



## European IPR Helpdesk

### Fact Sheet

### *IP assets for financial advantages*

July 2015<sup>1</sup>

Introduction.....	1
1. Sources of finance .....	2
1.1. IP asset-backed securitisation .....	3
1.2. IP sale and leaseback .....	4
1.3. Banks as debt finance.....	5
1.4. Equity finance.....	5
1.5. Public sector .....	8
1.6. IP valuation and due diligence.....	11
2. Financing the innovation process stages.....	12
Useful Resources .....	13

### **Introduction**

Beside the research activity, the costs of developing a new technology into a product and then marketing it are generally very high. Moreover, it is common that many small businesses do not have enough financial resources to commercialise their innovations and indeed they usually seek support from national financial schemes.

This fact sheet gives an overview of the different means at the disposal of Small and Medium-sized Enterprises (SMEs) and Research Organisations (ROs) to access finance, in order to obtain liquidity from their intangible. The aim is to show that IP can be used as leverage for attracting investors, as collateral for obtaining credit and loans as well as receivables for securitisations. All of this can derive from banks, equity investors and the public sector.

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<sup>1</sup> This fact sheet was initially published in November 2013 and updated in July 2015.

These sources of finance can be used to bring a product to the market, when financial capabilities are scarce, but also to exploit Intellectual Property (IP) not used by the company, the so-called sleeping IP. Which of these sources is the most appropriate depends on the specific case and several factors should be considered, such as the phase of the research and development project, the company's size, the amount of money required, the level of innovation involved, the market capacity etc.

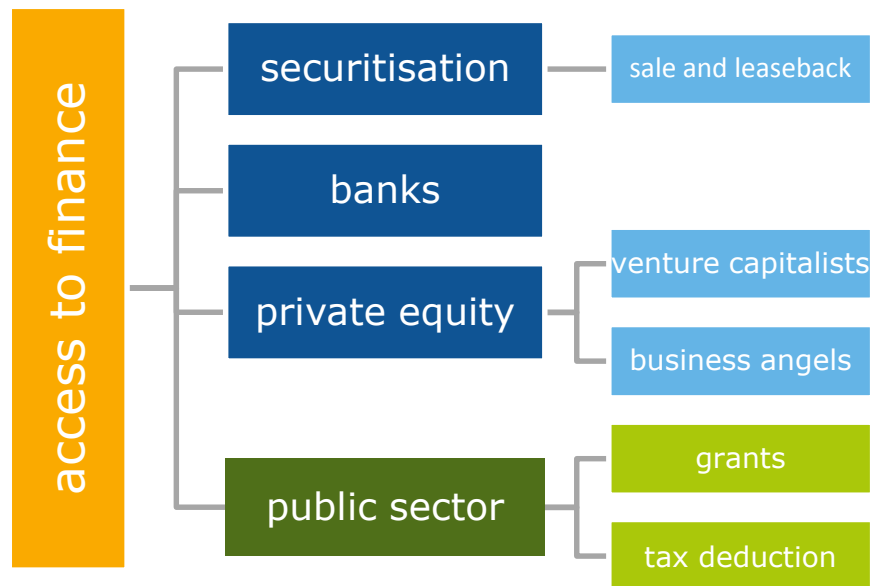
What is important to bear in mind in all these cases is the necessity for SMEs and ROs to make a valuation of their intellectual capital, in order to understand its value and access finance on more affordable terms. Therefore, given the technicality and complexity of this matter, the support of IP and financial consultants should be sought in order for the funding option to be adapted and customised to the individual case.

## **1. Sources of finance**

IP financing is intended as the use of intangible assets – e.g. patents, trade marks, design rights, copyright, trade secrets, and so forth – made by companies to access credit. This is also known as raising capital, considered as the capability for SMEs and ROs to realise money out of their intellectual capital, namely IP monetisation.

