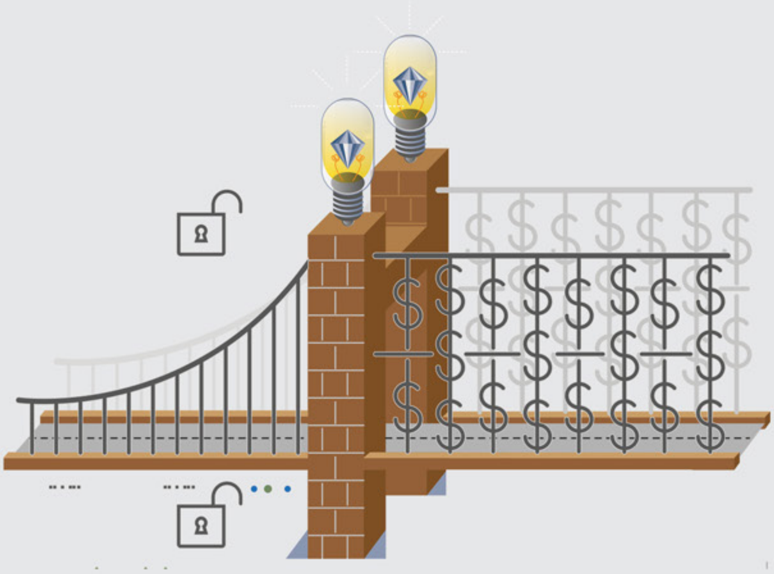
UNLOCKING YOUR IP'S FINANCING POTENTIAL

How to harness IP's hidden value when obtaining funding to grow your business

INTELLECTUAL PROPERTY OFFICE OF SINGAPORE

IPOS INTERNATIONAL



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Introduction

In knowledge-based markets, nothing stays still for very long. Keeping ahead of the competition requires a continuous process of innovation. If this costs more than you can fund from retained profits, then you'll need to look for external sources of funding to support your plans.

This guide sets out to explain the funding landscape from two IP-related angles. The first concerns the routes you might take to fund the creation of your IP; the second looks at the routes you can take to fund more IP, once you have some already.

Chapter 1 sets the scene by considering why and how IP and funding often go hand-in-hand. It introduces the principle of risks and returns to explain how each main type of funding may suit different development stages. It explains in general terms how IP is a consideration in equity investment, debt finance and grant-awarding, and how you might combine them to raise the funding you need.

Chapter 2 starts from your IP. It looks at the characteristics of intangible assets that are likely to make them more or less well suited to use for raising finance, providing a 'scorecard' to help you determine where you might be on the IP attractiveness scale.

Chapter 3 focuses on the type of funding which is most commonly associated with IP-intensive companies: equity investment. After characterising the types of business for which selling shares makes the most sense, it examines why IP matters to investors, how their expectations may vary by development stage, and what 'due diligence' they may conduct on it, with a checklist to help you prepare.

1. **Why IP needs funding**
2. **IP-friendly finance options**
3. **IP and equity fundraising**
4. **IP and debt finance**
5. **IP and grant application**

In the past, it has generally been the case that lenders took little notice of IP and intangibles. However, now that growing companies typically have few of the tangible assets banks like to use as collateral, IP is starting to become a consideration. **Chapter 4** sets out the main types of debt available, the types of IP most likely to be considered valuable and how security is taken over them, and the limitations that banking regulations impose on IP use.

Chapter 5 concludes the guide with a section on grant funding. It considers who can qualify, what strings may be attached, and how grant awards can help businesses secure other forms of finance. It also considers how to look after the new IP that a grant award is likely to help you create.

Produced by **IPOS International**, these intellectual property management (IPM) business guides aim to deliver a suite of IP solutions for enterprises based on industry best practices. As the expertise and enterprise engagement arm of the Intellectual Property Office of Singapore (IPOS), IPOS International helps enterprises and industries use IP and intangible assets for business growth. Some of these engagements may be eligible for Enterprise Singapore (ESG) funding, such as the intangible asset audit and strategy development aligned with business goals. IPOS International's business portal ***www.iposinternational.com*** also contains case studies and videos of enterprises leveraging IP to gain a competitive edge in their innovations. Should you have questions on IPM matters or wish to speak with our Intellectual Property Strategists, do email us at **enquiry@iposinternational.com** or call **+65 63308660.**

How does IP fit with funding?

