



EUROPEAN STRUCTURAL FUNDS PROGRAMMES IN SCOTLAND PROJECT PROFILE

PROJECT NAME	Probability Adjusted Contextual Valuation
PROJECT SPONSOR	Scottish Enterprise

PROJECT ORIGIN AND DEVELOPMENT

The European Commission sponsored a study by the Centre for European Policy studies in Brussels on the Intangible Economy in Europe. The two of the four main diagnoses of this key study are that in Europe:

- there existed a capital market failure particularly in respect of hi-tech industries
- capital markets undervalued industries with a high intangible base and reacted in too volatile a manner to such industries.

The background to this project is an understanding that growth in the developed economies will depend on knowledge and intellectual property and its efficient conversion into high value products and services. As a result the funding mechanisms for this type of business may require to be based on the securitisation of knowledge rather than on tangible assets.

Securitisation is defined as the repackaging of asset cash flows into securities. In this way, sources of cash flow are legally isolated from avoidable risk, and debt, backed by this future revenue stream, is issued. This debt can then be placed privately or in the public-listed debt security market. The methodology for securitising an intangible asset is well defined.

The last few years have witnessed a significant growth in the variety of asset classes securitised, In addition to revenue streams from performing art, traditionally unused asset classes including trademark licenses and patent-related royalties have been securitised. The expansion of new asset classes underlines the premise that if an asset can generate a predictable, steady stream of revenue, it may be a candidate for securitisation. At present:

- the concept of securitisation of intellectual property, although already in use, is quite new and has significant potential for raising funding at rates better than bank borrowing, or for securing debt
- the tools required to conduct a securitisation exist: the IP/technology bundling, the valuation of the package for the designed use, the due diligence process for the IP and the deal making skills are all available.

The challenge is that at present only bundles with a predictable future cash flow are Securitised, and typically only from large existing organisations. To extend this technique to Small & Medium sized Enterprises (SMEs) and to investments around new products and services will require the incorporation of techniques such as probability based valuation and multiple value release assessment.

PROJECT AIMS AND OBJECTIVES

The purpose of this project is to examine new approaches, techniques and methodologies, which if successful may allow the development of an investment product, which can secure capital against intangible assets.

PROJECT ACTIVITIES

The project will be divided into two phases:

Phase 1 – Development of approach to determine securitisation value

Phase 2 – Pilot application to a group of SME looking for investment.

Actual investments will be out with the scope of this project but will be considered by the Scottish Enterprise Investment team.

Phase 1 – Development

During this phase two interlinked approaches will be developed.

- Probability Adjusted Value Evaluation (PAVE)
Probability Adjusted Value Evaluation is a proposed technique for determining the values of nascent business or innovations in existing businesses. The development of a PAVE tool could allow the assessment of potential revenue for a particular technology to be calculated and to be offset against the predicted cost to develop the technology and probability of achieving that revenue.

This work will be technology/industry specific and will require an initial analysis phase to see if the current set of techniques can be adapted and combined into a tool that could be used by SMEs.

- Value Release Context Engine (VRCE)
The nature of knowledge and its commercialisation may allow SMEs to create multiple revenue streams from one piece of knowledge. Internationally there is some initial work in looking at creating multiple value streams from knowledge but this exclusively within large multi-nationals. The possibility of transferring this work to a Scottish / SME context would have to be developed.

If successful when combined the two techniques will provide the potential securitisation value taking into account probability of success and the risk factor for multiple value release streams.

The purpose of this is to provide a mechanism to allow assessment of investment decisions in companies whose business is based more on Knowledge.

As this combination of tools is new and the application of the technique to SMEs has not been carried out before there is a possibility that the work will not proceed to a pilot. But assuming a suitable level of confidence after phase one is complete, the second phase of this work would pilot this technique with some potential investment requests from companies.

Phase 2 – Pilot application to a group of SME looking for investment

Phase two would:

- identify 3 initial market sectors that would be tested.
- identify suitable potential investment requests (collaboration with SE investment team)

Carry out detailed securitisation analysis.



PROJECT STRUCTURE

This project will require close project management to coordinate the different aspects, including the use of external expertise for specific knowledge inputs. It is intended that Scottish Enterprise (SE) will manage this co-ordination and be an active participant in the development of this work. It is therefore proposed that senior members of the SE Investment function and Competitive Business Innovation Operations will manage this project.

Scottish Enterprise has in place European Funding Systems and Procedures which cover the preparation and submission of claims, record-keeping and monitoring, notification of significant changes, and compliance with conditions of grant, including publicity requirements. The Competitive Business team will be supported in the management of the EU funding aspects of the project by Scotland Europa. This will include a project start briefing meeting at which all the above aspects will be covered, and co-ordination of the claims process.

PROJECT FINANCE

Funding Partners	Scottish Enterprise
Total Costs (£)	£192,000
Eligible Costs (£)	£192,000
ERDF/ESF Support (£)	£ 96,000
Priority/Measure	3 – Knowledge Access, Knowledge Flows & Knowledge Management

PROJECT PERFORMANCE

The project if successful will:

- develop a knowledge based Securitisation technique
- pilot the approach with 6 SMEs to assess investment possibility.

This will provide a new mechanism to allow investment for innovation for existing organisations and organisations that are more based on intangibles..

PROJECT FUTURE

The work will be considered by SE as the basis of a future investment product.

At the appropriate point SE intends to publish this work both in Europe and the US. SE will also share the output with interested partners through involvement and presentations at suitable seminars and conferences.

PROJECT CONTACT

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