  - General standards and
  - IVS 210, Intangible assets (IVS 210).
- IVSC Technical Information Paper 3, *The valuation of intangible assets* (TIP 3) 2012 and
- Red Book VPGA 6, Valuation of intangible assets.

**1.3** IVS 210 (paragraph C1) defines an intangible asset as:

‘a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and economic benefits to its owner’.

The categories of identifiable intangible assets identified in IVS 210 are:

- marketing related
- customer or supplier related
- technology related and
- artistic related.

**1.4** IP is a legal concept that refers to creations of the mind that are derived from intellectual or creative effort for which exclusive rights are recognised. IP rights are negative rights in that they give the owner the right to prohibit others from using the property without permission. IP can be categorised as registered or unregistered, and includes:

- trademarks
- patents
- copyright
- design rights
- plant breeders’ rights and

- confidential information.

**1.5** IVS 210 and TIP 3 refer to certain IP rights when describing categories of intangible assets, but do not provide detailed guidance about the characteristics of particular categories of IP that should be considered in a valuation.

**1.6** The purpose of this guidance note is to describe how the legal, functional and economic characteristics of IP influence the definition of the subject asset, the extent of investigation, the choice of valuation methodology and the valuation analysis. Limitations in the scope of this guidance note are:

- The identified legal, functional and economic characteristics of different categories of IP are not intended to be exhaustive.
- The legal rights attached to specific IP rights may vary by jurisdiction. This guidance note identifies general principles but does not cover variations in rights between jurisdictions.
- No elaboration is provided regarding the valuation methods described in TIP 3. The intention is to identify issues that should be considered in selecting and applying valuation methods.
- As with other asset categories, the value of IP can vary significantly under different bases of value. Bases of valuation as described in the IVS Framework and VPS 4 in the Red Book are beyond the scope of this guidance note.
- There are a wide range of applications of IP valuation; it is beyond the scope of this guidance note to address matters specific to a particular application.

**1.7** This guidance note is effective from publication in May 2015.

## 2 Defining the subject IP and assessing legal characteristics

### 2.1 Introduction

**2.1.1** IVS 210 states that:

‘the intangible asset shall be clearly defined by reference to its type and the legal right or interest in that asset.’ (IVS 210, paragraph 2)

Regarding brands, TIP 3 indicates that this term:

‘is often used to describe marketing-related assets. It is a generic description that typically refers to a group of complementary assets that can be separately identified and therefore distinguished from goodwill. The rights to marketing-related assets such as trademarks, trade names or trade dress often are protected by registration under statute.’ (TIP 3, paragraph 3.3)

Similarly, the term ‘technology’ is often used to describe a group of complementary assets that can include patents, confidential information, registered designs and copyright.

**2.1.2** The subject of a valuation can be a single right, or a portfolio of complementary IP rights and other intangible items. Intellectual property rights that are frequently the subject of transactions and valuation reports are those associated with brands, technology and artistic works.

In order to illustrate frequent commercial applications, and due to similarities in the economic attributes of each grouping, this guidance note separately considers brand-related IP (brand-IP), technology-related IP (tech-IP), and artistic-related IP (artistic-IP). The commentary covers different types of IP within each category (for instance trademarks, copyright and design rights are discussed within brand-IP).

Commercial substance is applied when grouping IP within these categories. For instance, if a brand logo is protected by copyright, this guidance note will categorise it as brand-IP rather than artistic-IP to mirror its commercial use.

**2.1.3** Brand-IP, tech-IP and artistic-IP can comprise a number of distinct legal rights and the ownership of these rights can vary between jurisdiction and classes of product and service. It is therefore important that the valuer identifies, defines and describes the specific rights attached to the IP in the valuation report.

**2.1.4** When considering whether an IP right should be valued as a stand-alone asset or with a group of complementary assets, the valuer should consider the following factors:

- the purpose of the valuation (for instance, a valuation supporting an IP transaction will be influenced by the pooling of IP in the transaction)
- normal commercial practice in the relevant industry regarding the pooling of IP rights for licensing or sale
- the separability of individual rights and
- alignment of useful economic life and other economic characteristics of the IP.

**2.1.5** Unless a valuation clearly

- identifies the legal rights that underpin the subject asset
- assesses the breadth and strength of these rights and
- indicates whether ownership of the rights has been established,

the remaining steps in the appraisal can be compromised.

### 2.2 Brand-IP

**2.2.1** As there is not a generally accepted legal or financial definition of the term ‘brand’, it is essential for a valuer to define the pool of rights that are the subject of a brand valuation. The valuer should always consider the following IP:

- registered trademarks
- common law rights in trademarks (depending on the law within the relevant jurisdiction)
- copyright in artistic works within the brand design/logo and
- design rights/registered designs.

