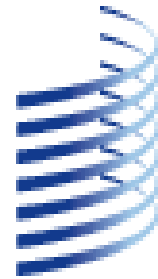




Ethiopian Intellectual Property Office

WIPO



Training of Trainers Program on Effective Intellectual Property Management by Small and Medium-Sized Enterprises (SMEs)

# IP and Finance: Accounting and Valuation of IP Assets and IP-based Financing

Addis Ababa, July 24, 2015

Pierre El Khoury, Ph.D  
Sagesse Law School  
Beirut, LEBANON

# What does finance have to do with IP?

- ▶ In a word, **everything**. It costs money to develop new products, to prototype new gadgets, to get professional help and to pay official fees.
- ▶ Depressingly, while the IP owner only gets his reward **if his creation results in a profitable venture**, everyone else – banks, accountants, lawyers, market consultants, advertising agencies, patent and trademark registries – gets paid regardless of whether an IP-backed project excels or fails

- ▶ Most of us are born **without money**.
- ▶ Thus we have to raise the money we need to **promote** and develop our creative talents to the full.
- ▶ This might mean a **bank loan** or **mortgage** (often in return for a share of any IP profits, or with the lender holding the IP right as security for repayment), or a **grant** from public funds.

- ▶ A growing share of commerce in today's global information economy **revolves around IP assets** rather than the physical commodities that dominated the industrial age
- ▶ IP financing, or the **use of IP assets** (trade marks, design rights, patents and copyright) to gain access **to credit**, is gaining increasing attention in IP circles.
- ▶ Actually, enhancing innovation is a very important issue for all nations, and access to financing **is critical for innovative SMEs and start-up.**

- ▶ Multinational corporations as well as SMEs, are **leveraging their IP assets** in exchange for finance
- ▶ and lending institutions around the world are increasingly extending their business to provide **loans on the basis of IPRs**

# What are the Financing Practices?

- ▶ **Traditional** IP financing tools:
  - Licensing (royalties)
  - Direct sales of patents or trademarks (assignment of rights)
  
- ▶ **New ways** to raise funds using intangible assets:
  - **Auctioning** their IP: live and online auctions: selling fast = rapid liquidity
  - (ex. Ocean Tomo; IP Bewertungs AG; IP Auctions Inc., etc.)

- ▶ Another method: Using the value of IP as collateral

Tangible assets (real estate, equipment) are used to secure asset-based loans,

But the **collateralization of IP** can also increase the amount of available credit.

Where borrowers pledge their patents, trademarks or copyrighted works, the **potential for a successful loan is increased.**

And the increased cash flow associated with the collateralization of IP is **attracting attention** on financial markets around the world.

# Is this secure?

- ▶ Usually collateralization of IP requires that the IP be **assigned to the lender** with a license being granted back to the debtor.
- ▶ IP asset-backed securitizations are most common in the **film and music industries**, but the practice is increasing in the biotechnology and software industries



## Example:

- ▶ In 1997, David Bowie issued 10-year asset-backed bonds on the basis of future royalties on publishing rights and master recordings from 25 pre-recorded albums, and raised **US\$55** million.
- ▶ The main purchasers of the bonds were institutional investors, such as pension funds and insurance companies as part of their diversified investment portfolios

There are two classes of intangible assets:

1 – Cash flow assets:

Which generate royalty payments by licensing (patents, trademarks, copyright).

This is the preferred asset category for investors because they are valuable collateral with sufficient cash flow for repayment.

2 – Assets with implicit value:

Non-licensed IP rights or IP rights exclusively used internally (e.g. customer lists, database rights).

# From a legal point of view: is this legal?

Most jurisdictions still do not offer adequate legal means for financing IPRs

But legally speaking, there is nothing impeding collateralization of IPRs. This follows from the freedom of contract principle.

Nonetheless, an ideal legal system would remove legal obstacles to secured credit and could thus have a beneficial impact on the availability and the cost of credit.

The issue of IP financing is the subject of policy development at the international level.

## Example 1:

The International Chamber of Commerce has published an overview of business and government action.

It believes that intellectual property protection encourages the development of knowledge-based industries, and creates a favorable climate for foreign direct investment and technology transfer.

<http://www.iccwbo.org/advocacy-codes-and-rules/areas-of-work/intellectual-property/>

## Example 2:

The United Nations Commission on International Trade Law (UNCITRAL) established a Working Group to address security rights in personal property, including intangible assets and IPRs.

They developed recommendations for an efficient legal regime for security rights.

<http://www.un.org/documents/ga/docs/56/a5617.pdf>

# From a practical point of view: IP Valuation

Valuation is a key tool in the process of financing based on IP assets.

How much does a trademark or a patent or a copyright cost?

For the purpose of securitization, technical valuations of IPRs are required.

So far, no standard methodologies have been developed that are generally applicable to all IPRs big or small.

- ▶ In 2007, the German Institute for Standardization (DIN) published the “General Principles of Proper Patent Valuation” to assess the quality of valuation reports and expert assessments.
- ▶ But this was for the purpose of assessing the quality of the valuation, not a standard methodology for valuation per se.

- ▶ The available methodologies for IP valuation work best with individual major patents and brands but they are considered to be too subjective.
- ▶ As the owner/manager of an SME, you must take steps to understand the commercial value of the IPRs of your SME, and ensure their proper valuation by professionals.
- ▶ Thus they could be included in your business plan when presenting it to potential investors/lenders.



# How do we do the IPRs valuation?

- ▶ There are specialized professionals / organizations for IPRs valuation but they do not rely on one methodology of valuation.
- ▶ Generally speaking the valuation process necessitates gathering much more information as well as in-depth understanding of economy, industry, and specific business that directly affect the value of the IPRs.

