Discussing Domain Names: A Framework

Alex Tajirian

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When one discusses or communicates relevant information about a domain name, it is important to tailor the discussion to the audience. Below, I consider five such groups and highlight the important issues for each audience. Such discussions almost never fail to ultimately lead to valuation issues.

Analogies are commonly used and are helpful a technique for communicating a message to an audience. However, analogies have to be based on the knowledge and interests of the audience. In attempts to draw on existing knowledge, similarities between domain names and other markets have been drawn with real estate, leasing, and patents, to name a few.

The least controversial classification of a domain name is that of being an intangible asset; it lacks a physical existence. Unlike tangible assets such as property, plants and equipment, intangible assets derive their value from the rights and privilege granted to the entity using them.

Audience Groups

There are at least five important audience groups that may be interested in the discussion.

1. **Business**

    For a business enterprise, the most important question is "what can domain names do for me?" I have attempted to answer the question in "Roles of Corporate Domain Names." Based on the outlined roles, the analogies vary from instruments of traffic generation to patents.

    A company's decision to acquire a domain name is a capital budgeting decision. Each domain name acquisition is an independent project among the company's list of desired projects. Thus, as long as a domain name's expected net value creation exceeds its purchase price, it should be acquired.

    Like any other asset, companies should be aware of sources of domain name risk and instruments that mitigate them.

2. Investor

I distinguish between two types of investors: non-diversified and diversified. For the former, the most important issue is whether domain names outperform other assets on a risk-adjusted basis. On the other hand, a diversified portfolio holder needs to know whether adding domain names, as an investment class, improves the portfolio's risk-reward ratio. An asset class has the greatest positive diversification effect if its returns are perfectly negatively related to movements in the market, typically represented by the S&P 500.

There are two components of return calculations: end-of-period value and intermediate dividends in the form of traffic monetization revenue.

The investor has also to consider whether to choose the "do it yourself" approach or choose to use a professionally managed domain name investment account.

3. Accountant

For an accountant, the two major issues are:

a. As an intangible asset with limited useful life, its purchase price is typically amortized.
b. That it is an off balance sheet item.

4. Legal

Yet unresolved issues include:

a. What is a country?
b. Is a domain name property?
c. Should domain names be protected in a manner similar to intellectual property?
d. Can a domain name be owned?

5. Personal User

Applications include email, family website, resume, etc.

Valuation

The market value of any asset at a specific time is the sum of two components: its intrinsic value and the magnitude of dispersion from intrinsic-value.

The intrinsic value is measured by the net benefits generated from its expected best use over its life. The dispersion from intrinsic value component (positive or negative) can be as short as few seconds or as long as several years. The latter scenario prevails in markets where there are obstacles to arbitrage. (The Internet bubble, for example, has been rationalized within an arbitrage context.)

Intrinsic valuation methodology is well developed. However, naïve appraisals can be useful too.