**2.2.2** In certain licences and transactions a broader pool of rights might be included in the definition of ‘brand’:

- copyright in brand guidelines and marketing collateral
- recipes, formulations and other product-related confidential information and
- URLs and social media sites.

When defining the subject asset and reviewing comparable transactions the valuer should consider whether it is

appropriate to treat such items as complementary to the subject trademarks, copyright and design rights, or whether they should be separately valued.

**2.2.3** Each form of legal protection can vary by jurisdiction, so a brand can consist of multiple rights that differ by jurisdiction and also by class of product or service. An immediate valuation implication is that the valuer should consider the appropriate level of segmentation for the valuation as different legal rights might result in different valuation assumptions by country or product category.

**2.2.4** There are different methods of determining ownership of each type of IP; some rights are automatic while others require examination and registration by the appropriate body.

**2.2.5** A further complication is that ownership of each right can be vested in different parties. For instance, where a trademark includes an artistic work, this might be protected by copyright, which is a separate and distinct right from the trademark. Also, the two assets can be owned by different parties. This is of particular relevance as the creator of an artistic work is the initial owner of the copyright (rather than the party that paid for the work).

**2.2.6** The legal remedies available for breach of copyright or trademark protection vary, and where both rights subsist in a brand, either or both can be used for enforcement.

**2.2.7** Within each jurisdiction trademark registrations are by class and in respect of specific goods and/or services. Registration in one class does not necessarily provide the right to use the mark in another class.

**2.2.8** Common law trademark rights vary by jurisdiction (some countries have a 'first to file' regime) and are typically only fully tested in a passing off action.

## 2.3 Tech-IP

### 2.3.1 Overview

Technology-related IP includes:

- patents
- designs
- plant breeders' rights
- circuit layout rights
- copyright
- technical know-how and
- trade secrets pertaining to formulations and other technical information.

In some instances it is appropriate to value specific rights on a stand-alone basis and in others it is appropriate to identify a pool of complementary assets. In instances where the term 'technology' is used to describe a subject asset, the valuation should clearly identify the specific rights included in the definition.

### 2.3.2 Patents

**2.3.2.1** For a set period, patents provide patentee(s) with the exclusive right to exploit an invention. In return for this exclusive right the invention that is the subject of patent protection is published about 18 months after the first filing date.

Patents are governed by specific country legislation and also by international treaties. As such, the extent to which a technology benefits from patent protection can vary by jurisdiction.

**2.3.2.2** The term of patent protection is typically 20 years, however, there are some exceptions to this rule. For example, some jurisdictions have a two-tier patent system that includes innovation or utility patents, which have less onerous patentability requirements and shorter periods of protection.

An extension to the patent term may also be granted under certain circumstances.

**2.3.2.3** The claims within a patent specification define the scope of the exclusive right conferred by the patent (or the protection sought by a patent application). The breadth, validity and enforceability of the claims are therefore central to the value of a patent.

**2.3.2.4** Patents are generally subject to a lengthy and complex examination period prior to grant. The earnings and risk profile of a patent application differ from those of a granted patent. This is because a patent application might not proceed to grant or, if it does, the claims of the granted patent can be of narrower scope than the initial patent application. It is therefore necessary to differentiate between a patent application and a granted patent.

For patent applications, the communication between the regulatory authority and applicant, referred to as the prosecution history, can provide insight into obstacles to particular claims.

**2.3.2.5** Patents expire if maintenance fees are not paid, so the grant of a patent does not imply that it remains in force until the end of the patent term.

**2.3.2.6** Even once granted, the validity and scope of a patent can be challenged, thus an enforcement risk remains after grant.

A granted patent can subsequently be found to be invalid due to a range of factors, including:

- the existence of prior art that was not identified during the prosecution process and
- flaws in the construction of the patent claims, resulting in a definition of the invention that is less than full, clear, concise and exact.

**2.3.2.7** The commercial strength of a patent can be compromised if it is difficult to prove that another party is infringing it; this reduces the ability of the patent owner to

enforce its exclusive right to the invention. The ease of proving infringement differs depending on the subject matter of a patent.

**2.3.2.8** The right to the grant of a patent resides with the inventor(s) or owner(s) of the underlying technical innovation. Ownership can be assigned from the inventors to the applicant or patentee in terms of a contract of employment or subsequent agreement. The rights of the party claiming patent ownership can be compromised without proper transfer of ownership from the inventor(s). Inventorship and ownership can be complicated legal issues that can have significant valuation consequences.