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1. How does IP fit with funding?

Why is funding such an important issue for IP-rich businesses?

It is possible to start a successful business with just a few dollars. However, IP-rich companies seldom fall into this category. Putting a novel idea into practice normally takes money—and many businesses need to fund on-going investment to stay competitive.

In some industries, like biotechnology and pharmaceuticals, developing strong and valuable inventions may take years and involve successive, multi-million-dollar funding rounds. Where there is no fundamental science to be explored, inventions can often be brought to market for much more modest sums of money, but may still involve setting up a factory or store, equipping a production line, writing reams of code, paying for raw materials and/or recruiting staff before any cash starts flowing in. Also, whenever you are selling something underpinned by IP, there is (by definition) some difference between what you are offering and the 'status quo', so you may need to pay to promote your new product or service for some time before you develop traction and profits.

For all these reasons, entrepreneurs and businesses that have a 'big idea' often need money from elsewhere to make it a reality. Fortunately, one of the advantages of IP is that it can help businesses achieve much higher returns on their investment because they can protect their points of differentiation. That can make fundraising a bit easier.

“Big ideas often need some form of external financial support to help realise them”

What types of funding are best suited to innovative businesses?

If you need to seek external funding for your business, you are likely to have three main options: applying for a grant, selling shares in your business, or borrowing money from formal or informal sources. IP is potentially important to obtain any of these, but its relevance will vary depending on your development stage.

The key point to bear in mind is that the **rewards** that can be unlocked with IP have to be balanced against the associated **risks**. Successful inventions, brands, designs and creative content (and the IP rights that support them) can be worth vast sums, but unsuccessful ones are generally worth little or nothing. For financiers, these costs are usually 'sunk' because there is a low prospect of cost recovery if market acceptance does not materialise (despite everyone's best efforts).

The three main sources of funding for innovation can be summarised in terms of their risk appetite, which in turn has implications for their likely relevance to your particular situation.

The three main business funding sources

	Type	What is it?	Typical sources	Risk appetite
1	Grants	*A grant is money that you don't have to pay back. It is usually provided for a specific purpose*	**Government and industry bodies, charities and research foundations**	**High**—*grants generally aim to encourage and support the sort of scientific, cultural or artistic work that would struggle to find commercial backing due to the risks involved*
2	Equity investment	*Equity means dividing up ownership of your company by inviting other people to buy your stock—in anticipation of capital value appreciation, dividend payments or both*	**Informal investors (friends and family), crowdfunding platforms, business angels, syndicates, venture capital firms, private equity companies, stock markets**	**Medium**—*equity investors can negotiate larger stakes for their money when risks are higher, and some like to 'get in early' for this reason. However, there must still be a compelling business case for all types of equity investment (except perhaps 'friends and family')*
3	Debt finance	*Cash may be made available to creditworthy companies, in the form of working capital facilities (typically overdrafts), project finance, term loans or specialist products like venture debt*	**Banks, alternative finance providers and specialist funders (including peer-to-peer lenders)**	**Low**—*lending markets are highly competitive which means that margins are comparatively low. Defaults therefore have to be low as well. Also, there is no extra upside for a lender if a business does spectacularly well*

1. How does IP fit with funding?

How does IP feature in grant applications?

Innovation generally involves risk and uncertainty. Recognising that for some firms, getting (or staying) in front may cost more than a company can fund from its resources or profits, some sectors offer financial incentives to encourage companies to invest in developing new IP.

Grants are especially important to early-stage businesses looking to develop IP, across a range of activities ranging from cultural and artistic works to fundamental scientific research. Grants generally come from public sources such as government agencies, or industry bodies like scientific foundations: they offer funding that does not have to be repaid (if you do have to repay, you are really looking at a 'soft loan' not a grant).

