



# Extracting Enterprise Value from Organizational Creativity

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In 1975 tangible assets (i.e., real property) such as buildings and equipment, cash and bonds, inventory, and land represented 83% of the total value of the companies making up the S&P 500. By 2015 the situation had completely flip-flopped with the value of intangible assets such as patents, trademarks, copyrights, and trade secrets representing essentially the same percentage of the total valuation of the S&P as tangible assets had 40 years earlier. Then by 2020, intangible assets made up 90% of the total value of all S&P 500 companies, a staggering \$21 Trillion.

Today, IP-intensive industries account for almost 40% of the total Gross Domestic Product of the United States and over 50% of all US merchandise exports.

The reality is, however, that many organizations continue to lag in following the example set by the world's largest enterprises, and that is translating valuable organizational creativity into an intellectual property (IP) asset that substantially enhanced enterprise value. Given the limited resources available to an organization, it is unsurprising that there is a reluctance to spend valuable resources on protecting creativity, when there is a perception that tangible assets make up the bulk of the net worth of an organization in the same way that such assets make up much of our personal wealth as consumers. The reality is, however, that intangible assets now often play an outsized role in enhancing the long-term enterprise value of an organization even if there is a short-term reduction in profit by converting organizational creativity into IP.

## Taking a Step Back – Profit and Enterprise Value

Profit results from the maximization of revenue and the minimization of costs over a fixed period. Direct revenue is generated from routine activities such as the sales of goods and the rendering of services. Indirect revenue is income from other than routine activities such as licensing. Costs can be reduced directly by such things as enhanced efficiency. They can also be reduced through the concept of cost displacement. Cost displacement relates to the revenue potential lost by accepting one piece of business over a competing opportunity. Finally, there is also a concept known as cost avoidance, which is taking action that avoids having to incur costs in the future.

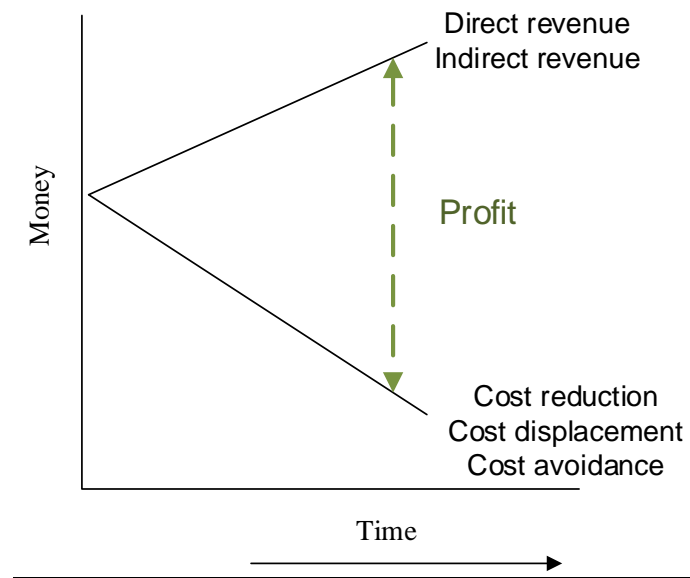


Figure 1 -- Profit

While often tied to profit generation, the reality is that enterprise value encompasses more. For example, do my products or services provide a competitive advantage? Are they more valuable than corresponding offerings of my competitors? What about return on investment? If more money is invested in my enterprise, will an investor get a greater return on that investment in the long-term than with a different business opportunity. As a final example, what if I wanted to sell my enterprise? Is my organization an appealing acquisition target as compared to other potential targets? It is in answering such questions that the potential value of turning organizational creativity into intangible assets in the form of intellectual property becomes clearer.

## Organizational Creativity

Fundamentally, organizational creativity falls into one of two buckets. The first bucket comprises know-how. It is everything associated with developing, producing, and delivering an organization's product and services. These include:

- Business, customer & vendor data and lists
- Pricing/discount information
- Manufacturing processes
- Make-up of a product or a service
- Marketing/business strategy
- Sales projections & target markets
- Software code
- Marketing, sales and use analytics

The second bucket relates to outside perception or messaging. What is the content of your products and services? How is your brand perceived? What is your reputation in the market place?

Of course, not all creativity is created equally. The goal is to determine when it makes sense to take formal steps to convert specific organizational creativity into a business asset. Turning first to profit generation, will it increase revenue, or will it reduce cost in the longer term even if costs go up in the short term by spending limited resources to convert the organizational creativity into an IP asset? Alternatively, is there some long-

term benefit apart from profit that makes certain enterprise creativity worth identifying and securing, namely an enhanced enterprise valuation that real property cannot provide?