**2.3.2.9** A patent excludes other parties from practising the invention but does not guarantee that the owner has the freedom to exploit the patent without infringing patents owned by other parties. A freedom to operate search can be carried out to provide a legal opinion as to whether the subject of a patent can be used without infringing other rights.

**2.3.2.10** A patent that relates to an industry standard may be the subject of licensing obligations required by the standards organisation. These obligations can limit the enforceability of the patent.

### 2.3.3 Other types of tech-IP

**2.3.3.1** The term **trade secrets** generally refers to know-how that:

- confers an economic benefit
- is not in the public domain and
- is subject to reasonable efforts to maintain its confidentiality.

Confidentiality can be protected:

- through physical, legal and electronic security measures
- by limiting access to the information within the company
- by contractual obligations and
- by enforcement of non-disclosure and non-compete agreements.

Risk of inadvertent disclosure and value impairment is influenced by the strength and enforcement of security. Clear identification and marking of trade secrets reduces the risk of unintended disclosure.

A trade secret provides no protection against independent conception of the same know-how by a third party.

The period of legal protection is not limited unless protection is reliant on contractual terms.

Confidential know-how that is subsequently integrated into a patent application, or registered copyright, enters the public domain and loses the right of protection as a trade secret.

**2.3.3.2 Copyright** can protect certain documented know-how, designs, integrated circuit designs, and computer software code (which may be protected by both patents and copyright).

Copyright protects the expression of the work and not the idea or process underlying the work. In the case of software, the source code represents the expression of the work. Other legal characteristics of copyright are identified under subsection 2.4, Artistic-IP.

**2.3.3.3 Industrial designs** protect the visual design of objects that are not purely utilitarian. These can be registered in individual jurisdictions or through international treaties that provide a single application mechanism for registering an industrial design in several countries.

Registered designs typically have a five-year period of protection with a right of renewal. Some jurisdictions also provide protection for unregistered designs.

## 2.4 Artistic-IP

**2.4.1** TIP 3 states that artistic-related intangible assets:

‘arise from the right to benefits such as royalties from artistic works such as plays and other performed works; books, newspapers and other literary works; films, television and other visual media; music, including lyrics (either published or performed), or photographs, illustrations, drawings and paintings.’ (TIP 3, paragraph 3.6)

**2.4.2** Copyright is the primary IP protecting this category of intangible asset. As copyright is vested in the creator of the work, it is necessary to establish the author of the work and the copyright holder if there has been an assignment of ownership. Ownership rights can be influenced by employment contracts or other contracts entered into by the author.

**2.4.3** Registration is not necessary to establish copyright protection, but in some jurisdictions copyright can be registered and this can support copyright litigation. In some instances a copyright owner’s protection can be enhanced through notification that the subject item was subject to copyright.

**2.4.4** In describing the subject asset, it is necessary to identify the type of work (e.g. architectural, literary, dramatic, musical, artistic, cinematographic or sound recording) and potential sources of earnings, such as broadcast, distribution, display and reproduction.

**2.4.5** Copyright represents a range of rights and it is essential to identify the rights that are the subject of a particular engagement. In addition to the author’s right there might be separate rights to display, disseminate, sell, make copies or create derivatives of the original work. It is necessary to define whether the subject asset is the

unencumbered ownership of the copyright or a right to use the copyright for a specified purpose.

The total earnings generated by the copyright works might therefore be split between the owners of different rights to the copyright.

**2.4.6** The period of protection depends on the relevant jurisdiction.

## 3 Clarifying and disclosing the extent of investigation

### 3.1 Disclosing restrictions in scope

**3.1.1** IVS 101 (Scope of work, paragraph (g)) states that:

‘Any limitations or restrictions on the inspection, inquiry and analysis for the purpose of the valuation shall be set out in the scope of the work.

If any relevant information is not available because the conditions of the assignment restrict the investigation, if the assignment is accepted these restrictions and any necessary assumptions or special assumptions [...] shall be recorded in the scope of work’.

**3.1.2** The value of brands, technology and artistic work is influenced by the strength of the underlying legal rights and their commercial utility, which is influenced by their functional and economic characteristics. Hence, the valuation of these assets requires multi-disciplinary inputs.

Before undertaking a valuation of IP, the valuer should consider whether he or she is competent to identify and assess the relevant characteristics of the subject asset, and/or whether expert opinion is required.

**3.1.3** As legal, technical and market factors can materially influence the value of IP it is important for the user of a valuation report to be informed of the extent to which these factors have been assessed, or if they are covered by special assumptions.

**3.1.4** TIP 3 (paragraph 3.8) states that:

‘where an intangible asset is international in its use, or potential use, and the rights are dependent upon statutory protection, expert legal advice may be required.’

