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The impact of IP on company valuations, investments and exits.

Blog

Most people tend to think that intellectual property is something only lawyers should trouble themselves with. Most people are wrong. IP is the single most significant contributor to the value of companies these days – especially if your company is a tech startup.

Everyone knows that IP is important. This is especially true for companies that rely on technology in order to create value. But in what way does IP impact the value of such companies – especially in the context of an exit, either in a sale scenario (weather in an acquisition or investment transaction) or in an IPO? In other words, if I were an entrepreneur, a founder or an executive in a tech company (and possibly all three), should I mind the company's IP? What will be the impact of my IP position on my company's value?

First, let's establish a baseline. There are many models for evaluating how much a company is worth. I will not go into that here. Let's just say that every company has a certain economic value, that there are many factors contributing to a company's value and that some companies are more valuable than others. Pretty trivial so far.

Many companies invest quite a lot of money, time and effort in developing IP assets. Such assets may include patents, trademarks, copyrights, secret know-how, etc. What is it good for? There are many ways in which IP assets can create value for a company. We are not talking only about the ability to block competitors (which is the "classic" function of IP) but also on transactions that can actually generate revenues and profits or bring about other strategic and competitive advantages. These functions obviously have economic value, but how much does this actually contribute to a company's Worth?

Well, a lot. According to a survey done by Ocean Tomo, intangible assets (which mostly means IP) accounted for 84% of the total worth of companies in the S&P 500 index in 2015[1]. Interestingly, 40 years ago that number was a mere 17% – so there is clearly a trend here.

IP is therefore a major contributor to the value of companies. This is even more true with respect to tech companies – and doubly so for (some) tech startups. A tech startup usually has no real estate, no machinery, no other tangible assets – and often no product and no market share. All it has is its (existing or future anticipated) IP and the economic value it holds (or the future economic value investors believe it can generate). For tech startups IP is the main – and sometimes only – contributor to company value. It does not mean that for every tech company its value is only reflected in its IP, but there is certainly more into IP than what most people think. In fact, a company's IP is probably most valuable (in relative terms) and makes the most significant contribution to a company's value in the two extremes – when a company is very young and later when it (hopefully) matures to become a large and stable company with significant

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market share.

This point was ascertained in a research done a few years ago[2]. The research, which looked at thousands of VC-backed startups, showed that there is a correlation between a startup's IP position and its chances of success (measured from the VC's perspective – to reach an exit or an IPO). The main conclusions were: (1) startups with strong IP positions were six times more likely to become "winners" rather than "losers" for the investing VCs; and (2) a strong IP position can mitigate risks for investors and create a channel for potential recuperation of the investment (or at least part of it) if the company eventually fails. In another research, researchers from Harvard and NYU concluded that being able to obtain initial patents can positively impact both a startup's ability to continue to innovate and to get more funding from investors[3].

All of this shows that, by building a strong IP position, your company can: (1) increase both its survivability and chances of success; (2) increase its value to investors (which will make it both more attractive and capable of getting more investment at higher valuations with less dilution for existing shareholders); and (3) significantly increase your chances of a healthier and faster ROI, whether through an exit, an IPO or simple profits. This is true for tech startups but also for mature companies looking at their strategies.

Think about that next time you sit with your board…

[1] Cate M. Elsten and Nick Hill, **Intangible Asset Market Value Study?** les Nouvelles Sept. 2017 p. 245 (available at: https://ssrn.com/abstract=3009783.

[2] Joseph Hadzima, Bruce Bockmann and Alexander Butler, **IP in early-stage commercial and investment success, Intellectual Asset Management**, March/April 2010, p. 49.

[3] Joan Farre-Mensa, Deepak Hegde and Alexander Ljungqvist, What Is a Patent Worth? Evidence from the U.S. Patent 'Lottery', USPTO Economic Working Paper 2015-5 (Available at: https://ssrn.com/abstract=2704028).

Key Contacts

Dr. Ziv Rotenberg
Partner

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