Risks Associated with IP Financing: Can They Be Curbed?

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Links &
contacts

About the presenter

Peter Kaldos is an intellectual property (IP) valuation specialist.

Peter is experienced in the valuation and analysis of IP and intangible assets including patented technology, trade secrets and trademarks for companies and research institutes.

He works together with IP professionals, patent attorneys and law firms to provide independent valuations for a wide range of purposes including licensing, joint ventures, acquisitions, strategic decision-making and financial reporting.

Topics discussed previously

- IP-based financing and why is it so important?
- How does IP-backed lending differ from traditional asset-backed lending?
- IP financing policies of different countries
- … risks that are inherent in IP financing and what can be done to mitigate them.
- The future of IP financing for economic growth

Aims – questions to ask ourselves

- What is the optimal level for financing for SMEs startups and scale ups?
- What is the best way to fund IP-rich businesses?
- How can IP financing be scaled up?
- What can startups / TTOs / companies do to better access IP finance?

IP-backed lending

Uses intellectual property (IP), such as patents, trademarks, copyrights, or trade secrets, as collateral.

These are intangible assets whose value comes from

- The legal rights and protections they provide
- Their supposed ability to generate future revenue

IP financing landscape today

	IP assets considered systematically to support financing decisions?	IP as collateral?
Debt finance (loans and credit)	IP rarely investigated, not valued	Often only as a “package” together with other assets, without defined value
Equity finance (investment in return for equity)	Investigation of IP in due diligence process	?
Grant finance	IP sometimes investigated, not valued	Unlikely

Proposition (IP-backed lending)

Relatively to other forms of finance, the volume and impact of IP-backed loans is minimal globally

- Is it too risky?
- Too early?
- Something else?

Risks related to IP-backed lending

Main risks:

- Ensuring that all goes according to plan in case of loan default
- What happens if the lender has to take possession of the collateral?

Some risk areas:

- Information asymmetry between lender and borrower
- Unfamiliarity with IP
- Valuation of IP (risks related to IP value)
- Legal aspects of IP
- Regulatory
- Liquidation

Mitigating risks

Aim:

To reduce the impact of potential risks by developing a plan to manage, eliminate, or limit setbacks as much as possible

- Borrower side mitigation
- Mitigation by policy makers (or private sector?)

Valuation risk (risks related to IP value)

Difficulty in accurately valuing IP, leading to over- or underestimation

IP asset value may fluctuate with context:

- Use / utilisation
- Market demand
- Technology advancements, obsolescence (eg patent on outdated technology)
- Legal protection (eg inadequate maintenance of rights and unfavourable licences)
- Market shocks (eg brand shocks)

Consequences of misvaluation

- Overvalued IP can lead to loan defaults
- Undervaluation may restrict funding.

Mitigation of valuation risks

Mitigation by borrowers / policy makers

- Engagement of IP valuation expertise
- Regular valuations of IP, monitoring
- Subsidies for IP valuation
- Guidelines / valuation standards

Related issues:

- Complexity of IP valuation
- Cost of valuations
- Unfamiliarity with IP valuation
- Trust issues with valuers
- No one-size fits all valuation method
- Insufficient data available

Benchmarking initiatives globally:

- Republic of Korea: IP valuation subsidy in IP finance program
- Japan: JPO guidelines for IP valuation
- Singapore: Intangible asset disclosure framework
- Republic of Korea: IP Valuation and Management Center
- International valuation standards

Liquidity risk

IP is still a relatively illiquid asset class

Orderly disposal - In a liquidation scenario, the IP collateral must be monetised, which can be a more resource-intensive, complex process in comparison to liquidating many tangible asset types.

Specifically:

- Uniqueness of IP assets
- No transparent active markets
- Orderly disposal realistic only through brokerage or other monetisation

Consequences

- Failure to monetize collateral in case of default?