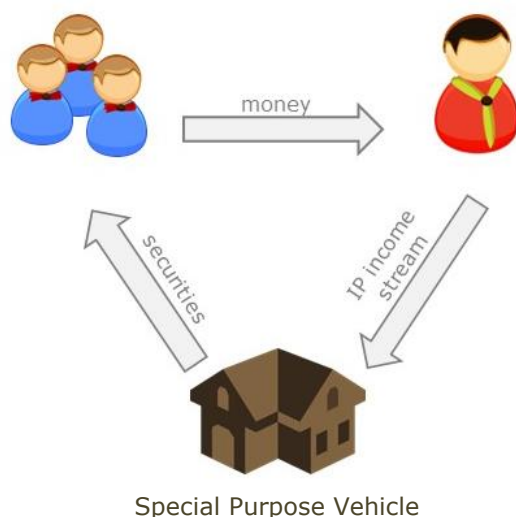
IP financing practices are gaining more and more attention as they provide alternative means to companies, mainly small businesses and start-ups, to fully exploit the value of their IP assets. Moreover, taking into account that a significant portion of a company's value is often constituted by intangibles, the opportunity for small businesses to raise funds by way of IP becomes vital. Indeed, when the financial considerations are effectively integrated by companies in the IP management, the value of their intangibles can be used strategically for the commercial benefit of the business.

Several options exist about access to finance for companies involved in technological innovation projects. Generally they come from the public sector, banks or private sources. Loans extended on IP assets are a practice carried out mainly by banks, while venture capitalists usually provide capital in return for company shares and are referred to also as private equity. To the latter category also belong business angels, who invest in high risk companies in return for an active involvement in the decision making process. The public sector, on the contrary, is more inclined to allocate funding in the form of grants for research and development projects and non-reimbursable finance for start-ups. Lastly, securitisation and leaseback consist in using IP assets as security to support the borrower's solvency.



### 1.1. IP asset-backed securitisation<sup>2</sup>

IP assets are more and more used to raise capital as financial security backed by receivables, i.e. income payments such as royalties or lump sums. This is a very complex type of financing where the payments stream from IP assets is converted into marketable securities<sup>3</sup> placed with investors. To put it simply, the IP owner transfers to the investors (usually businesses or banks) the payment flow deriving from its IP rights, e.g. the song royalties or patent licences. This is done commonly through the creation of a controlled society called *special purpose vehicle* (SPV) where the payment stream is transferred to and placed with the investors in the form of stocks and bonds. In exchange, the IP owner receives cash from the investors, being paid by the IP revenues.



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<sup>2</sup> Securitisation means the process of taking many individual assets and combining them into a group, or pool, so that investors may buy interests in the pool. The process can encompass any type of financial asset and promotes liquidity in the marketplace.

<sup>3</sup> Securities are certificates evidencing ownership of equity (stocks) or debt obligations (bonds).

IP asset-backed securitisation is mainly used by the music and film industry but it is also becoming an increasingly used practice in the technology sector. Given the complexities and risks of this operation, it is necessary to analyse several factors carefully, such as the IP asset value, the taxation of the country where the operation is effected, the risks related to the intangible concerned and so forth. All this certainly requires a deeper IP due diligence than for normal commercial negotiations.

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### IP securitisation features

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|--|---|
| <ul style="list-style-type: none"> <li>• Immediate cash flow<sup>4</sup></li> <li>• Property of IP retained by the owner</li> <li>• Likelihood of increased IP value over the period</li> <li>• Advantageous taxation on the capital raised<sup>5</sup></li> </ul> | <ul style="list-style-type: none"> <li>• Concerns over litigation and product piracy</li> <li>• Technology obsolescence</li> <li>• Substantial due diligence required</li> <li>• Insurance may be required</li> </ul> |
|--|---|

## 1.2. IP sale and leaseback

This is short-term financing mechanism to obtain immediate liquidity. Through IP sale and leaseback, the IP owner transfers the ownership of an IP asset to a specialised leasing company<sup>6</sup> for a lump sum. At the same time, the specialised company (lessor) leases back the same asset to its former owner (lessee) under payment of fees, which correspond to the loan interest. At the end of the leasing contract period, the lessee has the option to buy back the ownership of the asset at a fixed price, by exercising a purchase option.

