CURRENT ACADEMIC AND MANAGERIAL VIEWS ON THE VALUATION OF INTERNET DOMAIN NAMES

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Abstract

The Internet is the platform par excellence for the e-presence of individuals and entities, and identification on it, in the form of a domain name, is critical. Domain names´ nature, business significance, and capacity to provide many functions have been discussed for several decades. There is a consensus that domain names are relatively close to trademarks or trade-names, they heavily influence commerce and can even serve as an investment. Yet the valuation of domain names plus the appropriate methodology is subject to much discussion, in which prima facia not reconciliable opinions of academics and managers are, often chaotically, argued. This paper's key hypothesis is that there is an objective and, depending upon the circumstances, adjustable methodology for domain name valuation, endorsed by theoretical academics and also practical managers, and even by generation Y. The conclusions of this paper shed new light in this field, confirm the key hypothesis and suggest concrete instruments and criteria for domain name valuation, which should be further researched.

Key words: domain name, generation Y, IFRS, methodology, valuation

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Introduction

The global, post-modern, knowledge society heavily relies on virtualization and employment of information systems and information technologies ("IS/IT"), like the Internet, for both private and professional purposes (MacGregor, 2015). The Internet is a decentralized Meta e-network of e-devices hierarchically organized in domains of cascade levels, which are attached to e-devices and carry unique domain names. Each e-device directly attached to the Internet has its IP numeric code address and can allow for control of a certain part of the Internet, domain, to which a Website can be attached. The conversion between IP addresses and domain names is done by a system and mechanism of Nameservers and communicative Resolvers, the Domain Name System ("DNS") (Angster & Bücking, 2010). Each domain belongs under a Top Level Domain ("TLD") and has its unique domain name of which the part before the last dot is creative and original, the part after the last dot is standardized and refers to a particular TLD (MacGregor, 2015). TLDs can relate to a country, ccTLDs, or to a branch, gTLDs, or to a subject, new gTLDs. The most popular TLD has been TLD .com.

Pursuant to the majority opinion, domain names are significant and can operate as an address, reference, and marketing instrument (MacGregor, 2013). However, there is a mix of ignorance, discrepancies, inconsistencies and myths regarding the value and valuation of domain names and matching methods. *"Digne puer meliore flamma!"* No two identical domain names can exist, this technical exclusivity makes, from domains, truly unique social and commercial assets (MacGregor, 2015). As domains are platforms to which Websites can be attached and are seen as a billboard or shield for Websites, generally for e-commerce, they are potentially significant for all businesses, regardless whether from the IS/IT sphere or agriculture, and to have a value (Cvik & MacGregor, 2015). This is just a potential, the majority of domain names never become a value per se. Identification, recognition, referring, marketing and other functions can mostly occur only in case of a related Website with appropriate content or the impossibility for others to have such a Website. Businesses require various categories of e-shopping (www presentation, e-commerce, integrated services of e-commerce and e-business conduct) giving them the weight and attention they so richly deserve (Bílková & Dvořák, 2012). In creating and maintaining a competitive advantage, as well as efficiently and effectively conducting business, the Website content, plus its verbal address, the domain name, merits strong consideration. The question is - how to evaluate it?

The entire managerial population, much of academia and the majority of members of generation Y, know about the domain name and its capacity to serve as more than a mere neutral technical record and assign significance and even value not only to the domain name as such, but also to its pre-dot post-dot parts (MacGregor, 2013). Though domain names are intangible assets which are rather subject to "package" deals than individual transferring, with transfer prices seldom disclosed, there are reports of completed sales of domain names with prices easily exceeding 1 million USD followed by the demand to valuate and report the value of domain names as an intangible asset on balance sheets and even on tax returns (Sottilos & Jones, 2013). Managers, and generation Y also, speculate about how these figures are and/or should be calculated and reached, while academia shows only mild interest in the scientific and conceptual establishment of the valuation mechanism and methodology for domain names (Tang et al., 2014). Occasionally, it is discussed the cost and revaluation models, first quality price index in re a benchmark for domain names (Lindenthal, 2014), a general appraisal model (Tang et al., 2014) or second-market pricing (Salvador& Nogueira, 2010).

Despite globalization, there are strong economic and cultural differences in financial reporting (Kubíčková et al., 2014) and in IS/IT readiness. However, the universality, omnipresence and business significance of domain names invites academia, businesses and generation Y to seek for a generally acceptable valuation method for domain names. A research of multi-spectral sources with Meta-Analysis must be conducted and comparatively assessed, while a deeper understanding of current views brings a new light in this sphere.