It is recommended that a valuation discloses whether ownership of the subject IP has been determined through a legal assessment or whether this is a specific assumption of the report.

**3.1.5** Assessment of the functional utility of patents and other categories of tech-IP can require a high level of technical expertise. Disclosure should be made as to whether there have been any limitations to the scope of the functional assessment of the tech-IP, including matters such as the breadth and validity of the claims and freedom to operate.

**3.1.6** The future economic performance of brand IP is influenced by the attitudes of buyers of the branded products and services. Disclosure should be made as to whether there have been any limitations to the scope of the market and functional assessment of the brand-IP.

### 3.2 Segmenting the valuation analysis

**3.2.1** The legal rights protecting a brand or technology can vary by jurisdiction. Differences in the pool of IP constituting the subject asset can influence earnings capability and risk, therefore, it is appropriate to carry out the valuation at a level of segmentation that is aligned with differences in the underlying rights.

**3.2.2** In addition to legal considerations, the functional and market assessments that support an IP valuation can be better assessed by market segment (for instance, region or product category) rather than at an aggregate level.

In considering these factors, the appropriate level of segmentation for a particular engagement is also influenced by the purpose and scope of the valuation.

# 4 Assessing the functional and economic characteristics of the subject IP

## 4.1 Introduction

**4.1.1** TIP 3 (paragraph 4.2) makes several references to the need for a valuer to understand the 'nature and attributes of the subject intangible asset'. TIP 3 also refers to 'characteristics', 'attributes' and 'functionality' of the subject asset.

This is important, as the functional, market and economic characteristics of IP influence its earnings capability, risk profile and value.

**4.1.2** The need to assess market factors is consistent with the requirements of a valuation of a business and all other asset categories. This guidance note restricts its commentary on market assessment to establishing the market potential of the subject IP and benchmarking with any comparable IP.

**4.1.3** Unique characteristics of brand-IP, tech-IP and artistic-IP are outlined in subsections 4.2 to 4.4. Generic economic characteristics of IP are:

- IP is generally not diminished by use, so although its useful economic life might be limited, it will not suffer from wear and tear.
- IP can be simultaneously used by multiple parties.
- The relationship between cost of creation and IP value need not be linear. This can result in a high risk of wasted investment, however, conversely it may also result in high upside potential.
- It is generally more difficult to detect and prevent unauthorised use of IP than physical assets.

## 4.2 Brand-IP

### 4.2.1 Overview

**4.2.1.1** The legal rights that protect the name, design and visual identity of a brand are fundamental to its value. However, the legal rights are only partly responsible for generating cash flow. The ability of brand-IP to generate a higher price and/or higher volume than an unbranded product results from the extent to which it influences consumer attitudes and purchasing behaviour towards the underlying product or service.

**4.2.1.2** The value of brand-IP therefore depends on its market strength and reputation in addition to the owner's ability to prevent other parties from exploiting the reputation of the brand.

### 4.2.2 Market performance

**4.2.2.1** Measures such as market share and historic performance can be indicators of the market strength of brand-IP. However, the market performance of a branded product can be driven by factors other than the strength of the brand-IP, for instance:

- a high market share can result from barriers to entry rather than preference and loyalty towards the brand-IP
- growth in market share might result from improved distribution capability rather than improvements in the consumer appeal of brand-IP and
- low share of a broadly defined market can disguise the strength of brand-IP in a niche market segment.

**4.2.2.2** Measures of price premium and price elasticity can provide insight into the market strength of brand-IP, however, these can result from superior product performance as well as from the appeal of the brand-IP.

**4.2.2.3** The valuation of brand-IP requires an assessment of the economic contribution of the brand relative to other value drivers of the branded product. Some sophisticated, data-rich brand owners carry out econometric modelling or predictive research to isolate and quantify the impact of brand-IP relative to other factors that influence market performance. However, quantitative analysis of this sort is rarely available to valuers.

### 4.2.3 Brand equity

**4.2.3.1** The market research and marketing professions use the term 'brand equity' to describe the aggregation of consumer attitudes towards a brand or the reputation of the brand. This is distinct from residual business goodwill because it is inextricably linked to the brand-IP. The benefits of brand equity follow the ownership, or right to use, the brand-IP.

Descriptions such as 'brand strength' can be used instead of brand equity.

**4.2.3.2** Although brand equity is a generally accepted concept among marketers, there is no standardised definition. Most reputable brand equity models include measures of brand awareness, brand associations concerning quality and image, and the level of consumer affinity towards the brand.

Sophisticated brand owners collect attitudinal measures of this type through quantitative consumer research.

**4.2.3.3** Where available, consumer research can provide an insightful input to the assessment of the market strength of the subject brand-IP. If no such data exist, the valuer should consider whether the purpose and scope of the valuation justifies such research to be commissioned.