This type of funding usually concerns an activity that is relatively self-contained and has clear pre-determined deliverables. Importantly, these aims should be things that would not have happened otherwise, otherwise there will be no 'additionality'. They might require some collaborative development activity, or be done by one company.

Apart from the type of grants that are provided for infrastructure or community projects, it is generally expected that a successfully funded project will produce some new intangible assets, which may include registrable IP rights. Having a track record of creating and filing for IP is, therefore, an important credential, as Chapter 3 explains.

Four questions to ask when applying for grants

	Question	Explanation
1	**How much match funding do you need to find?**	*Grants often have at least some requirement for a financial contribution (or sometimes, an 'in-kind' contribution based on time invested). If you can't obtain the match funding that is required, a grant might not be the best way of advancing your idea.*
2	**Will anyone else try to claim ownership over the IP?**	*Confirm where the rights to any intangibles and IP will reside: under some circumstances, the grant-giving body could acquire rights to own or exploit them.*
3	**Are IP protection costs eligible under the grant conditions?**	*If you do create potentially valuable IP as a result of your grant, you will want to take steps to protect it, which might include professional advice and statutory filing fees. It is wise to determine whether you can reclaim these as part of the project you are contemplating.*
4	**When can you claim?**	*You may only be able to claim in instalments, or on completion, and you may need to provide evidence of defrayal (actual payment, not just commitments to incur costs) before you can 'get your money back'. You may have to plan your cash flows quite carefully to ensure you can complete the project.*

*A separate guide in this series—***Partnering For Commercial Advantage***, sets out some of the key points to bear in mind when entering into grant funding applications with research institutions, universities or other commercial partners. It is worth noting that many types of IP investment can attract tax perks—these are covered in another guide—***Making Tax-efficient Use Of Your Assets***.*

1. How does IP fit with funding?

Why do equity investors care about IP?

Taking shares in a company aligns the interests of both parties. Generally, an investor is looking to make a return by selling a stake that has increased in value. Therefore, anything that helps a business to grow, and makes it more likely to become an acquisition target, is of potential interest; IP falls into this category.

It is important not to overstate the role IP plays. Outside of a few very specialised and highly technical areas, most investors will generally prefer to back a great team with an average idea than an average team with a great idea.

The thinking is that a great team is more likely to make an idea work, at least to some degree. Also, investors understand that you may need their money to **create** the IP in the first place (or to make more IP to strengthen your portfolio) and that the important assets your business will ultimately have might not be visible for some time.

That said, as Chapter 3 sets out, investor expectations will vary depending on the development stage of your company and its intangibles. They also appreciate that, when a company is starting out (and in many cases, even as it grows), its most important and valuable ones are likely to be intangible. Accordingly, if you are looking to negotiate a value for shares you wish to sell to raise capital, you may well have to justify it by referring to the existing or potential value of your IP—if only because there may be few other 'hooks' that you can credibly use.

There are two key aspects of IP that make it important in attracting investment. While the terms used may vary, these are commonly referred to as **barriers to entry** and **freedom to operate**.

Barriers to entry and freedom to operate

	Type	Why	How IP helps
1	Barriers to entry	*If you have a new creative or inventive proposition that needs investment, any investor is likely to ask, 'what's to stop everyone else copying you if it turns out to be any good?'*	**IP protection provides an answer to this question because it provides a means to stop imitators and pursue them for damages (if resources permit)**
2	Freedom to operate	*This is the 'flip side' of point 1. An investor will want to be confident that you are not likely to get prevented from trading or taken to court by a competitor because you are infringing their rights*	**It is very difficult to be 100% sure that you are not infringing anyone else's IP. However, if you have secured your rights, it shows you are aware of the issue and have done some homework. If someone does accuse you of infringement, at least you have assets that might form the basis of a counter-claim**

Chapter 2 explores which assets might be most important in securing investment under different circumstances—but in general, the more creative or inventive your idea, and the more you can claim that you have a decisive advantage over your competition, the more investors will expect to see IP at the heart of your strategy.

