Value Synergies from Domain Name Portfolios

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ABSTRACT
The paper outlines the sources of synergies and transaction cost savings when analyzing domain name accumulation or divestiture decisions. It points out the limited relevance of "bundling" in such analysis. A distinction is made between applying valuation and risk-return analysis.

WHAT IS THE VALUE OF A PORTFOLIO?

In this paper, value refers to the worth of an asset based on its intrinsic fundamentals, which are driven by the asset's best use. In a well functioning market, the market value of an asset is driven by its fundamentals, and thus, these two values should be equal.[1]

At any time, the value of a portfolio of assets is equal to the sum of the values of its individual components. That is, there are no additional "portfolio effects" that contribute to value. Nevertheless, a domain name may be worth more or less to someone else, based on its utility to the user.

WHERE DO PORTFOLIO CONSIDERATIONS COME INTO PLAY?

Portfolio considerations come into play under three scenarios:

Scenario 1: Valuation of a Contemplated Action

Under this scenario, an action such as the sale of the entire portfolio, or a component, or the acquisition of other domain names (or domain derivatives[2]) is being contemplated.

When considering the structuring of the sale of a portfolio of domain names, the economics of bundling (or 'tying') comes to mind.[3] However, the uniqueness of each domain name requires a different approach. Yet, this does not mean that there are no advantages to trading bundles.

[1] See the following papers by Alex Tajirian: "Market Price and Value Can Diverge," DomainMart, Alex Tajirian (2005), "Price Inefficiencies in Domain Name Markets: An Empirical Investigation," and "Appraisal Based on Estimating the Value Generating Process."

[2] Derivatives are leases and trademarks on a domain name.

[3] See the Appendix for a discussion of bundling.

A more useful framework is that of mergers, acquisitions, and divestitures. To implement the framework, one needs to analyze the sources of synergy that can create additional revenue and reduce operating costs.

There are two sources of portfolio value creation from the perspective of an owner:

a. Transaction cost savings from transfer and price impact:

   Buying and selling portfolios reduces the cost of transfer logistics and price impact of high acquisition frequency. If one were to individually acquire a large portfolio of domain names, he/she would alert potential sellers, who would then jack-up their ask prices.

b. Synergies:
   i. One source of synergy is positive branding effect. An example would be when an owner has all the major extensions of a brand name[4] except the ".com." Acquiring the dot-come has a spillover benefit to the entire portfolio. Another source of synergy is from obtaining a trademark on the .com of a domain name.

   ii. An example of a negative synergy is when a company owns or is associated with one adult website in its portfolio of names. In such a scenario, eliminating the domain name or its content from the company's portfolio can have a positive impact on the rest of the portfolio. Thus, a divestiture creates value under this scenario.

Scenario 2: Estimation of Expected Return
When examining portfolio returns, a risk-averse investor should consider the risk-return tradeoffs. Portfolio risk diversification benefits stem from co-movements between domain name prices.[5]

Scenario 3: Corporate Portfolios
From a corporate perspective, the portfolio objective is to maximize the return on domain name investments while taking into account the various roles of domain names and the company's portfolio of search engine keyword ads.[6]

[4] Such portfolio benefits would not exist when considering traffic domains, as they would potentially be a source of traffic overlap, and thus, reducing their value contribution.

[5] For portfolio return factors, see Alex Tajirian, "Toward Large Domain Name Portfolios," DomainMart. For risk factors of individual domain names, see Alex Tajirian (2005), "Domain Name Protection: A Risk-Analytic Framework," DomainMart.

[6] See Alex Tajirian, "Roles of Corporate Domain Names," DomainMart.

CONCLUDING REMARKS

When analyzing portfolios one needs to distinguish between sources of value creation and risk-return drivers. Each tool is used to answer a different set of questions. Valuation is used to evaluate various action options, while risk-return framework is used to construct an optimal portfolio of expected returns for a desired level of risk as determined by the portfolio owner's appetite for risk.

APPENDIX

Product bundling is a marketing strategy that involves offering several products for sale as one combined product. This strategy is very common in the software industy with complementary products (for example: bundling Word, Excel, and PownerPoint into a single Microsoft Office suite).

How does bundling work? Suppose you own two domain names, "Dom1.com" and "Dom2.com," and there are two potential buyers. One is willing to pay $3,000 to buy "Dom1.com'' and $2,000 for "Dom2.com," while the other is willing to pay $3,000 for "Dom2.com" and $2,000 for "Dom1.com." If you owned other close substitutes for each of these domain names, and if you sold each domain separately at auction, you would get about $2,000 for each. However, if you bundled them into "Dom1.com and Dom2.com" and assume that the buyers would either buy both or none, you would get $5,000 for each bundle.

When each domain name is unique, when sold separately, the seller is able to price discriminate without bundling. Thus, there is no benefit to a bundling strategy.