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What Is Intellectual Property (IP) Financing And Why You Should Know



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The New World, Where Intangible Assets Reign Supreme

Only less than 30 years ago, it would be intolerable for a company founder to enter their banker's office without historical financial statements, a brick and mortar location, and contracts for future purchases. But, thanks to the "internet-of-things," the mention of such prerequisites is slowly becoming laughable. As it was during the shift from the horse and buggy to the automobile, it is now, as innovation drives the focus from tangible to intellectual assets.

Innovation is often correlated with value creation through industry-disrupting technologies, business models, or products. Intellectual property plays a critical role in driving innovation and economic growth. With survival in mind, today's founders, investors, and lenders must quickly adopt a culture of considering intangible assets as viable financing collateral.

Intellectual Property Types Eligible for Financing

Intellectual property(IP) can categorically be narrowed down to informal and formal IP. Informal IP often referred to as a "company's know-how," includes intangible assets

such as branding, supplier relationships, and business process. Informal IP must be well-articulated to demonstrate its value bankability. IP finance is almost always reserved for formal IP such as trademarks, patents, copyrights, and design rights. The securitization of IP assets has several advantages and disadvantages for companies seeking capitalization.

Companies must calculate intellectual property into their overall business plans and corporate value proposition to ensure long-term economic success. Four basic structures could be used to monetize the value of your intellectual property: (1) IP Backed Loans, (2) IP Sale-leaseback, (3) Legal Finance, and (4) IP Royalty Securitization.

IP-Backed Loans

IP-backed loans are helpful for businesses lacking tangible assets or cash flow to support a traditional credit solution. The loans model the structure of conventional asset-backed loans on real estate equipment or inventory. Lenders secure a security interest in a Company's IP assets as collateral for a loan in exchange for interest payments. It is important to note that IP-backed loans amounts are typically determined by the percentage of the IP portfolio's liquidation value and overall risk as determined by the lender or investor.

IP Sale-Leaseback

An IP sale-leaseback is similar to a real estate sale-leaseback where there is a change in ownership. More specifically, an investor acquires the IP, and the selling company pays a lease or licensing fee. This financing structure provides holders of IP with immediate liquidity with limited restrictions. In most cases, IP sale-leaseback transactions include a repurchase option allowing the seller to buy back the ownership within a predetermined period.

IP Legal Finance

Accelerated innovation is quickly correlating to infringements on patents and trade secrets. The IP legal finance structure allows IP owners to advance funds against the future value of their outstanding IP infringement disputes. In addition to covering general operating expenses, the capital is often used to mount a successful case against infringing parties. Driven by quantifiable outcomes, IP legal finance has quickly become one of the preferred IP financing vehicles for large investors.

IP Royalty Securitization

The number of securitizations using IP as the underlying assets has significantly increased over the years. IP royalty securitizations generally require an IP owner to sell an IP-related income stream for a fixed duration in exchange for a non-dilutive, up-front cash payment. The primary difference between securitization and an IP-backed loan is that the IP owner is not borrowing money but is instead selling a stream of future cash flows.

Intellectual Property Types Eligible for Financing

Proper management of IP assets should include a strategy to monetize and protect the portfolio effectively. IP financing has several advantages and disadvantages for companies seeking capitalization.

Advantages of IP Finance

- IP finance opens the credit markets for "hard-asset-light" services businesses needing asset-based financing.
- Under a credit-enhancement structure, IP financing may attract lenders by lowering the borrower's risk profile if the IP is transferred to a special purpose, bankruptcy-remote investment vehicle.
- Recapitalization through IP finance can increase liquidity for investment in projects with returns that outpace the cost of financing.
- Companies may be able to restructure high-cost debt, address liquidity events and prevent equity dilution by utilizing IP financing facilities with attractive terms.

Disadvantages of IP Finance

- The valuation used in IP financing is generally based on a liquidation value that yields lesser proceeds to borrowers and benefits lenders in the event of default.
- When IP is a company's mission-critical asset pledged as collateral, a technical default in the financing arrangement could liquidate all company assets.
- Due to its uniqueness, IP finance is often a more expensive alternative than conventional financing options.
- IP assets are considered valuable based on the secondary market demand. However, lenders may find it challenging to establish potential suitors of defaulted IP debt for genuinely innovative IP.

As the world deeper into the fourth economic revolution, business success will largely hinge on a company's ability to produce ground-breaking innovation that caps rising competition. Companies must include a strategic financial partner who understands the IP financing landscape. Properly structured IP financing can fuel a company's long-term strategic growth and guard its competitive advantage.

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