# Quantitative or Qualitative?

- ▶ Two approaches of IPRs valuation are generally used simultaneously by professionals and organizations: The quantitative and the qualitative valuation.
  - The quantitative approach relies on numerical and measurable data, to calculate the economic value of the IPRs
  - The qualitative approach is focused on the analysis of the characteristics (such as the legal strength of the patent) and uses of the IPRs

# Quantitative Approach Methods

- ▶ The Cost-based method

Where the cost is measured by gathering all costs associated with the purchase or development of the IPR under valuation, or the costs that would be spent to obtain an equivalent IPR.

(Today's price is taken into account)

# Quantitative Approach Methods

- ▶ The Market-based method

Relies on the estimation of value based on similar market transactions (e.g. similar license agreements) of comparable IPRs.

(Utility and technological specificity are also taken into account if unique product)

# Quantitative Approach Methods

Where to get the information from?

a) companies annual reports;

b) in court decisions concerning damages.

c) specialized online databases such as:

□ Royalty Source – Intellectual Property Valuation and Licensing:

[www.royaltysource.com](http://www.royaltysource.com);

□ Recap: [www.recap.com](http://www.recap.com);

□ PharmaVentures: [www.pharmaventures.com](http://www.pharmaventures.com);

□ Royaltystat: [www.royaltystat.com](http://www.royaltystat.com);

□ Knowledge Express: [www.knowledgeexpress.com](http://www.knowledgeexpress.com);

□ Intellectual Property Research Associates: [www.ipresearch.com](http://www.ipresearch.com);

□ Royalty Connection: [www.royaltyconnection.com](http://www.royaltyconnection.com);

□ ktMINE: [www.ktmine.com](http://www.ktmine.com); etc.

# Quantitative Approach Methods

- ▶ The Income-based method

The value of an asset is intrinsic to the (expected) income flows it generates, including:

- The projected future cash flows, which are
- The future royalty income stream

# Qualitative Approach Method

It does not rely on analytical data. It is performed rather through the analysis of different indicators with the purpose of rating the IPRs, i.e. of determining its importance.

# Qualitative Approach Method

The indicators cover all the aspects that can impact the value of an IP asset, covering legal aspects, the technology level of the innovation, market details and company organization.



# Qualitative Approach Method

Commonly, the method is implemented through a questionnaire comprising all these different criteria. Examples of questions included in such questionnaires can be:

- How would you define the intellectual property innovation compared to the actual state of the art?
- Which level of its life cycle has the IPR (e.g. patent) reached?
- What is the geographic coverage of the reference market?

# Which method to apply?

- ▶ Selecting the valuation method to use in a given situation is complex.
- ▶ But in theory all methods may be applied
- ▶ Several factors should be considered in the procedure, such as the type of IPR at stake, the level of development of the technology as well as the purpose of the valuation.
- ▶ However, there are some situations where certain methods are more likely to be used:

	Method	when/why	advantages	disadvantages
<b>QUANTITATIVE</b>	<b>cost-based</b>	<ul style="list-style-type: none"> <li>✓ Valuation of an asset in the early stages of development</li> <li>✓ Cases where there is no market revenue data</li> <li>✓ Accounting and tax purposes</li> </ul>	<ul style="list-style-type: none"> <li>✓ Simplicity</li> <li>✓ Information gathered easily since most of it is in the accounting sheets</li> </ul>	<ul style="list-style-type: none"> <li>✓ May be difficult to isolate the costs related to the intellectual property assets from the other research costs</li> <li>✓ The economic benefits associated with the assets are not taken into account</li> </ul>
	<b>market-based</b>	<ul style="list-style-type: none"> <li>✓ Valuation for internal purposes</li> <li>✓ Valuation for IP transactions</li> <li>✓ Valuation in litigation situations</li> <li>✓ Trade mark valuation</li> </ul>	<ul style="list-style-type: none"> <li>✓ Accuracy, since it is close to market reality</li> <li>✓ Objectivity</li> </ul>	<ul style="list-style-type: none"> <li>✓ May be difficult to gather comparable or similar data, since transactions are often confidential</li> </ul>
	<b>Income-based</b>	<ul style="list-style-type: none"> <li>✓ Valuation for fund raising</li> </ul>	<ul style="list-style-type: none"> <li>✓ Analytic</li> </ul>	<ul style="list-style-type: none"> <li>✓ May be difficult to use in high risk sectors</li> <li>✓ Subjective assumptions can be made</li> </ul>

<b>QUALITATIVE</b>	<b>Qualitative method</b>	✓ Internal management decision making	✓ Simplicity	✓ Subjective
--------------------	---------------------------	---------------------------------------	--------------	--------------

# Useful Resources

- ▶ Agreeing a price for IPRs, published by the UK Intellectual Property Office

<http://www.ipo.gov.uk/iprpricebooklet.pdf>

- ▶ IP Valuation at Research Institutes; an essential tool for technology transfer, published by the Hungarian Intellectual Property Office

[http://www.sztnh.gov.hu/hirek/kapcsolodo/IP\\_Valuation\\_for\\_Technology\\_Transfer\\_EN\\_web.pdf](http://www.sztnh.gov.hu/hirek/kapcsolodo/IP_Valuation_for_Technology_Transfer_EN_web.pdf)

- ▶ The use of IP valuation in IP transactions: a global survey of IP brokers, European IPR Helpdesk Bulletin n. 4

[http://www.iprhelphdesk.eu/sites/default/files/newsdocuments/European\\_IPR\\_Helphdesk\\_Bulletin\\_N4.pdf](http://www.iprhelphdesk.eu/sites/default/files/newsdocuments/European_IPR_Helphdesk_Bulletin_N4.pdf)

# Thank you

[el.khoury.pierre@gmail.com](mailto:el.khoury.pierre@gmail.com)