Hence, this financing mechanism allows an organisation to secure short-term funding through the sale of its IP portfolio, without impeding the utilisation of the same asset in its daily business activities.

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<sup>4</sup> The amount of money is based on the receivables spread in the time frame necessary to repay the initial loan.

<sup>5</sup> Taxation of capital raised through securitisation should be checked at national level, as different regimes may apply.

<sup>6</sup> Information about leasing companies throughout the EU can be found at <http://www.leaseurope.org/index.php?page=home>.

Leaseurope, the European Federation of Leasing Company Associations, is an umbrella body composed of 44 member associations in 33 countries.

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### IP sale and leaseback features

- Immediate cash flow
- Transfer of IP ownership
- Taxes need to be paid on the sale<sup>7</sup>
- Option to repurchase the asset sold
- Very cheap
- Fees/interests on the IP use

### 1.3. Banks as debt finance

As a conventional source, banks are willing to finance innovation by way of loans or credits extended on IP assets. Moreover, banks may offer assistance in financial transactions, insurance and risk management and provide investment consultancy services, which can prove to be extremely useful into the quality of the financial management of an organisation. On the other hand, because technology-based companies are deemed to be risky ventures, banks are often reluctant to invest in the equity of such entities.

It is important to note that, since they apply interest in lending money, this method of financing should be used by companies having a positive cash flow to pay back the interest. Accordingly, organisations may use the profits deriving from the exploitation of their IP rights as collateral for debt service coverage.

In general, what banks look for from the borrowers is the competence and quality of the management (i.e. thoughtful business plan), cash-flow expectations, IP asset liquidity and marketability, all necessary to ensure the capability of the company to repay the loan.

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### Debt finance features

- Flexibility of loan terms
- Property of the company retained by the owner
- Cash flow needed
- From small sums up to millions of Euros
- Security is required
- Interest has to be paid
- Strong business plan

### 1.4. Equity finance

Private equity<sup>8</sup> is characterised by the fact that private investors – venture capital funds or business angels – provide capital in return for company shares. Therefore they become co-owners, proportionally to the amount of money invested in the financial operation. Indeed, this practice allows the investors to

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<sup>7</sup> Tax regulations should be checked at national level, as different regimes apply.

<sup>8</sup> Equity generally refers to ownership interest in a firm, often represented by security in its form of stocks. For more details on private equity, take a look at "[The little book of private equity](#)".

keep track of company performance and to participate in its management in order to make their investment profitable.

Unlike banks, equity investors are more risk-inclined, since the higher the commercial risk, the greater the possibility of high returns. For these reasons, private equity financing is appropriate for high-risk companies with very rapid growth rates.

### Venture capital

Venture capital<sup>9</sup> is one of the most important sources of finance for technology-based companies to fund their innovation. In fact, IP is deemed to be one of the key factors for venture capitalists when deciding to invest in a company. The value of a company's IP portfolio is thus at the basis of a venture capital investment.

Venture capitalists do not invest for an immediate profit. On the contrary, they allow the company to expand, as their ultimate goal is to increase its value for a consequent profit greater than the initial investment. That is why venture capitalists have more interest for innovative SMEs that may have little performance history but a strong growth potential. Accordingly, this private funding scheme is very suitable to relatively young technology organisations wishing to increase their value.

When deciding to invest in an organisation, venture capitalists look for several factors, among others the following:

- ✓ The *Internal Rate of Return (IRR)* as an indicator of the worth of the investment, to measure the potential of the growth and profit;
- ✓ The *Market Potential* of the R&D project, as innovative projects may create new markets with great potential for returns;
- ✓ The skills and capability of the *Management Team* proposed by the organisation, to create a profitable business around the technology;
- ✓ The *IP Rights* on the technological innovation and their undisputed ownership;
- ✓ The *Size of the Investment*.