1 Static-conceptual approach – domain names nature and valuation

The selection of valuation methods and models directly reflects the perception of domain names and their nature by academia, management and generation Y. Boldly, if domain names are properties and/or assets and can get categorized, then the valuation method for such a category should be deployed for domain names as well and should reflect International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS"). A domain name can satisfy a myriad of tasks related to the business conduct and ultimately determining business success. The majority, but not all, of views perceive domain names as intangible assets and/or property with a market value determined by a set of factors, which includes the impression capacity, its shortness, the capacity for being remembered, commercial use, attractiveness, end abbreviation indicating the pertinent TLD, conflict potential, easy pronunciation, easy spelling (not typos), etc (MacGregor, 2015). Still, there are continental law academia opponents which reject the property feature of domain names.

Common law academia and managers have pragmatically reached, without any difficulties, the conclusion that domain names are sui generis e-property rights or even e-property comparable to trademarks as such, and they recognize both the in rem and in personam regime to them (Komaitis, 2010). Continental managers and the entire generation Y have a similar, though more asset oriented view (MacGregor, 2015). Yet there is a split in continental law academia, one opinion stream focuses on the lack of "official" registration of domain names by a state authority, proclaims them mere "relative private records" and strips them of any value, except for the cost. They conclude that since 95% of domain names do not get sold for more than their registration and renewal costs (Huber & Hitzelberger, 2010), which are often only a few USD or EUR, domain names are insignificant parts of IP portfolio with a low, if any, value, and unable to operate as trademarks and trade-names.

This perception needs to be assessed while considering the evolution of other IP assets and it is illustrative to remember that originally trademarks were also perceived as mere identifiers and their “propertization” and recognition to be a business instrument and even investment came much later. The strong disbelief regarding the propertization of trademarks and a rejection of their capacity to be intangible property belongs to the dustbin of history and perhaps domain names undergo the same hard continental law pathway as did trademarks (Komaitis, 2010). The suggested submission of domain names to merely the *in personam* regime would mean the denial of a their potential. A mere observation of the practice shows that the domain name has the potential to have a significant value and to be an economic commodity, and a valuable element of enterprise worth millions of EUR and USD.

It is pointless to dwell much on the classification of domain names within conventional law categories. Domain names are a spontaneous outcome of academic, military and business endeavors that occurred mainly in the USA and financed by the U.S. Government. They have a common law origin and none of their father creators or original facilitators and users have ever had an affinity for the continental law positivistic philippics about categorization strictly leading to a pre-set rigid regime. Plus, the continental law is based on Roman law which has been open to use abstraction and develop and/or adjust current concepts or even to adopt them from outside ‘their’ universe, see *ius natural, ius gentium*, and preatorial legislation. The re-occurring argumentation for exclusively *in personam* regime contradicts the reality and ultimately leads to the denial of the property feature of domain names. If a domain name does not operate *erga omnes* and its beneficiary has just relative claims against one party, then the discussion about the valuation of domain names takes a dramatically subjective and casuistic turn. The value of domain names as a private inter-parte record is only as much as parties assign to it and can be sued for it, period. Further, the view shared by some continental law academics that a domain name is neither a right nor a *re* nor a piece of IP leads to the question – who are the parties, i.e. persons only between whom the domain name has the effect. On one side for sure the Registrant, but on the other side – Registrar, Registry, ICANN, or U.S. Government? Managers have no difficulties recognizing that “their” domain name can be commercialized for prices totally unrelated to the cash-flow and capital strength situation of Registrars or Registries. Generation Y successfully shares its knowledge with managers and open-minded academics, while other academics sink deeper in their total confused perception of domain names. Generation Y is supplying the new business professionals – domain name brokers and domain name appraisers. A domain name is not a mere contractually freely set record in a private database, it is rather a kind of a virtual reference, address and real estate (right) which is close to business or personal names and trademarks (Catty, 2010). It is a property, or at least an asset, needing a value determination. Valuation of domain names can be done only if domain names are properly understood and a suitable regime is assigned to them. Opinions on valuation of domain names and on related methodology are legitimate only if their proponents are aware about the DNS, domain nature and function potential and manage to match this knowledge to current business trends and globally acceptable valuation standards and methods, like Statements of Financial Accounting Standards ("SFAS"), IAS, IFRS and GAAPs.

2 Dynamic-functional approach – valuation according to the use

Opinions that domain names are just a worthless identification or an economically insignificant Internet address have never prevailed in the cradle of the Internet and DNS, the USA, and fortunately have evaporated from the European managerial circles and partially from academia. This is in compliance with IAS 38 describing an intangible asset as an asset without a tangible (physical) substance, which can be identified, controlled, used and can generate economic benefits. Domain names are treated much alike by both SFAS and IFRS in definition and in value methodologies following either the always available cost or revaluation model (Catty, 2010). These two models reflect three theoretically available approaches – the cost approach, the market approach and the income approach.