When does IP matter to lenders?

Since lenders earn money by charging interest, they need to be confident that borrowers have the ability—and the intention—to honour their commitments. Where assets support cash flows, they may be taken into consideration for serviceability, and lenders may also take them as security to create an additional incentive to repay.

As with equity investment, it is important not to overstate the role that IP plays in lending. Many banks have become accustomed to ignoring both on- and off-balance sheet intangible assets because they assume they have no realisable value. Further, for reasons set out in Chapter 4, even if your bank understands your IP and takes a security interest over these assets, it will not be permitted by current regulations to allocate a realisable value to them—at least, not in the way that it could harness your house, office, factory, lorry or van (or even your invoices).

However, times are changing. With growth businesses now typically investing more in intangibles than in so-called 'hard' assets, lenders are running out of conventional collateral to rely on, and any they can secure is increasingly divorced from the real sources of value and cash flow within their client companies.

1. How does IP fit with funding?

Specialist lenders have now shown how asset-backed finance, venture debt and even unsecured cash flow lending can benefit from understanding the assets that really make a business 'tick'. Accordingly, the chances that your IP will be taken into consideration in some way, if only as a 'comfort factor', are increasing.

If a lender does take an interest in your IP, they will probably want two main things: a clear inventory setting out what all your intangible assets are (and how they add value to your business and help secure its cash flows), and an IP valuation report so that they can see whether the contribution these assets are making is a material one. Their requirements are considered in more detail in Chapter 4.

Two reason lenders are starting to pay attention to IP

	Reason	How IP helps
1	*The IP-led investment profile of technology and knowledge-based firms often means they have weaker-looking balance sheets. This is because it is not permissible to capitalise IP at the value it contributes to a business, and because a lot of costs of innovation will be 'sunk'.*	**If a lender can understand how much you have invested in your IP and what assets this has produced, they may be able to take this into account when looking at your historical profitability, and understand your true ability to repay borrowings.**
2	*Companies are increasingly unable to provide the forms of readily tradeable, tangible assets that banks and their regulators are accustomed to using. Even where they can, these 'hard' assets are increasingly peripheral to the ways in which knowledge-based companies drive value.*	**Lenders can take charges over IP and intangible assets that are actually driving your business, so that they have more effective recourse to them if you get into difficulties.**

*A separate guide in this series—***Uncovering your Hidden Value***, explains how IP valuation works and why accounting regulations make it increasingly necessary.*

Can I 'mix and match' funding methods?

> *Most forms of funding are not mutually exclusive—you can 'mix and match'*

While the three main funding routes are very different and work best at different stages of development, they are not mutually exclusive. Equity investment often works well with grant funding, and debt can also be used to make equity investment go further and last longer. Generally, the more sources of funding you can access, the better!

As one example, investors are generally more willing to support early-stage businesses that can show they can to attract grants. Because grant funding is **non-dilutive**, a business can obtain more money with a smaller equity raise (which reduces existing shareholdings less).

This works both ways. Larger grants are generally easier to obtain if an enterprise can show that it can raise match funding. Also, some grants are only reclaimable periodically against milestones, and on proof of expenditure, so you will need additional cash to have the money to spend while you await reimbursement.

Lenders also like to see a strong equity commitment to a business. This counts as 'skin in the game'; it shows there is a group of people who may be prepared to stand behind the company if it gets into difficulties. Where new ventures have accumulated a substantial amount of equity backing, specialist lenders may offer venture debt as a 'top-up' based on the business and technology due diligence already conducted.