Mitigation of liquidity risks

Mitigation by policy makers

- IP finance insurance
- IP finance loan guarantee scheme

Benchmarking initiatives globally:

- USA: private sector IP finance insurance
- China: IP insurance
- Republic of Korea: IP smart guarantees/IP fast guarantees
- Singapore: IP Financing Scheme guarantee - The IPFS pilot program offered banks a guarantee of 80 per cent of the IP value, subject to a cap. The IPFS had a total guarantee facility of 100 million Singapore dollars

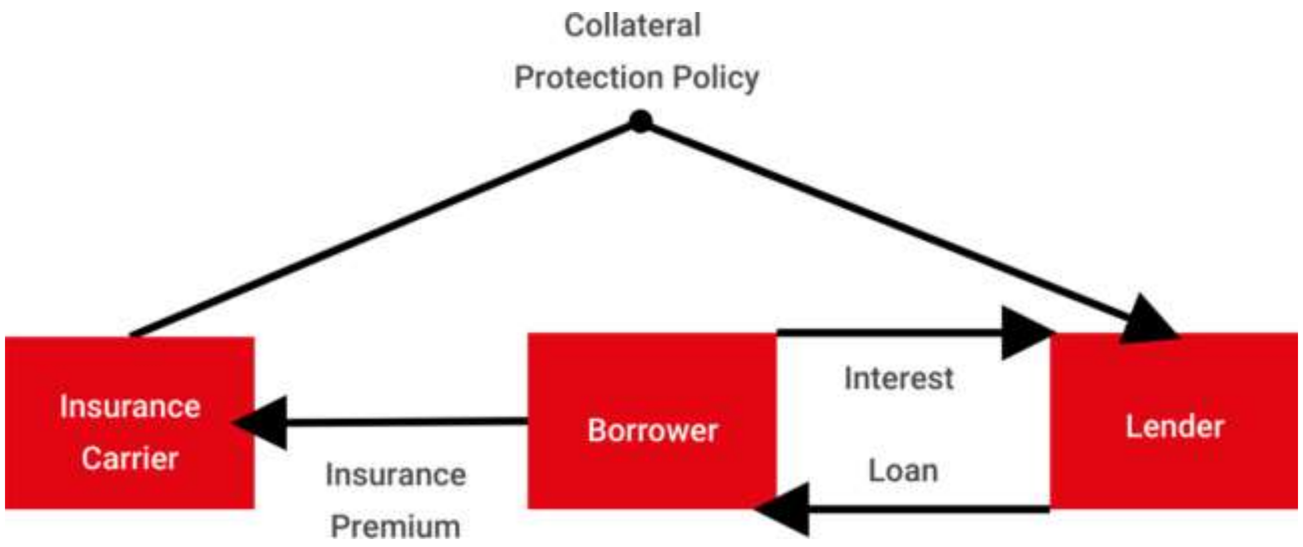
Many countries have business loan guarantee schemes not specific to IP finance.

IP finance insurance at a glance

Specialist insurers with technical expertise wrap policies around IP portfolios, transferring risk from lenders to insurers

It is then the burden of the insurers to recoup their losses by monetising the collateral

(similarly to the scenario where a home buyer purchases homeowner's insurance at the same time they close on their mortgage).



https://www.iam-media.com/report/special-reports/q2-2024/article/primer-ip-backed-finance-growing-companies

Information asymmetry & Unfamiliarity with IP

One party has access to more information or better information

Parties have limited understanding of how IP assets can be used as collateral

Specifically:

- Limited information about the borrower's value generating IP assets
- IP assets are not disclosed adequately
- IP and intangible assets are not on balance sheet

Consequences

- If IP fails to generate anticipated revenue, borrowers may default.
- High perceived risks
- IP finance does not happen
- High transaction costs of IP finance.

Possible mitigation of informational risks

Potential risk mitigation by borrower

- Adequate identification and disclosure of IP assets by companies

Potential risk mitigation by policy makers

- IP Disclosure frameworks for companies
- IP audit frameworks
- Include intangible in financial statements as much as possible
- Reviews of accounting for intangible assets
- IP collateral registers

Benchmarking mitigation initiatives globally:

- Singapore: Intangible assets Disclosure Framework
- International: IASB review of accounting for intangible assets

Singapore Intangibles Disclosure Framework (IDF)

- Supports the disclosure of consistent information about a company's IA, so that stakeholders can make more informed assessments of an enterprise's business and financial prospects.
- A public-private initiative led by IPOS and the Accounting and Corporate Regulatory Authority

https://www.ipos.gov.sg/manage-ip/intangibles-disclosure-framework

Conclusions today

IP Financing: A Valuable but Risky Venture

IP financing can drive innovation and growth but comes with inherent risks.

Risk curbing strategies are essential

Through valuation accuracy, market vigilance, and regulatory support, risks can be managed.

Future of IP Financing

As IP financing matures, standardized practices and innovative risk management solutions are expected to reduce risks.

Q&A

Thank You!

Open the floor for questions.

Invite discussion on specific risks or case studies if relevant.