An open-minded direct field observation by the authors (MacGregor, 2015) indicates that the cost approach is available for the valuation of all domain names, while the market approach only if an active market with domain names exists and the income approach only if an income generating potential can be linked to the domain name, e.g. in the case of an e-business oriented Website. SFAS and IFRS pass on the alleged issue of the only *in personam* regime and perceive domain names as properties/assets to be acquired and developed at cost, to be traded on markets and to directly or indirectly generate income and to become an investment instrument. The appraising person must correctly identify the nature and function of the valuated domain name to select the most appropriate approach and model. For a freshly registered domain name which is (so far) out of the market and without an attached Website, the cost approach should be used. If the domain name has a little bit of history and at this point is parked and not used, i.e. no Website is attached to it, and there is a primary or secondary market for it, then the market approach should be taken. If the domain name is put to consistent and continued employment by the attached Website, ideally e-business oriented Website, then the income approach should come in the picture. These three approaches are flexible and have several variations, e.g. “Acointegration analysis”, which emphasizes information on price trends, historical returns and the fundamental risk related to the Internet domain name (Lindenthal, 2014). These approaches are not always available and each of them is impaired by drawbacks. The cost approach is ridiculed by TLDs with low (if any) costs which cannot have any key (if at all) impact on the choice and valuation of domain names.

Tab. 1: Number of domain names registered within TLDs and registration fee

TLD	Number of domain names in millions	Registration and annual renewal fee in USD
.com	127	8-10
.tk	26	0
.net	16	6-8
.de	14	9-11
.eu	4	4-6

Source: Prepared by authors based on http://research.domaintools.com/statistics/tld-counts/, http://www.domparison.com/domain-name-price-comparison/index.php?want=register&ext=eu

A large majority of gTLDs, and even a significant part of ccTLDs and new gTLDs, are open to subjects from all over the world to register and renew domain names for a marginal cost. Registrants have many TLDs to select from and costs do not really influence their choice.

There is the primary, the secondary and the re-registration market for domain names (Salvador & Nogueira, 2010), where professionals provisory re-register a lapsed domain name while trying to resell it – if a buyer appears, the re-registration and transfer becomes final, if there is no buyer , the re-registration fails and the domain name is definitely dropped. The market approach faces 2 key issues. First, it is extremely complex to follow markets and to find the amount of truly paid prices. Boldly, the vast majority of domain name transfer prices are not made public. Next, even if there is an active market identified and genuine prices published, there is a massive problem regarding for what the price was paid.

The income approach looks appropriate in light of the property feature of the domain name, i.e. if the domain name is perceived as e-property and the domain with Website as the e-real estate (Lindenthal, 2014). Conventionally, the income approach methodology considers rents and values of similar real estate, so the income approach for domain names should work with “how much the domain name gains annually for the Registrant” and “for how much are sold similar domain names”. These are two big unknowns, the first one is hardly to be calculated (how to separate the domain name from the rest) and the second one is hardly available.

A fragment of managers recognize that these three approaches are rather unsatisfactory and recognize a solid business potential to create their "own" valuation methodology and commercialize its outcomes, e.g. the analysis tool VALMATRIX, which works with the 20 most important predictors and contributors to value for a trademark or a patent and uses some of them for domain name valuation. For domain names, it works with four primary drivers of domain name value – TLD (20%), domain name structure (20%), market awareness/recognition (30%), commercial development potential (30%) (Catty, 2010). VALMATRIX is globally perceived as good for scoring, which is perhaps too analytical and static, partially arbitrary and slightly underplaying the functional aspects, i.e. not fully considering the impact of domain name functions, such as the name, identification, association, information, advertising, marketing, shopping forum, product, investment and criminal functions. Plus, all four drives are sensitive to cultural and linguistic differences and it is unclear how well WALMATRIX deals with national preferences, linguistic issues, etc.