CHECKLIST

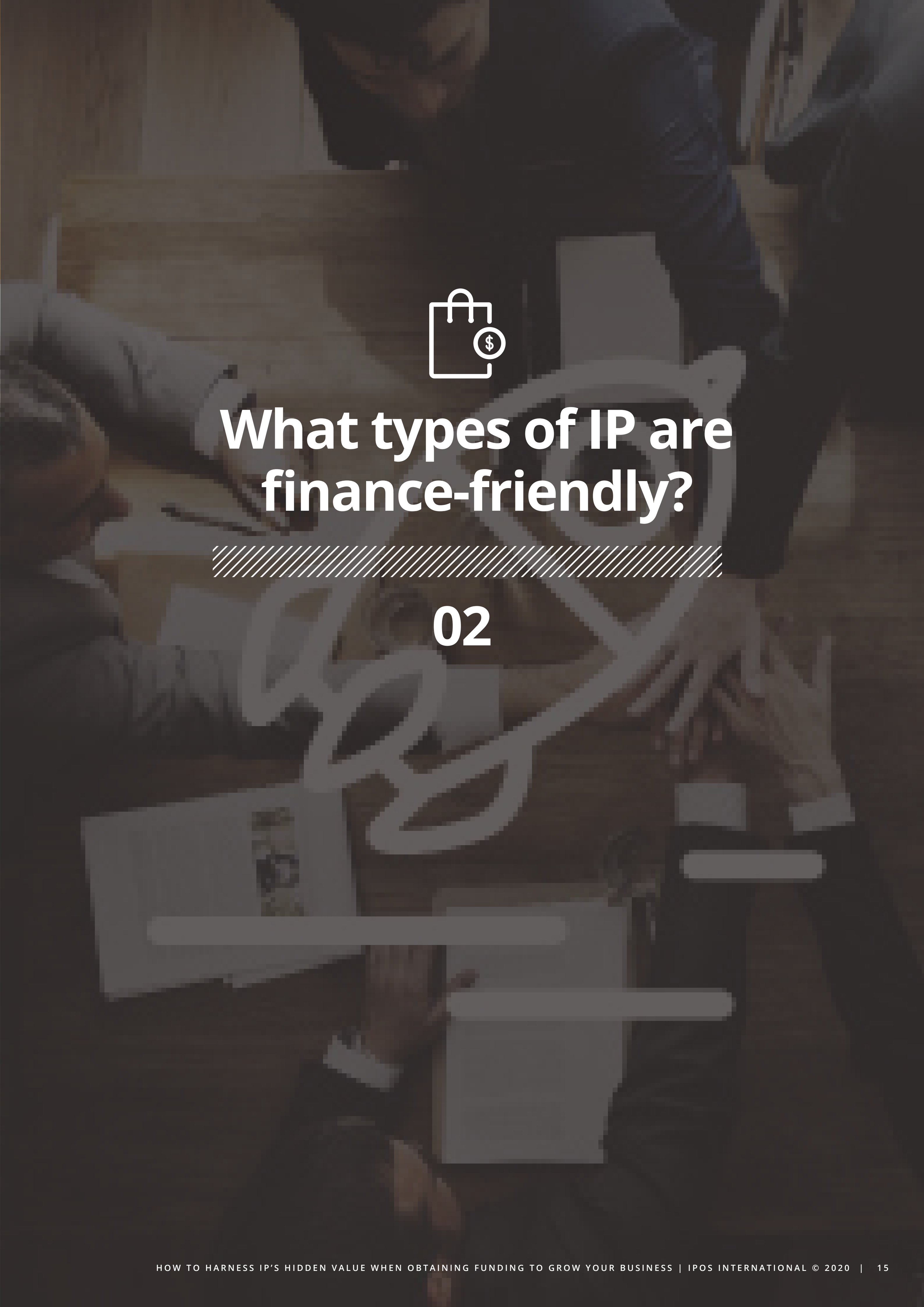
Which types of funding might be most applicable to my IP's stage of development?

NOTE: The following table does not apply if you are a listed company (with access to stock markets), or already making money from other activities.