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<sup>9</sup> Some information on where to find Venture capital is available at [www.evca.eu](http://www.evca.eu), the website of the European Venture Capital Association created with the active support of the European Commission, DG Enterprise.

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### Venture capital features

- Focused on high-growth potential companies
- Company's added value
- Equity shared
- Thorough business plan
- From 250.000 € on
- No security required
- No interest to be paid
- Decisional power

### *Business angels*

Business angels<sup>10</sup> are informal investors, usually wealthy individuals willing to finance innovative ideas. As with venture capital, such investors are interested in high-risk innovative organisation offering high returns on their investments. Hence, technology-based organisations have a strong chance to raise funds through this financing model.

They can invest alone or in a small group, which has an impact on the amount of money they are prepared to capitalise. While as individual investors business angels tend to invest in small quantity, when co-financing in a group (the so-called *syndication*) the entire investment may amount to a considerable sum of money.

The criteria applied by business angels to evaluate whether the innovation may generate the desired return from their investment are generally the same as those of Venture capital, although less stringent. So for example, they will look at the business management proposed by the organisation, its market strategy as well as its well-thought business plan. It is therefore very important to have a thorough IP strategy when approaching a business angel.

Because they are individuals, non-economic factors may somewhat apply, such as the common understanding with the entrepreneur, among others. On the other hand, since the capital invested is generally less significant than that provided by Venture capital funds, business angels may have lower expectations of growth and internal rate of return.

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<sup>10</sup> Some information on where to find Business angels is available at [www.eban.org](http://www.eban.org), the European Trade Association for Business Angels, Seed Funds and Early Stage Market Players.

### Business angels features

- Focused on high-risk innovative companies
- Company's added value
- Equity shared
- Non-economic factors involved
- Up to 250.000 €
- No security required
- No interest to be paid
- Decisional power

## 1.5. Public sector

*Loans* and *grants* are the main sources of public sector financing. Funding schemes may be accessed by organisations at EU and national level<sup>11</sup>. On the other hand, organisations should check the *tax regimes* at national level, as they may be provided with some tax deductions insofar as the income generated by the IP exploitation is concerned.

### EU loans and grants

Innovation is a key element in making EU businesses competitive and to this end EU support is available to help organisations keep up with competitors, as long as they are at the state-of-the-art in the technological development and protect their innovative ideas.

Organisations interested in transnational Research and Development projects capable of bringing an added value to the EU innovative landscape might be eligible to apply for **EU grants**<sup>12</sup>. Such financial contributions directly made by the European Commission (EC):

- **Serve as complementary financing, as the EU does not finance projects up to 100%;**
- **Are meant to help projects *break even*<sup>13</sup> financially; they cannot result in a direct profit for the grant beneficiary;**
- **Are awarded on a one-grant-per-project basis.**

<sup>11</sup> Information related to access to finance at EU level is taken from and can be found in greater depth at: [http://europa.eu/youreurope/business/funding-grants/access-to-finance/index\\_en.htm](http://europa.eu/youreurope/business/funding-grants/access-to-finance/index_en.htm).

<sup>12</sup> Direct funding grants from the European Commission or its executive agencies for projects with specific objectives may be found at [http://ec.europa.eu/contracts\\_grants/grants\\_en.htm](http://ec.europa.eu/contracts_grants/grants_en.htm). Furthermore, to know if a particular programme is relevant to your particular case, we strongly suggest that you contact your local **Enterprise Europe Network** partner, who can give you one-to-one advice and support in applying for EU funding. You can find the contact details of the Enterprise Europe Network member nearest to you here: <http://een.ec.europa.eu/about/branches/>.