### 4.2.4 Brand investment

**4.2.4.1** The extent and duration of advertising expenditure can provide an indication of the market strength of brand-IP, particularly when tracked relative to competing brands. However, valuers should not assume that there is a linear relationship between brand investment and the value of brand-IP.

**4.2.4.2** 'Share of voice' is a term that describes a brand's level of advertising expenditure as a percentage of the total advertising expenditure of all competing brands.

## 4.3 Tech-IP

### 4.3.1 Overview

**4.3.1.1** The earnings capability of tech-IP depends on functional and commercial utility. Incremental utility can result from performance of the end product in which the IP is embedded, or from operating efficiencies resulting from the use of the IP.

**4.3.1.2** The risk profile of tech-IP that is still being developed includes development risk, which takes account of:

- the risk associated with each development hurdle and
- the cumulative probability of successfully commercialising the technology.

This is further discussed under subsection 6.1.4.

**4.3.1.3** Once commercialised, the earnings of tech-IP is subject to risks resulting from economic, market regulatory and technical factors.

### 4.3.2 Technology investment

The historic cost of developing tech-IP is not necessarily reflective of its value, but can be a useful reference point. Research and development (R&D) costs that are accompanied by verified progression through development phases are likely to increase value through the progressive reduction in development risk.

### 4.3.3 Patent characteristics

**4.3.3.1** For a patent to be granted, the invention that is the subject of the patent must (among other things) be novel and non-obvious. However, this does not imply that it:

- is capable of use or manufacture
- is marketable or
- can be profitably exploited.

As a result, a patent requires ongoing legal costs, but provides no certainty of earnings.

**4.3.3.2** In a patent document it is necessary, to some extent, to identify:

- how the invention is or will be used
- the product or process to which it relates and
- the relevance of the claims of the patent to the utility of the product or process.

The extent of the increase in utility relative to existing technology influences the value of a patent.

**4.3.3.3** The economic importance of a patent's function is illustrated by the following example. Within the pharmaceutical industry the earnings potential of patents varies depending on whether they protect a compound, formulation, diagnostic method, method of treatment or manufacturing process. Furthermore, economic differences may arise depending on the indications covered within the scope of the claims; for instance cancer, diabetes or colds and flu.

**4.3.3.4** Within the commercial application of a patent, it is necessary to assess the breadth and relevance of its claims. Some products or processes will be protected by multiple patents. The economic contribution of each contributory patent will be influenced by the relevance of its claims to the incremental commercial utility of the technology.

Where a patent's claims offer a wide scope of protection, this will tend to have commercial advantages, unless the increased breadth compromises the patent's validity and enforceability in light of prior art.

**4.3.3.5** The ease of developing alternative technical solutions that circumvent a patent has a significant impact on its useful life and value. The likelihood of circumvention can be reduced by broad (and enforceable) patent claims or a portfolio of complementary patents.

Where pre-existing technologies exist, these can provide evidence of the ease of circumvention. Alternatively, patent network mapping, a review of published research, or the opinion of a technical expert can inform the likelihood of circumvention.

**4.3.3.6** Even in situations where a patent appears unlikely to be profitable in use by the owner, it can block other parties from using infringing technology and thereby create earnings through deterrent, licensing or litigation.

**4.3.3.7** The useful economic life of a patent might be shorter than its legal life and cannot exceed the remaining term of protection. Patent specifications become publicly available, so, once the period of legal protection has expired, the invention can be used by other parties and surplus earnings will be eroded. Standard patents generally have a life of 20 years from the filing date. However, some jurisdictions, including China, have special types of patent that have a shorter life.

**4.3.3.8** A 'blockbuster' patent typically provides a significant increase in utility, is difficult to design around, has a significant useful life and is not difficult to enforce.

#### 4.3.4 Characteristics of trade secrets

**4.3.4.1** As with other tech-IP, the value of trade secrets depends on their contribution to income generation or cost efficiency.

**4.3.4.2** Unlike patents, trade secrets do not prevent other parties from using similar know-how if this is independently discovered. Hence, the incremental earnings generated by a trade secret are influenced by the likelihood of third parties reverse engineering the know-how or creating similar know-how of their own.

The competitive advantage resulting from trade secrets can be rapidly lost through inadvertent disclosure.

**4.3.4.3** Costs associated with maintaining trade secrets are influenced by the methods used to protect them.

## 4.4 Artistic-IP

**4.4.1** Economic benefits of copyright include the length of statutory protection, low costs, difficulty in circumvention, and the potential for higher statutory damages.

