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IP-Backed Financing in India: Navigating Challenges and Harnessing Potential

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This article aims to provide comprehensive insights to businesses for making informed decisions while maximizing the potential impact of their intellectual property worldwide. It delves into the nuances of IP-backed finance, considering challenges with due diligence, valuation intricacies, and the requirement of specialization and ensuring continuing validity. The article emphasises the benefits of using IP as collateral, including enhanced security, long-term value growth and a diversified pool of assets. The case studies from the UK, USA, Singapore and India are used for highlighting the benefits as well as potential challenges experienced by firms when utilising the intellectual property as collateral to receive finance, providing essential insights into the accomplishments and challenges of IP-backed financing. The article highlights India's expanding IP ecosystem and suggests collaborative efforts among regulators and financial institutions to unlock India's IP potential for economic growth and innovation.

Keywords: *intellectual property, finance, collateral, assets, valuation, patents.*

INTRODUCTION

Intellectual property is essential to modern economies, encouraging innovation, creativity, and competitiveness. It includes a vast spectrum of intangible assets created by human knowledge and creativity. These assets can be safeguarded by several types of Intellectual Property Rights, which allow the inventors or owners exclusive rights for a specified length of time. Intellectual property enhances economic growth since it helps create new job opportunities and market possibilities. Companies frequently rely on their intellectual property portfolios to maintain a competitive edge in the market. Investors are increasingly drawn to enterprises founded on innovative ideas and cutting-edge technology.

As the significance of intellectual property has grown, business organisations have started to utilise them as collateral to acquire funding. Surprisingly, this idea of using intellectual property as collateral to raise loans has been prevalent for over a century. Thomas Edison used his patent on the incandescent electric light as collateral to acquire a loan and create his own company in the late 1880s.[1]

IP is typically classified as formal and informal IP. Informal IP, sometimes known as 'know-how' includes intangible assets, including branding, supplier connections, and business procedures. It is critical to accurately convey the relevance of informal IP in order to establish its financial viability and worth. When it comes to IP financing, however, the emphasis is mainly on formal IP, which includes trademarks, patents, copyrights, and design rights. These sorts of intellectual property are more easily identified and lend themselves well to financing options.[2]

UNDERLYING CHALLENGES IN IP-BACKED FINANCING

Due diligence and valuation: Lenders must do extensive due diligence and examine the underlying value of IP assets presented as collateral. Due diligence procedures for intellectual property assets may differ from those for traditional collateral such as land or machinery since they are more time-consuming and complex. Intellectual property is an intangible asset having no physical presence, and unlike tangible assets, their value is highly subjective and is determined by a variety of factors such as:

Rapid technological advances: This can have a substantial impact on the value of intellectual property assets. New breakthroughs and innovations in industries driven by innovation, such as technology, biotechnology or pharmaceuticals, can render current IP assets obsolete or less

[1] Esteban Mazzucco, 'Security Interests in Intellectual Property Rights: the Time Has Come for the Enactment of New Laws' (LLM thesis, University of Georgia School of Law 2003)

[2] Jason Jackson , 'What Is Intellectual Property (IP) Financing And Why You Should Know' (*Forbes*, 31 January 2022) <https://www.forbes.com/sites/forbesfinancecouncil/2022/01/31/what-is-intellectual-property-ip-financing-and-why-you-should-know/?sh=29d425341c15> accessed 11 July 2023

valuable. For example, a patent protecting an AMOLED display technology may become less valuable if a newer, more sophisticated technique arises.

Consumer Tastes and Trends: Consumer tastes and trends can change quickly, influencing demand for products or services connected with certain IP assets. A popular brand or trademark may lose its charm if customer tastes change to new trends or rivals. This shift in demand may cause the value of the IP asset to fall.

Market Dynamics: Market dynamics, such as changes in supply and demand, the competitive landscape, or economic conditions, can have an impact on the value of intellectual property assets. Market disruptions, new market entrants, or changes in pricing tactics by rivals can influence an IP asset's market position and prospective revenue generation.

Regulatory Changes: Changes in laws and regulations can directly impact the protection and enforceability of intellectual property assets. For example, changes in patent laws or copyright protections may affect the scope and duration of IP rights, thus reducing their value. Changes in trade regulations or international agreements can also have an impact on the global reach and market potential for IP assets.

Legal Complications: IP assets might face legal issues such as infringement claims or ownership. Litigation or settlements related to these legal issues might result in significant expenses and uncertainty, lowering the value of the IP asset.