A domain name should be a growing passing investment allowing for increasing sales and profits and enjoying symbiotic support with other intangible assets belonging to the same IP portfolio. It is highly instructive to consider the trends of real "hard numeric" data about paid prices for domain names along with academic, business and other comments about it. First, the most popular TLD, TLD .com, has been continuously growing for three decades, despite periods of significant drops in the average price for a domain name, e.g. the decrease of the average price for a domain name by 50% in 2008 as compared to 2007 (Catty, 2010). Being under the most populated and well-known TLDs seems rather a must with a potential than a bonus per se. Next, domain names considered to be the most attractive and profitable are becoming rare and investors are starting to see the value in the accumulation of a domain name portfolio (Salvador & Nogueira, 2010). Naturally, the most populated TLDs hardly allow fresh registration of attractive domain names, because they are already taken and thus already very rare and desirable. Boldly, being attractive and rare within TLD .com is the top strategic goal of a large part of businesses. Thirdly, it is correctly suggested that for certain industries and branches domain names are more important than for others and the decisive point is how easily and conveniently pertinent products can be commercialized via the Internet, i.e. businesses active in communications or financing "need" more domain names (Salomon, 2012). Fourthly, recently hundreds of new gTLDs emerged, but only few of them are perceived as reliable and attractive, e.g. TLD .xyz, to expand the Registrant choices. Another detour from TLDs represents the growth of the Search Engine Optimazation ("SEO") and of the social media with a mutated use of TLD .com, e.g. facebook.com. Fifthly, successful domain names should last and be saved and thus the regime and jurisdiction of the particular TLD is critical. Sixthly, Registries and Registrars "make money" on domain name registrations, the Registry of TLD .com, Registry, VeriSign, Inc., is a public corporation traded as NASDAQ, VRSN, S&P 500 Component with an ongoing growth of the value of shares in the last five years, i.e. from USD 20 per share in 2011 to USD 90 per share in April 2016. In recent years, VeriSign's annual revenue has been around USD 900 million and annual net income over USD 320 million. VeriSign, Inc. has other activities, but financial statements suggest that the domain name registration line is key for its´ success. The data about the top domain name prices paid are illustrative.

Tab. 2: The list of the most expensive domain names

Domain name	360.com	Insurance.com	Sex.com	Fund.com	Porn.com	Fb.com
Price in USD	17 mill.	16 mill.	12 mill.	10 mill.	9.5 mill.	8.5 mill.
Year	2014	2009	2006	2008	2007	2010

Source: Prepared by authors based on http://most-expensive.com/domain-name and http://www.gotw.com/example-domain-name-prices-2015.htm

Authors went over available records regarding more than 30 most expensive domain names and see a clear pattern that these domain names are from TLD .com and are generally short, attractive and generic English terms with easy spelling (insurance, sex, fund, porn, facebook, business, diamond, beer, casino, toys, etc.). Authors have reviewed hundreds of records about prices paid in recent years for domain names in different languages using the Latin alphabet from different TLDs and suggest that English attractive domain names from TLD .com (with 127 million registrations) can go for millions of USD while German attractive domain names from TLD .de (with 14 million registrations) can go for a hundred thousand of USD. French, Spanish, Italian, etc. domain names seem to be cheaper. Finally, authors observed trends about TLDs and identified that some are "doomed" and despite a reduction of registration and renewal costs and many "openings", the Registrants are less and less interested in them and their value has been dropping (MacGregor, 2015). The cost approach, the market approach, the income approach, the Acointegration and the WALMATRIX are just a fragment in a large mosaic in which should be added criteria related to the pertinent TLD, its Registry, regime and jurisdiction, as well as related to linguistic-cultural preferences. The puzzling patterns about pre-sales of pre-registration of domain names, the “unpredictably” high or low prices for domain names and abandoning of allegedly good TLDs and domain names suggest that domain name valuation is unsettled, the market is not transparent, not a broad public discussion is developed about it and a lack of information and expectations prevails. However, similar to accounting rules (Kubíčková et al., 2014), a pragmatic drive for a spontaneous harmonization on the common valuation criteria is noticeable despite the general asymmetry of information, confusion and cultural differences.

Conclusion

The valuation of domain names is a volatile topic and a particular issue per se. Its complexity is due to many factors, like the intangible, omnipresent and unique nature of each and every domain name plus the capacity of a domain name to perform many functions. Most all domain names have an insignificant value, even below registration cost, and half of them are not used at all. A 1-5% minority of domain names have a dramatic potential to reach a seven digit price in USD. The direct field observation and available data about completed sales shows deficiencies of three approaches based on IFRS and IAS, Acointegration and WALMATRIX in the context of an underdeveloped academic and laic discussion. However, there is an emerging objective, circumstance sensitive, adjustable methodology for domain name valuation which is built on appropriate conventional methods and models,s closely reflecting the evolution of the domain name market and open to be improved by adding criteria. Attention has to go to all stakeholders, i.e. for the valuation of domain names are critical both intrinsic features (culture, length, language, spelling, genericity) and extrinsic features (what industry, which Registry, which Registrant). The resulting valuation must reflect trends and function dynamics of domain names, and not only static conventional instruments. It’s exact parameters need to be subject to a further research.

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