**4.4.2** The method of monetising copyright is influenced by the nature of the underlying work, the market appeal of the work, and the ability to distribute and control its use. The ease of distributing copyright works through digital technology has increased revenue-generating opportunities and also the risk of unauthorised use.

**4.4.3** The ease of duplication and detection of unauthorised duplication can impair copyright value and differs by the form in which the copyright is expressed.

**4.4.4** Having identified the various rights associated with the subject copyright, a valuer should consider copyright strength, which varies according to the extent of original expression in the work. For instance, factual works typically have narrower copyright protection than work with more creative content. Facts and other information that is in the public domain do not demonstrate the originality and creativity required of a copyright work.

## 5 Selecting an appropriate valuation approach

### 5.1 TIP 3 (paragraph 4.2) states that:

‘understanding the nature and attributes of the subject intangible asset and the nature and characteristics of the market for that asset is generally critical to determining the most appropriate valuation approach’.

### 5.2 Having assessed the subject IP, the factors considered in determining the appropriateness of the **cost approach** should include:

- the strength and degree of differentiation of the subject IP, and the probability of success in developing a replacement asset of similar utility
- for tech-IP, the likelihood of the owner of a replacement asset having freedom to operate without infringing existing patents. This is linked to the strength and breadth of the subject IP, and the ease of designing around it
- the position of the subject IP within its expected useful economic life, as this will influence the need for an obsolescence provision and
- the expected time required to develop IP of similar utility and ability to reasonably estimate the associated cost, including the development time, probability of success, and opportunity cost.

### 5.3 Having assessed the subject IP and identified the relevant market(s), the factors considered in determining the appropriateness of the **market approach** should include:

- the extent of novelty or differentiation of the subject IP and the likelihood of there being other assets that are sufficiently similar to enable comparative analysis. Comparability testing should cover legal, functional, market, and economic characteristics such as risk and return and
- to the extent that there are comparable assets, whether there is sufficient relevant and publicly available data concerning arm’s length transactions.

### 5.4 Having assessed the subject IP, the factors considered in determining the appropriateness of the **income approach** should include:

- whether the subject IP has established earnings that are consistent with the basis of valuation. The absence of existing earnings does not invalidate the income approach, but can increase the difficulty in forecasting earnings

- if the subject IP is still under development, the extent to which reasonable estimates can be made concerning the probability of successfully completing the development, the period of development and commercialisation, and the method of pricing the IP
- where the subject IP does not/will not generate stand-alone earnings, whether:
  - sufficient information is available to isolate the earnings generated by the subject IP from other contributory assets and functions
  - there are sufficiently comparable assets for which arm’s length royalty rates or earnings are available or
- the extent to which reasonable estimates can be made regarding future earnings and risk.

### 5.5 The commentary to IVS 210 notes that the heterogeneous nature of many intangible assets means that there is often a greater need to consider the use of multiple methods and approaches than for other asset classes.

This is particularly true of IP which, by definition, is unique. There will be instances where information gaps or other difficulties will compromise the use of all valuation approaches. In these situations the use of more than one method helps support key assumptions and the valuation opinion.

### 5.6 TIP 3 also refers to the use of sensitivity analysis to perform cross-checks and reasonableness checks on an asset valuation. In the case of IP, sensitivity analysis can be of great benefit to both the valuer and user of a valuation report.

# 6 Integrating IP characteristics into valuation analysis

## 6.1 Income approach

**6.1.1** TIP 3 states that ‘all the intangible asset valuation methods under the income approach require prospective financial information for some of their inputs’ and that ‘estimates of these financial parameters are critical to derive a credible valuation’ (paragraph 6.2).

The impact of legal, market, functional and economic characteristics of the subject IP on all prospective financial information should be considered.

### 6.1.2 Useful economic life

#### 6.1.2.1 Overview

TIP 3 states that ‘estimating the remaining useful life of an asset will include consideration of legal, technological or functional and economic factors’ (paragraph 8.4).

Relative characteristics of IP relating to brands, technology and artistic works are identified in subsections 6.1.2.2–6.1.2.4.

#### 6.1.2.2 Brand-IP

a) Different periods of legal protection are provided by different rights supporting a brand:

- Registered trademarks can be renewed on an ongoing basis so long as the necessary fees are paid and the mark remains in use.
- Common law trademark protection varies by jurisdiction and generally depends on the extent of use and novelty of the mark.
- Copyright has a long but finite period of protection.
- The term of a registered design varies by jurisdiction and is typically five years with a right of one renewal for another five-year period.

b) The useful economic life of a brand can exceed the life cycle of branded products and there are many examples of successful brands that are more than 100 years old. This has to be balanced against high rates of attrition for start-up brands and the decline of some brands that previously achieved a strong market position.

c) Factors that can influence the useful economic life of brand-IP include:

- the extent of the legal rights that enable the brand owner to protect its brand equity
- the market position and historic performance of the branded products and services
- the brand equity, or other measure of consumer attitudes towards the brand, and trends therein

- if the brand-IP is closely associated with a single product, the life cycle of the underlying product category and
- the extent and trend of related advertising and marketing expenditure.

d) For well-established brand-IP with no sign of impairment and no foreseeable limit to the period over which economic returns can be generated, an indefinite useful life can be appropriate.