✓	Development stage	Grant?	Why/why not?	Equity?	Why/why not?	Debt?	Why/why not?
	Idea	**Y**	*Support may be available to determine feasibility and size markets*	**N**	*Too early for anyone except family and friends—there needs to be a plan!*	**N**	*You don't have cash flows. Your only option is to borrow on your personal account*
	Build specification	**Y**	*Where you have a specific defined project, grants can help you fund it*	**Y**	*But only for investors with high risk/high return appetite*	**N**	*No cash flows*

1. How does IP fit with funding?

✓	Development stage	Grant?	Why/why not?	Equity?	Why/why not?	Debt?	Why/why not?
	In build	**N**	*Grants are less likely to be available for something you're already doing*	**Y**	*Once project is underway, additional investor groups may relate to it*	**N**	*No cash flows*
	Near market	**Y**	*You may be able to obtain help with market access, especially international markets*	**Y**	*Risks reducing, so the range of potential investment sources will be increasing*	**N**	*Sorry, still no cash flows...*
	On sale	**N**	*Once you're up and running, grant givers will usually prioritise other applications*	**Y**	*This is 'scale-up' territory where risk is further reduced but significant returns can still be made*	**Y**	*Once you have sales, debt products like invoice discounting be-come possible*
	Established	**N**	*Mature IP and companies do not usually meet the additionality requirements of grant funding*	**Y** *(large and high growth-firms)*	*To secure an ongoing flow of capital, a firm may list on a public market, increasing share liquidity*	**Y**	*This is debt's 'sweet spot'—borrowing is limited only by your cash flows, profits and collateral*



What types of IP are finance-friendly?

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2. What types of IP are finance-friendly?

Why might some types of IP be preferred over others?

When it comes to supporting finance applications, not all IP assets are created equal. While the overriding factor will be their relevance to your business, it is helpful to be aware that in some industries, a kind of 'hierarchy' is likely to be at work.

In terms of **relevance**, the assets likely to be most helpful will depend on your sector and your business model. If, for example, your company engages with the general public and needs to compete directly with other firms offering broadly similar goods or services, then strong brand protection and promotion are bound to be business-critical. In relation to these aspects, registering trade marks (in all your major markets) will be a very important element in protecting your interests. If on the other hand your activities are technical and you trade based on significant product differentiation, patents are more likely to be the priority.

This isn't quite the full picture, however. The following table provides some useful pointers on the attitudes you may encounter from an 'IP savvy' financier towards your rights and trade secrets.

Type of right	Likely financier attitude	Follow-up questions you may be asked
Granted patent	*Provides evidence that you are doing something novel and inventive—because an independent examiner has said so. Should be enforceable, and may have transferable value.*	• What does it cover? • What territories are protected? • How much will it cost to maintain? • Who else has similar rights? • What is the likelihood of legal action?
Patent application	*Indicates you have a claim to be doing something unique. Shows you understand the importance of protecting your IP.*	All of the above, plus: • Is it likely to grant?
Trade secrets	*Accepted as the best way to protect some processes and methods that would be copied if they were patented. You may face some scepticism about how 'real' they are.*	• Why did you decide to use secrecy? • Are your secrets truly unique? • Aren't they just know-how? • Who knows them? How committed are they? • Can you really protect them? • What steps are you taking to protect them?
Registered trade mark	*Especially important for a 'B2C' proposition, but value very closely tied to your business's fortunes*	• What markets are covered? • Are they the right ones?

Type of right	Likely financier attitude	Follow-up questions you may be asked
Registered design	*Can be useful, but have a reputation for being easy to design around and hard to enforce (because they are not examined).*	• **Is your styling truly distinctive?** • **Do you have anything patentable?**
Copyright assets	*Have a history of being used for a range of transactions for books, films and music. May not be seen as offering very strong protection for software, as imitators may copy the idea, not the code itself.*	• **How does this protect your business model?** • **Are there licensing opportunities?**

It is important to remember that people's level of IP knowledge varies widely. Many will not be as savvy as the hypothetical financier above! If IP rights are important to your business and differentiate it from your competitors, the onus will be on you to get this message across in your presentations clearly and compellingly.

Does size matter when it comes to IP portfolios?

Most funders understand that the breadth of a company's IP portfolio is related to its development stage, so will not expect an early-stage company to have a mature or extensive set of rights. Getting as many assets registered as possible is unlikely to be the priority: it is more important that the IP a company owns or will own in future, supports its business model.

