WORLD TRADE ORGANIZATION

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Council for Trade-Related Aspects of Intellectual Property Rights

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INTELLECTUAL PROPERTY AND INNOVATION: INTELLECTUAL PROPERTY FOR INVESTMENT/FINANCING/FUNDING

COMMUNICATION FROM AUSTRALIA, CANADA, CHILE, THE EUROPEAN UNION, JAPAN, SWITZERLAND, THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU, THE UNITED KINGDOM AND THE UNITED STATES

1 INTRODUCTION

1. Financing affects every stage of the innovation cycle from idea creation to commercialization, expansion and long-term business sustainability.[1] There is untapped potential in financing, relating to the innovation process, potentially bringing benefits to humankind, in line with the issues explored in this document.

2. Innovative and creative businesses can often find it difficult to use their existing or potential IP assets to unlock funding, particularly when compared with businesses that hold more conventional, tangible assets.

3. A key challenge to innovative businesses is the lack of awareness in the financial services sector of the role of IP in generating cash flow. A business may seek funding from debt, equity (including hybrid debt/equity) or grant finance.

2 ROLE OF IP IN GENERATING CASH FLOW

4. IP supports cash flow in ways that can support international trade[2]:

   a. Direct routes to cash generation – through sales of licences or franchises of IP which can broaden the reach of businesses into different regions or territories.

   b. Indirect routes to cash generation – through sales of products or services provided where the IP protects the ideas behind the product or service.

3 BUSINESS FINANCE AND THE CHALLENGES FOR IP INTENSIVE BUSINESSES

Debt finance

5. Debt finance involves borrowing money and means that the company will need to both pay back the money that it has borrowed and pay interest. Some loans may be backed by guarantees from government or other third parties, however many lenders will require collateral. For IP to be used as collateral it must fulfil the requirements of the lender and the laws of the country where the lender is based, including accounting regulations which may not recognise internally generated intangible assets on company balance sheets).

[1] WIPO Global Innovation Index 2020: Who Will Finance Innovation?
[2] Noting the territoriality of IPRs.

6. Debt finance may not be suitable for early stage businesses because a borrower will need to demonstrate sufficient cash flow to repay the loan as well as the interest. IP intensive businesses may be less likely to have tangible assets and may not yet generate enough cash at their early stage.

7. The main benefit of this type of finance to the borrower is to reduce the dilution of equity for the current shareholders. According to OECD research[3] the main source of external finance for most small and medium sized businesses (SMEs) is bank debt.

Bank Debt

8. There are some factors that pose challenges to bank debt with IP as collateral. In particular, the banking regulations introduced after the 2008 financial crisis, the international Basel III framework, specifically exclude intangible assets such as IP from the definition of assets for the purpose of calculating the banks' ratio of assets to loans. As a result, banks have a limited appetite to lend to businesses without tangible assets for collateral.

Venture debt

9. Venture debt is usually obtained by start-ups or early stage businesses that have already completed rounds of equity financing (see below). It is usually complementary to equity finance and could be provided by banks that specialise in venture lending or non-bank lenders. Often, these specialised lenders have greater awareness and expertise around assessing IP compared to traditional banks.

Private Debt

10. The term Private debt usually applies to non-bank debt that is not traded on an open market. Private debt will typically be used to finance business growth or working capital.

Equity finance

11. Equity finance involves selling a portion of shares in the company, which means selling a stake in the ownership of the business in exchange for cash. The company will not need to pay interest to the investor but will give up a share of the profits when the company becomes successful. Often the investor will become involved in some of the decision making in the company. The investors will exit their investment by selling the shares.

12. Sources of Equity finance for IP intensive businesses vary at different stages in their growth journey. Cross border deals are possible, subject to regulations:

a. Business Angels use their own money to invest in promising start-ups. They will usually bring knowledge, experience and connections as well as capital.

b. Venture Capital (VC) typically invest a minority stake (less than 50%) in the equity of an early stage businesses showing potential for exceptional growth. Funds tend to come from financial institutions and are pooled to make an investment fund. VC investors will typically have a seat on the board and often offer management or technical advice in addition to capital.

c. Private Equity (PE) investors will typically buy a majority stake (more than 50%) in later stage companies that are well established.

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[3] OECD (2018) "Fostering the use of intangibles to strengthen SME access to finance" https://www.oecd-ilibrary.org/deliver/729bf864-en.pdf?itemId=%2Fcontent%2Fpaper%2F729bf864-en&mimeType=pdf

Grant finance

13. Grant funding is given for a specific purpose and is not usually repayable, subject to meeting the criteria. A potential drawback is that the grant can only be spent on something very specific and nothing else, the spending will need to be reported back to the grant provider.

14. Potential sources of grants include public bodies and charities.

Possible actions by governments

15. Aside from potential Grant Finance, there are several ways that governments, for example IP offices, may be able to assist innovative and creative businesses in using IPRs to support access to finance.

16. Governments can also push for infrastructural changes such as better financial reporting of intangible asset information to reduce information asymmetry between businesses and capital providers.

17. IP offices can provide basic guidance and assistance on various IPR aspects. Individual questions and needs may be met by preparing reader-friendly IP material, including patent and trademark basics, examination overviews, information on patent searching and resources on legal assistance that could be used by inventors and businesses in becoming investor ready.

18. IP offices could consider accelerated patent examination procedures for particular types of patent applications. This process could shorten the time between application and grant, enabling SMEs to attain financial support more quickly.

Guiding questions

1. What are Members' experiences with their businesses and other entities using IP to raise finance internationally?

2. What are Members' experiences of how TRIPS has influenced the flows of finance between countries?

3. What forms of IP-related measures taken by Members have proven useful for the support of SMEs in their financing/commercialization strategy and which ones have not?

4. How can Members work together to address challenges posed by international frameworks (e.g., banking and accounting frameworks)?

5. How can the awareness of the benefits of IP be raised with finance providers?

6. According to the experience of Members, what are the main challenges for IP intensive businesses in raising finance for international expansion?

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