#### 6.1.2.3 Tech-IP

a) The remaining legal life of a **patent** provides the ceiling to its economic life. An assessment as to whether the economic life is shorter than the legal life can include the following factors:

- the quality of the patent claims as reflected by the prosecution history and any legal challenges
- the ease of designing around the patent claims
- the market position and performance trends of any products or processes using the invention that is the subject of the patent
- the technology life cycle and barriers to entry within the industry that the patent is used and
- measures of commercial interest in the patent such as recent licences and the extent of forward citations.

b) An assessment of the useful life of **trade secrets** should include factors such as:

- time restrictions to any supporting non-disclosure or non-compete contracts
- the strength of procedures used to maintain confidentiality
- the degree of difficulty in competitors reverse-engineering the confidential information or creating equivalent know-how
- the technology life cycle within the related industry and
- if the trade secrets result in a customer-facing benefit, the extent of the resulting product differentiation, the extent of consumer appeal and the product life cycle.

#### 6.1.2.4 Artistic-IP

Copyright has a finite but lengthy period of protection. The economic life of artistic-IP is influenced by:

- the performance trends of the artistic work
- the useful life and sales curve of other works by the author, or of comparable works
- trends within the related sector or genre and
- the ability to control unauthorised use of the copyright.

### 6.1.3 IP earnings and growth

#### 6.1.3.1 Brand-IP

a) Brand-IP that is valued using the income approach will typically have an existing earnings stream, so a key assumption is the growth rate. Whether expressed as an explicit growth assumption or through a multiple, the assessment should include factors such as:

- economic trends and growth trend of the market segments in which the brand-IP operates
- maturity of the brand-IP and its historic performance relative to the market
- brand equity, or other quantitative measures of consumer attitudes, and the trends therein
- level of historic advertising relative to competitors and budgeted future advertising expenditure and
- anticipated legislative changes concerning the markets in which the brand is used.

b) Where the brand-IP's earnings are embedded in those of a business unit, methods such as those referred to in TIP 3 are required to estimate the brand's earnings contribution. These include relief-from-royalty, premium profits, excess earnings, and the Greenfield method.

When the relief-from-royalty method is used, the comparability factors identified in paragraphs 6.2.2 and 6.2.3 should be referred to. TIP 3 confirms that:

'any royalty information obtained should be adjusted to reflect the differences between the comparable royalty arrangement and the subject asset.' (TIP 3, paragraph 6.21)

Factors to be included in the comparison should include terms of the licence agreement and:

'differentiating characteristics such as market position, geographical coverage, functionality, whether they are used in connection with business-to-business or business-to-consumer products etc.' (TIP 3, paragraph 6.21)

#### 6.1.3.2 Tech-IP

a) When the income approach is considered appropriate for tech-IP that is still under development, assumptions are required regarding the expected date of commercialisation and future development costs. The assessment should consider:

- R&D plans and milestones
- technical complexity of the development project
- progress through designated phases of testing and, if applicable, regulatory approval and
- development cycles of similar R&D projects carried out by the IP owner, or of comparable IP or typical industry norms.

The probability of successfully concluding the R&D is considered under subsection 6.1.4.

b) Where the tech-IP's earnings are embedded in those of a business unit, methods such as those referred to in

TIP 3 are required to estimate the technology's earnings contribution. When the relief-from-royalty method is used, the comparability factors identified in paragraphs 6.2.2 and 6.2.4 should be referred to.

c) Future earnings and growth rates for tech-IP should take account of:

- if the IP is already in use, historic performance of the tech-IP relative to the market and its maturity
- the extent to which the functional performance of the subject IP is superior to alternative technology
- the expected ramp-up period and sales curve following market entry
- peak sales and sales curves of any comparable IP
- economic trends and growth trend of the market segments in which the tech-IP operates
- anticipated legislative changes concerning the relevant markets and
- the technology life cycle within the related industry.

#### 6.1.3.3 Artistic-IP

The factors that influence the earnings and growth of artistic-IP include:

- sales targets identified in any arm's length contracts regarding the use of rights concerning the subject IP
- the legal and market strength of the artistic-IP
- historic earnings of the subject IP and the stage of its life cycle
- peak sales and sales curves of other works by the author or of comparable works
- trends within the related market and genre and
- the ability to control unauthorised use of the copyright.