Ensuring Continuing Validity: Once accepted as collateral, the lender has a 'security interest' in the IP asset, allowing them to take and sell it in case the borrower fails to repay. Throughout the loan term, the lender must guarantee that the borrower immediately renews ownership of the IP asset and takes the required safeguards to retain proper ownership. Patents in India are valid for twenty years from the date of application, while trademarks are valid for ten years from the date of application. In the case of a default, the lender may be responsible for maintaining and monitoring prospective infringements, battling against infringement charges, and monitoring royalty payments. Proper management of the IP asset during the loan term is critical to protecting the lender's interests and mitigating the risks associated with IP ownership.[3]

Expertise in Valuation: Intellectual Property assets require expertise in valuation and management. Unlike tangible assets like real estate and machinery, intellectual property is intangible and unique, making its worth more subjective. Furthermore, each IP asset has its characteristics and commercial prospects, complicating the assessment process further. Expertise is required in IP valuation to deal with the complexities of this domain to effectively determine the value of IP assets. Understanding numerous elements such as market demand, competitive landscape, technical improvements, and potential dangers related to the IP asset is required. Unfortunately, many lenders may lack the essential expertise and experience, making it difficult to lend against intellectual property.

BENEFITS OF IP-BACKED FINANCING

Diversified Asset Pool: A diverse and valuable asset pool allows companies to access ample financing options. Among these essential assets, patents, copyrights, and trademarks are especially important. They not only represent the actual value of a company's portfolio but also add to its market value, attracting new financing alternatives. As a result, businesses are actively implementing steps to improve transparency and trustworthiness in intellectual property marketplaces. They do this through reporting regimes controlled by IP offices, which provide critical information and disclosure obligations.

For example, as part of a comprehensive national programme, the Singapore government made efforts to strengthen its status as a 'Global Hub for IP' in 2013. The government encouraged intellectual property rights holders to provide and convey crucial information about ownership, transfer, and licencing. Singapore aimed to attract enterprises looking to capitalise on their intellectual property assets and present itself as an attractive centre for Intellectual property-related operations by enhancing transparency in Intellectual property transactions.[4]

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[3] Manoranjan Ayilyath, 'Lending Against Intellectual Property Assets – Underlying Challenges in India' (*SSRN*, 26 March 2019) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3246410> accessed 13 July 2023

[4] Ashwene Vij, 'Everything you need to know about IP backed financing' (*iPleaders*, 07 October 2020) <https://blog.ipleaders.in/everything-you-need-to-know-about-ip-backed-financing/> accessed 13 July 2023

Enhanced Security: By defining intellectual property as a component of the financing structure, a bank is granted enhanced security, strengthening its position and reducing possible risks when the borrower faces a financial crisis. If the borrower defaults, the Bank gets a concrete and valuable asset to recover the existing obligations by specifically adding intellectual property to the collateral arrangement.[5]

IP gives another layer of protection directly linked to a company rather than an individual, making it simpler to recover the funds if necessary. Lenders frequently need personal guarantees from company founders or directors as collateral when seeking finance. Personal guarantees put an individual's personal assets at risk in the event of a default, and they can be a substantial burden for business owners since they may be required to pledge personal property as collateral, such as homes or savings. In contrast, leveraging intellectual property and intangible assets as security provides a compelling alternative to individuals. By pledging intellectual property and intangibles as collateral, company owners can safeguard their personal assets from potential financial risk while still obtaining the required funding.[6]

Appreciable Value: Intellectual Property assets provide a substantial advantage to well-run businesses compared to tangible assets, which generally deteriorate over time. The possibility for value appreciation is due to monopoly rights, branding, licencing options, technological advancements, growing market potential, portfolio synergies, and their involvement in mergers and acquisitions. Intellectual property's intangible character provides long-term competitive advantages and the possibility to develop additional revenue sources through licencing.

CASE STUDIES

Cambridge Display Technology UK: Cambridge Display Technology ('CDT'), a leader in cutting-edge flat panel display technology, owned substantial intellectual property rights through patents that were crucial to the evolution of polymer-based organic light emitting diode ('PLED') technology. In 2004, CDT established itself as a self-sustaining corporate organisation

[5] John P Ogier, 'Intellectual property, finance and economic development' (*WIPO Magazine*, February 2016) <https://www.wipo.int/wipo_magazine/en/2016/01/article_0002.html> accessed 12 July 2023

[6] *Ibid*

to accelerate its PLED research and development programmes. They raised $15mn from British banks by using their patents as security.[7]

Masai Group International (Masai Group) Singapore (2016): Masai, founded in 1998 in Switzerland, is a worldwide shoe company that creates, markets, and distributes footwear through its subsidiary. The firm was granted a patent in 2008 for its novel 'Masai Barefoot Technology (MBT),' a footwear technology that provides natural instability to stimulate and develop the body's supporting muscles.[8]

Masai had financial difficulties and finally declared bankruptcy due to fierce competition and the development of counterfeit items. As a result, the firm was purchased by a Singaporean shoe wholesaler and retailer. The market presence of counterfeit items has a significant influence on Masai Group's revenues. Following the acquisition, Mr Andy Chaw was appointed as the new CEO. Under his direction, the corporation sought financial assistance to re-establish stability and development. The company obtained a loan from an international bank using Masai's Intellectual Property as security.[9]