Quite simply, in the absence of enhanced organizational creativity, the providing of a product or service only results in commodity value. Any other enterprise can enter the market and provide the same value. On the other hand, identified and secured enhanced organizational creativity can provide a marketplace differentiator, making it more difficult for competitors. Typically, the value of differentiating creativity increases over time as it is exploited for commercial gain, but then its value begins to decrease, ultimately returning to representing a commodity value. An enterprise either needs to provide a new dose of secured creativity that is a differentiator in the marketplace, or a competitor may do so, leapfrogging the original secured creativity.

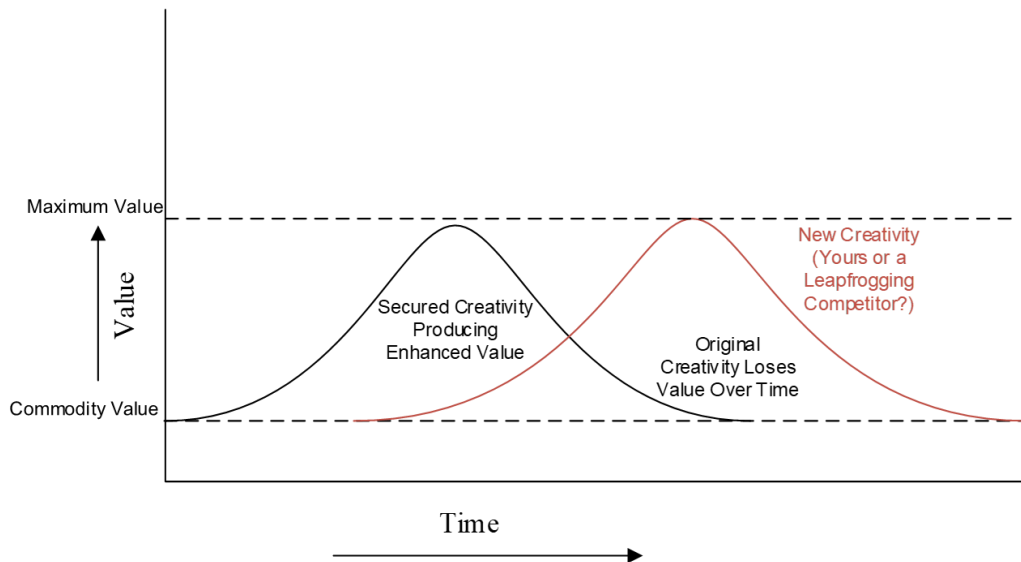


Figure 2 -- How Valuable is Valuable?

## The Under-Appreciated Magic of Converting Organizational Creativity into Intellectual Property

The magic of IP is that to the surprise of many, it has the essential characteristics of a tangible asset. For example, secured organizational creativity in the form of copyright, trademark and patent registrations along with trade secrets subject to contractual obligations may be capital assets in the same way that real estate and equipment are, and should often show up on enterprise balance sheets. Many forms of IP may be used to secure enterprise funding.

Unlike buildings and equipment, cash and bonds, inventory, and land, however, IP also provides an entirely different type of contributor to enterprise value. IP may provide the ability to block competitors dissuade potential market entrants and clear a technological path for future market share. Further, IP may be a critical component to branding, illustrating that an enterprise is both an innovator and a thought leader.

Thus, converting organizational creativity into an IP asset not only helps with securing financing in the same way that tangible assets do, but it may help with attracting partners, licensing and franchising opportunities, and even in settling disputes.

## IP Asset Valuation

In order to convert organizational creativity into an IP asset there are several prerequisites that must be met. These include the following:

- Identifiable creation
- Tangible evidence of existence (e.g., contract, license, registration, record in financial statement)
- Capable of being legally enforced
- Income stream separately identifiable and isolated from those of other business assets
- Capable of being sold independently of other business assets
- Subject to potential destruction or termination at an identifiable point in time

Once organizational creativity is both identified and secured as an IP asset the next step is to consider its particular value. Factors that go into valuation include the following examples:

- Earnings capacity and profitability
- Market share credited to the IP asset
- Legal rights, restrictions, competition, barriers to entry, and risks associated with the IP asset.
- Product life cycle and positioning
- Historical growth and future prospects in the applicable industry

Ultimately, some combination of three different valuation approaches are typically used to produce a final valuation.

- Cost Based Valuation – Takes into consideration both how much it costs to create an asset historically and how much it would cost to recreate it given current market conditions
- Market-based valuation – Looks at comparable market transactions, whether sale or purchase, of similar assets to determine value
- Income-based valuation – Looks at income stream attributable to the intellectual property based on historical earnings and expected future earnings

## Conclusion

Every organization has organizational creativity. To increase profit and provide enhanced long-term enterprise value, the goal of every organization should be to identify and secure the specific organizational creativity that provides the greatest value in terms of know-how or messaging, converting that creativity into an IP asset. Properly securing and monetizing intellectual property maximizes long-term enterprise value. 🍷

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