### 6.1.4 Risk assessment

6.1.4.1 With regard to the use of the weighted average cost of capital (WACC), TIP 3 states that:

'The WACC rate may not be appropriate if the subject intangible asset has a distinct risk profile from the rest of the assets and liabilities utilised in the business or if there is other evidence that indicates an alternative discount rate'. (TIP 3, paragraph 8.2)

6.1.4.2 The risk profile of a stand-alone pool of complementary IP is unlikely to be the same as the systematic risk of a company that operates in the same industry as the subject IP.

6.1.4.3 Special consideration is required for IP that is still in development. Where there is a significant probability of failure, the valuer should consider using risk-weighted scenarios or real options methods of valuation.

If the discount rate is used to reflect development risk, the probability of success should still be estimated and explicitly factored into the discount rate.

6.1.4.4 For **brand-IP**, factors that influence asset-specific risk are:

- strength of legal rights supporting the brand
- security of historic brand-IP earnings and the trends therein
- current brand equity and trends therein and
- market position and trends therein.

Arm's length brand licences or securitisation agreements can provide evidence of commercial recognition of the brand-IP's market strength and risk profile.

**6.1.4.5** For **tech-IP**, factors that influence asset-specific risk are:

- strength of legal rights supporting the technology, including the IP validity risk and IP infringement risk
- even once granted, the validity and scope of a patent can be challenged, thus an enforcement risk remains after grant
- phase of development of the technology underpinning the tech-IP
- security of historic tech-IP earnings and the trends therein and
- commercial utility of the technology underpinning the tech-IP, including design-around risk and technical obsolescence risk.

Arm's length technology licences or securitisation agreements can provide evidence of commercial recognition of the tech-IP's market strength and risk profile.

**6.1.4.6** For **artistic-IP**, factors that influence asset-specific risk are:

- strength of the legal rights supporting the artistic work, including the ability to control unauthorised use
- inadvertent disclosure risk and
- market strength of the artistic work including the risk of obsolescence.

Advances on publishing contracts and arm's length copyright licences can provide evidence of commercial recognition of the artistic-IP's market strength and risk profile.

## 6.2 Market approach

**6.2.1** TIP 3 states that:

'Because most intangible assets are heterogeneous it is rarely possible to find transactional data for an identical asset that can be used as a benchmark for the value of the subject asset. It is more likely that any market evidence will be in respect of similar rather than identical assets'. (TIP 3, paragraph 5.4)

Further:

'Adjustments as required to such transaction prices or valuation multiples, to reflect the differentiating

characteristics or attributes of the subject asset and the assets involved in the transactions'. (TIP 3, paragraph 5.2)

**6.2.2** For IP relating to artistic work, brands and technology the following characteristics influence the extent of comparability:

- type of underlying IP
- breadth and extent of available legal rights
- remaining term of protection
- industry and subsector
- characteristics of the markets in which the subject IP and comparable IP operate
- market position and trends in market performance
- proximity in time between the valuation data and comparable transaction and
- for royalty rates, terms of the licence agreement including up-front payments, duration, and exclusivity.

**6.2.3** Further comparability criteria that are specific to **brand-IP** include:

- price positioning
- brand equity and stage of development
- market position and
- level of advertising support.

**6.2.4** Further comparability criteria that are specific to **tech-IP** include:

- the specific purpose of the technology and its importance to product/process performance
- stage of development, including proof-of-concept and proof-of-economic-viability
- differentiation should be made between patent applications and granted patents and the quality of patent claims
- proof of freedom to operate and
- ease of infringement detection and enforcement.

**6.2.5** Further comparability criteria that are specific to **artistic-IP** include:

- reputation of the author of the artistic work
- type and genre of artistic work and
- ability to control unauthorised use of the artistic work.

## 6.3 Cost approach

**6.3.1** TIP 3 states that the cost approach should only be applied when it is possible to reasonably estimate the reproduction or replacement cost of an intangible asset, and that it is mainly used for assets that have no identifiable income streams (TIP 3 paragraphs 7.3 and 7.4).

**6.3.2** In situations where the cost approach is considered appropriate, the following factors should be considered:

- the stage of development of the subject IP and, if not yet commercialised, the remaining development stages and timeline
- the complexity and novelty of the subject IP and the degree of difficulty in creating an asset of similar utility
- the extent of obsolescence in the subject-IP
- the relevance of the historic development process to the reproduction of the IP or production of a replacement asset and
- the estimated time required to develop an alternative asset, the opportunity cost and the probability of success.



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