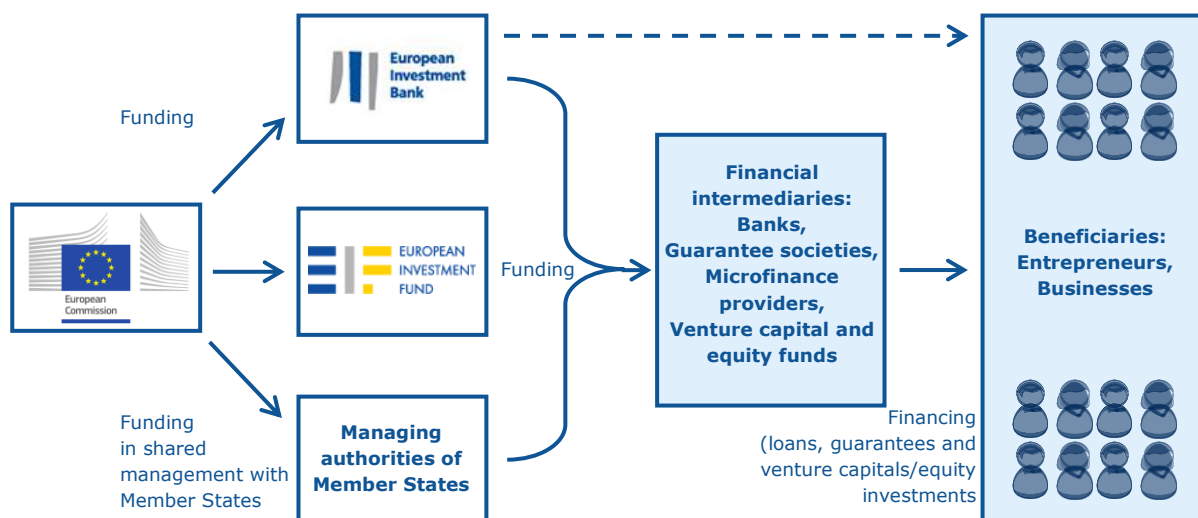
<sup>13</sup> The break-even point is the point in time when incomes equal expenses.



Besides, organisations may receive grants under Horizon 2020, the EU framework programme for Research and Innovation for the period 2014 – 2020<sup>14</sup>.

In both cases, the IP strategy reflected within the plan for the exploitation and dissemination of project results plays a fundamental role in the EC final decision to grant funds<sup>15</sup>.

As far as **loans** are concerned, the EC does not make direct loans to companies or start-ups<sup>16</sup>. On the other hand, the EC works together with various financial institutions – i.e. the European Investment Bank (EIB), the European Investment Fund (EIF) and managing authorities of member states – to increase the opportunities for small businesses to obtain finance from banks, guarantee providers and venture capital funds. The decision to provide the financing and its exact conditions (e.g. the amount, duration, interest rates and fees) however is made by the local financial institution.



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<sup>14</sup> For more information on Horizon 2020 visit <http://ec.europa.eu/programmes/horizon2020/en/>

<sup>15</sup> On the importance of having a well-thought IP management in EU funded projects, the European IPR Helpdesk has elaborated a series of fact sheets accessible in its online [library](#).

Costs related to IP activities (for example the filing and prosecution of IPR applications, including patent searches and legal advice or the payment of royalties to a third party for IP rights) carried out for the project implementation may be reimbursed as eligible costs. They should be discussed carefully during the negotiations, and be included in Annex I to the grant agreement (Article 6 of the Horizon 2020 general model grant agreement).

<sup>16</sup> The "Access2finance" website – <http://europa.eu/youreurope/business/funding-grants/access-to-finance/> – is one of the tools that can help you find a local financial intermediary which manages EU loans/guarantees. The same holds true with your local Enterprise Europe Network partner.

