Managing Equity Obtained via Technology Licenses

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This paper discusses the issues to consider when managing an equity position as part of a technology license agreement. Understanding those issues and how to manage them plays a crucial role in realizing a realistic return on equity (ROE). Failure to manage can result in significant value lost.

With concentrated, single-stock portfolios, investors must turn to ways to manage systematic and unsystematic risk. This paper looks at these single-stock risk-management issues.

Why Take an Equity Position?

Licensing institutions will often opt to take an equity position when available from their licensees. Numerous reasons exist and may include the following:

- Equity allows for additional upside revenue beyond the royalty or licensing fees.
- It may be seen as a risk premium to induce the licensor to license to a startup company licensee versus a more established licensor.
- Equity allows a licensee who is cash poor and equity rich to substitute an ownership position for a cash payment, e.g., for upfront licensing fees and/or for a reduced royalty rate.
- Equity allows the licensor to participate in the additional value a licensee obtains, either as a direct or indirect result of the license.

The discussion in this paper assumes that equity granted in a license agreement is not managed as part of a portfolio of stocks, but as a single-stock portfolio. That is, each position’s returns and risk are managed individually and not aggregated with returns from other equity positions. In addition, it is assumed that many positions are large enough to be considered concentrated stock positions.