As explored in more detail in the following chapters, it may well be that you need investment to create the rights you need to drive your business forward. The following table, organised by broad development stage description, provides a summary of what investors and lenders might reasonably expect you to have in place at different points in your innovation journey.

Development stage	Likely priority
Idea	*No-one will have expected you to have applied for any IP rights yet, but you will need to show you understand how IP is going to be important to your business, and appreciate the importance of keeping ideas confidential.*
Build specification	*You should have a business plan with an IP strategy section in it. You should have done some research into the availability of the rights you think your business may need.*
In build	*You could usefully be applying for rights at this point, though you may need to refine the details at a later stage in the build.*

2. What types of IP are finance-friendly?

Development stage	Likely priority
Near market	*You are approaching the point at which other people will become aware of what you are doing, so you should definitely be applying for any protection that is identified as important to your business by now.*
On sale	*The disclosure that happens at this stage will most likely prevent you from patenting anything if you have not already done so. However, you should still be able to register trade marks. If you have started your IP journey earlier, you may by now have identified more things to protect.*
Established	*At least some of your rights should be granted/registered and in force.*

If patents are important, and their importance has been recognised, you might expect that more patents would equal more value. More is not worse—but it is not necessarily better, either, because international studies show that even in a large company's patent portfolio, it is unlikely that the percentage of patents that really drive and generate value will be in double digits.

Having more rights than you need or use can have a negative implication because it adds cost (especially in terms of renewals), and could imply that you have not thought carefully about commercial utility. Financiers may not want to fund the process of casting a very broad net on a 'just in case' basis. They will, however, expect that you have thought about territories when deciding what you need to protect and where so that your most important revenue- and value-generative assets are covered.

What qualities add value to an asset in a financier's eyes?

If IP rights are integral to your business model—and they often are, in the case of growth businesses—you can expect them to be subjected to additional scrutiny in the funding process, especially if you are hoping to bring equity investors on board.

While it is important to understand that investors, lenders and grant giving organisations are not necessarily very well versed in IP matters, what counts is your ability to describe what you have and the purpose it serves compellingly. How much notice financiers take of your IP is partly down to how well you explain why it matters and how your rights compare with those of your competitors.

YOUR PITCH CHECKLIST

10 ways to demonstrate IP relevance and quality

How many of these points have you included within your funding proposal?

Every business is different, and this is not an exhaustive list (this guide also contains checklists tailored for equity and debt funding. However, it will help you to work out which qualities your IP portfolio possesses, and confirm whether you have featured all the relevant ones in any slide deck or presentation you are making.

Attribute	Ways to demonstrate or quantify	Covered?
Competitor intelligence	*Explain the main points of your IP strategy and show how your invention or creation differs from and is better than your competitors.*	
Application status	*Set out any rights that are registered or granted, and make the point that they have enforcement potential.*	
Spread within type of IP right	*Show that, within the types of IP protection that are most relevant for your business, you are not reliant on one asset but have several 'irons in the fire' (you are building a wall, not relying on one brick).*	
Spread by type of IP right	*Explain how your business model is supported by a variety of different IP rights (preferably registered or granted ones, depending on your development stage).*	
Support for a unique selling point (USP)	*List important features your products or services have (or will have) that are demonstrably underpinned by IP rights, making them harder to copy.*	
Support for a whole business	*Alternatively, explain how your business model is underpinned by enforceable IP rights.*	
Geographical coverage	*Demonstrate that you have obtained, or are in the process of getting, good IP coverage in all the markets that account for a material proportion of your production and/or sales.*	
Status in the landscape	*Explain how your IP has helped you carve out and maintain a niche in the competitive landscape, backed by evidence from your incomes and/or market share (this shows your IP is not only distinctive but also value-additive).*	
Lack of replicability	*Where applicable, make the point that you can do something* **no-one else can**, *and you have the IP strategy and the IP rights to back this up. Investors find this particularly attractive, provided you can demonstrate it to be true.*	
Proof of enforceability	*If you have successfully defended your IP in court or used it to pursue an infringer and extract compulsory licence fees and/or damages, your IP has incontrovertible worth—don't forget to mention it!*	

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