The *Risk Sharing Finance Facility*<sup>17</sup> improves access to debt financing for private and public companies undertaking R&D and innovation projects. It targets primarily innovative mid-sized companies. It also includes a *Risk Sharing Instrument*<sup>18</sup> to increase the supply of debt financing to SMEs and small mid-caps that have innovation potential or a focus on R&D and innovation.

Access to finance for SMEs is also facilitated through the *Competitiveness and Innovation Framework Programme (CIP)*<sup>19</sup> which, in the period from 2007 to date, has mobilised more than 2.3 billion euros in equity investments. The CIP financial instruments are implemented for the EC by the EIF on a trust basis. Two mechanisms are available that cover different needs, depending on the stage of development of the small business:

**The high growth and innovative SMEs facility (GIF) provides:**

- Risk capital for innovative SMEs in their early stages: EIF can usually invest 10 to 25% of the total equity of the intermediary venture capital fund or up to 50% in specific cases;
- Risk capital for SMEs with high growth potential in their expansion phase: EIF can invest 7.5 to 15% of the total equity of the intermediary venture capital fund or, exceptionally, up to 50%.

**The SMEs guarantee facility (SMEG) provides** loan guarantees to encourage banks to make more debt finance available to SMEs, including microcredit and mezzanine finance<sup>20</sup>, by reducing the banks' exposure to risk. SMEG provides co-, counter- and direct guarantees to financial intermediaries providing SMEs with loans, mezzanine finance and equity. Four "windows" give access to funding for:

- Loan guarantees - guarantees for loans to SMEs with growth potential;
- Microcredit - guarantees for loans of up to €25 000 to micro-enterprises with up to nine employees, particularly entrepreneurs starting a business;
- Equity and quasi-equity guarantees - guarantees to existing equity guarantee schemes and providers of mezzanine finance to support investments in businesses with up to 249 employees;
- Securitisation - guarantees to support securitisation structures to assist financial intermediaries in mobilising debt finance for SME.

<sup>17</sup> More information is available on the European Investment Bank website at: <http://www.eib.org/products/index.htm>.

<sup>18</sup> More information is available on the European Investment Fund website at: [http://www.eif.org/what\\_we\\_do/guarantees/RSI/index.htm](http://www.eif.org/what_we_do/guarantees/RSI/index.htm).

<sup>19</sup> For more information on the CIP programme visit: [http://ec.europa.eu/growth/access-to-finance/cip-financial-instruments/index\\_en.htm](http://ec.europa.eu/growth/access-to-finance/cip-financial-instruments/index_en.htm)

<sup>20</sup> This is a type of finance made available to organisations in a transitional period from being privately owned to being publicly quoted.

The new *Competitiveness of Enterprises and SMEs (COSME)* programme, which will run in conjunction with Horizon 2020, will largely continue the successful activities of the current CIP programme, but aims to respond even better to the needs of SMEs.

Two different financial instruments<sup>21</sup> will be available and built on those provided under the CIP:

- ***The Loan Guarantee Facility***
- ***The Equity Facility for Growth***

### *Tax deduction*

Organisations should also check the national tax regimes to ascertain whether they are providing for some incentives to encourage enterprises to exploit intangible assets.

More specifically, some governments throughout Europe have set up partial tax exemptions on the income and capital gains derived from the use of IP rights. These tax regimes aim to encourage investments in IP by allowing a tax deduction up to a certain percentage on IP income and offering attractive Research and Development incentives.

#### *The UK Patent Box tax regime case*

The UK Patent Box enables companies to apply a lower rate of Corporation Tax to profits earned after 1 April 2013 from its patented inventions and certain other innovations. The relief will be phased in from 1 April 2013 and the lower rate of Corporation Tax to be applied will be 10 per cent.

Source HM Revenues and Customs<sup>22</sup>

## **1.6. IP valuation and due diligence**

If it is considered that most of the innovative SMEs have IP as a main part of their business assets and that technology-based start-ups have sometimes no assets other than their IP, the importance for them to use their intangibles to access finance is fairly evident.