SITO Mobile US (2014): SITO, a well-known mobile data technology firm founded in 2002, specialises in providing strategic insights and media campaign services. SITO was delisted on NASDAQ on August 23, 2019. SITO Mobile signed an arrangement with an investment management group in 2014, obtaining US$ 11 million in funding. The funding arrangement entailed borrowing $10 million in debt and investing an extra $1 million in equity. SITO used its intellectual property portfolio of patents as collateral to get the credit.[10]

CASES IN INDIA

In Canara Badnk v N.G. Subbaraya Setty, the Supreme Court ruled that the assignment of the Trademark 'EENADU' to the Bank after the borrower defaulted on the loan was not permissible under the Banking Regulation Act. The borrower first obtained credit from the Bank but later failed to repay the loan amount for which he assigned the trademark 'EENADU'.

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[7] 'IP-Backed Financing: Using Intellectual Property as Collateral' (*Duff & Phelps*, December 2019) <https://ciiipr.in/pdf/CII-Duff-&-Phelps-Report-on-Using-IP-as-Collateral-2019.pdf> accessed 15 July 2023

[8] *Ibid*

[9] *Ibid*

[10] *Ibid*

However, the Supreme Court ruled that once a borrower has defaulted on a loan, a trademark cannot be transferred to the Bank because it was not part of the original security agreement.[11]

The Supreme Court further stated that the trademark assignment violated sections 6[12] and 8[13] of the Banking Regulation Act. The court emphasised that banks are limited to their main banking activities and cannot participate in businesses outside their specified scope. As a result, a bank cannot utilise a brand such as 'EENADU' to sell agarbattis or provide third parties permission to use the trademark in exchange for royalties. Violations of these rules can have profound implications, as here, the bank manager engaged in the assignment was dismissed and prosecuted.

However, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002 (SARFAESI Act 2002) was not considered during the case. The SARFAESI Act expressly covers intangible assets in its scope, defining 'property' in Section 2(1)(t)[14] and 'Security Interest' in Section 2(1)(zf)[15] to include intangible assets. Banks may sell or assign intangible assets, including trademarks, in the case of loan defaults under the terms of the SARFAESI Act, providing them with the authority to recover defaulted debts by selling the property.[16]

The Kingfisher Trademark, with its one-liner tag 'Fly with good times' is another example of intellectual property being used as collateral without producing any outcomes. Through an auction, the Indian Bank SBI tried to monetise the IP assets, which included the logo, label marks, and device marks; the auction failed to attract any bids, highlighting the difficulties in efficiently leveraging IP assets.[17]

CONCLUSION

[11] Surekha Rao, 'Can Trademark be mortgaged?' (*LinkedIn*, 12 Aug 2020) <https://www.linkedin.com/pulse/can-trademark-mortgaged-surekha-rao> accessed 18 July 2023
[12] Banking Regulation Act 1949, s 6
[13] Banking Regulation Act 1949, s 8
[14] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002, s 2(1)(t)
[15] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002, s 2(1)(zf)
[16] M Umarji, 'Why Intellectual Property Rights as security for loans is correct in legal terms' (*The Economic Times*, 20 June 2018) <https://economictimes.indiatimes.com/news/economy/finance/why-intellectual-property-rights-as-security-for-loans-is-correct-in-legal-terms/articleshow/64657067.cms?from=mdr> accesed 13 July 2023
[17] *Ibid*

India is on the precipice of an intellectual property revolution, with some of its most valued enterprises experiencing significant increases in brand values. On top of that, the country has emerged as the third-largest economy for start-ups in intellectual property-intensive industries. Despite these positive developments, India's IP financing remains relatively undeveloped, lacking notable IP financing deals.

One of the critical barriers to expanding IP-backed finance in India is the valuation of intellectual property assets. The valuation of intangible assets like patents, trademarks, and copyrights can be complex and subjective. Lenders could benefit from engaging intellectual property specialists with specialised knowledge and skills in working with various IP assets from multiple industries to overcome this barrier. Regular monitoring of technological developments and market trends is also essential for lenders to be informed about potential repercussions on the value of intellectual property assets. This proactive strategy enables lenders to respond to changing market conditions and make sound judgements.

In India, trademarks have been used as collateral to acquire finance; however, the valuation issues and ambiguities surrounding the possibility of recovering by selling the trademark to a third party during a default have resulted in insufficient outcomes. The nature of trademarks is such that if the business performs poorly, the previously assigned valuation becomes obsolete at auctions. As a result, banks are having difficulty selling trademarks to obtain the unpaid sum. On the other hand, patents have shown to be more economically effective for procuring funds, providing a possible channel for IP-backed finance.

Lastly, a collaborative effort by regulators and financial institutions is required to develop a progressive IP finance infrastructure that unlocks the actual value of India's intellectual property assets. India can indulge itself further in the IP revolution and harness its intellectual property to fuel economic growth and innovation in the country by cultivating a suitable climate for IP-backed finance.