In this respect, it is critical for an organisation to identify all its intangible assets and know their objective value through an *IP valuation*<sup>23</sup>, in order to fully exploit

<sup>21</sup> For more details visit [http://ec.europa.eu/growth/access-to-finance/cosme-financial-instruments/index\\_en.htm](http://ec.europa.eu/growth/access-to-finance/cosme-financial-instruments/index_en.htm).

<sup>22</sup> For more information visit <https://www.gov.uk/corporation-tax-the-patent-box>.

<sup>23</sup> Read the European IPR Helpdesk fact sheet on IP valuation, available in our [library](#).

their potential. Indeed, investors will be more interested in using IP assets as a way to secure financing if supported by reliable valuation methods.

In addition to that, for all the above scenarios an *IP due diligence*<sup>24</sup> analysis should be carried out to show the prospective investor the status of the IP held by the organisation. In general terms, IP due diligence assesses the right of the organisation to use the IP held and evaluates the risks and liabilities associated with its use.

## 2. Financing the innovation process stages

As outlined at the beginning, an organisation should seek financial aids depending on the funds that it needs in order to implement its project and also on the phase which the project is in.

The table below briefly sums up the different sources of finance that can be sought at the different stages of an innovative process.

Sources of finance in the innovation process	
Stages	Sources
<b>Research</b>	Public sector
<b>Development</b>	Public sector Venture capital
<b>Start-up</b>	Public sector Venture capital Business angels
<b>Exploitation</b>	Public sector Venture capital Business angels Banks

<sup>24</sup> The IP due diligence analysis is the subject of a separate fact sheet elaborated by the European IPR Helpdesk and available in the online [library](#).

## Useful Resources

For further information on the topic please also see:

- “The little book of private equity”, European Venture Capital Association:  
<http://www.evca.eu/media/19732/Little-book-of-Private-Equity.pdf>
- Banking on IP?, UKIPO study, November 2013, 2013/34:  
<https://www.gov.uk/government/publications/banking-on-ip>
- Fact sheet on “IP due diligence: assessing value and risks of intangibles”:  
<http://www.iprhelpdesk.eu/Fact-Sheet-IP-Due-Diligence>
- Fact sheet on “Intellectual Property Valuation”:  
<http://www.iprhelpdesk.eu/Fact-Sheet-IP-Valuation>

## GET IN TOUCH

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## ABOUT THE EUROPEAN IPR HELPDESK

The European IPR Helpdesk aims at raising awareness of Intellectual Property (IP) and Intellectual Property Rights (IPR) by providing information, direct advice and training on IP and IPR matters to current and potential participants of EU funded projects. In addition, the European IPR Helpdesk provides IP support to EU SMEs negotiating or concluding transnational partnership agreements, especially through the Enterprise Europe Network. All services provided are free of charge.

**Helpline:** The Helpline service answers your IP queries within three working days. Please contact us via registration on our website – [www.iprhelpdesk.eu](http://www.iprhelpdesk.eu) – phone or fax.

**Website:** On our website you can find extensive information and helpful documents on different aspects of IPR and IP management, especially with regard to specific IP questions in the context of EU funded programmes.

**Newsletter and Bulletin:** Keep track of the latest news on IP and read expert articles and case studies by subscribing to our email newsletter and Bulletin.

**Training:** We have designed a training catalogue consisting of nine different modules. If you are interested in planning a session with us, simply send us an email at [training@iprhelpdesk.eu](mailto:training@iprhelpdesk.eu).

## DISCLAIMER

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From 2015 the European IPR Helpdesk operates as a project receiving funding from the European Union's Horizon 2020 research and innovation programme under Grant Agreement No 641474. It is managed by the European Commission's Executive Agency for Small and Medium-sized Enterprises (EASME), with policy guidance provided by the European Commission's Internal Market, Industry, Entrepreneurship and SMEs Directorate-General.

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