Managing Intellectual Property as a Business Asset in China

For most businesses, intangible assets represent more than 50% of the value of the enterprise. The most significant group of intangible assets are those protected by intellectual property such as inventions, designs and brands. Since they form such a large part of the overall value, their management as financial assets is important to the success of the business.

Businesses that actively manage their IP as a financial asset outperform their peers by up to 30%. They do so by maximising the effectiveness of investment in the business, driving performance in areas that produce the best return and managing operational risk. They may also use their IP assets as security to obtain various forms of funding. Moreover, there are opportunities to gain strategic advantage in relation to the sale or purchase of a business.

Understanding the financial value to the business of specific IP assets is of particular importance when moving into a new market – product or geographic – because there will be new risks as well as opportunities. China presents some special challenges, and practical steps to protect the value of IP assets are often as important as legal ones. This article discusses how IP assets matter from a financial perspective and assesses how to manage them to the greatest business advantage.

Managing Return on Investment and Improving Performance

Where there are several IP assets, knowing the comparative return on investment of each one allows the overall business strategy to focus on those that will give the best return. It also means that the risk to the viability of the business if certain IP rights are lost can be assessed. This is important in deciding how to structure your commercial relationships and operations in China.

As with tangible assets, measuring the return on investment requires knowledge of their monetary value and of the amount of investment made in them over a given period. Ascertaining individual IP assets consists of identifying the technology and brand in each separate product and any brand that is used for more than one product.

Providing Security for Financing

IP assets can be used to provide security for a wide range of methods of raising funds. China has been at the forefront of the use of patent mortgages and a variety of fund-raising structures are readily available from Chinese financial institutions as well as European ones.

The range of fund-raising options includes:

1. **Providing security for existing bank borrowing.** It is not unusual for a company's IP to be covered by the general charge taken by its bank but at a nominal or nil value. Valuing it separately often increases the value of the security covered by the charge. This can be used either to increase the

borrowing or to reduce the interest charged on it. If the IP assets are to be used for another form of security it will be necessary to get them released from any bank charge. This will be easier if they are included at only a nominal value;

2. **Providing security for new debt.** This can be to support new bank borrowing for cash flow or for longer-term debt to fund investment in new products or markets. Lending against IP assets is a specialised form of lending usually carried out by dedicated teams within larger lending organisations or by smaller specialist lending houses;
3. **Patent (and other IP) mortgage.** A patent mortgage is one form of lending against patents or other IP assets. The significant difference between this and security under a charge is that a mortgage will usually transfer title to the lender immediately on default. It is a well-established form of lending by some Chinese banks who may have more familiarity with it than their international counterparts;
4. **Creating a vehicle for raising equity.** If IP assets are owned by a company created for that purpose and generate a royalty income then shares can be issued in that company to raise new equity finance;
5. **Securitisation (bond issue).** An alternative to issuing shares in an IP holding company is to use the company's assets as security for a bond issue in the market. This is more likely to be an attractive option for medium-sized businesses with brands or technology that is reasonably well-known in its own market-place;
6. **Secure assets to benefit a third party.** A further use of an IP holding company is to provide security to benefit a third party such as the company's pension fund or a new venture on the same group of companies.

IP assets are often undervalued in company accounts. However, identifying and valuing them can result in a worthwhile increase in the value that existing lenders will put on them as security for current lending. This can be very useful in a credit crunch.

The acceptability of IP assets for fund-raising will depend to a considerable extent on what valuation is put on them and whether they are owned by an appropriate entity.

There are several considerations that impact valuation, including whether the IP assets are clearly identified, consolidated in one ownership rather than dispersed, protected from insolvency risks associated with operational activities, protected by appropriate registrations, subject to a structured enforcement programme, licensed to group businesses and/or third parties to generate income, and being used to increase the profitability of the business.

Drawing Up an IP Strategy

A well-managed IP strategy makes a significant difference to the valuation of a company's IP assets. An evaluator will assess the economic impact of the IP on the company's business. Although there are several different valuation methodologies, all take account of the risk to the IP. A realistic IP strategy that is documented and demonstrates effective support for the overall business strategy will always enhance the ultimate valuation figure for the IP.

The IP strategy reinforces the overall business strategy and will change as the business moves through different stages of its development. It will often also differ from one market to another as the business will be at different stages of its life-cycle in each. The balance of which IP rights are most useful and so should get priority in investment and management time will vary accordingly.

For example, in establishing a new market, registration of trademarks and patents, designs or copyright to protect the product is likely to be more significant than enforcement against infringers. Once a business is established, enforcement is likely to take a higher priority. Where it seeks to increase market share compared with its competitors, then the focus may well be on defending litigation.

It is essential that the management of the company is involved in drawing up the IP strategy and understands how it will support the business objectives. The key people to be engaged are the chief executive, finance director, tax advisor, general counsel, chief technology officer and chief operating officer.

The IP strategy should be reviewed whenever the business strategy changes and at least once a year.

Conclusion

With a strategic IP management approach and the appropriate identification, valuation and protection of your IP assets, you can use your intangible assets to your advantage to provide security for financing and improve your company's overall performance. However, to best use your IP assets as business tools, Helpdesk experts strongly recommend that SMEs ensure that their key IP asset are protected by registration, adequately prevent your IP from being exposed by current and former employees and business partners and structure IP ownership that it is most appropriate for any planned use as security for raising finance.

CHINA IPR
SME HELPDESK

*The **China IPR SME Helpdesk** supports small and medium sized enterprises (SMEs) from European Union (EU) member states to protect and enforce their Intellectual Property Rights (IPR) in or relating to China, Hong Kong, Macao and Taiwan, through the provision of **free information and services**. The Helpdesk provides jargon-free, first-line, confidential advice on intellectual property and related issues, along with training events, materials and online resources. Individual SMEs and SME intermediaries can submit their IPR queries via email (question@china-iprhelpdesk.eu) and gain access to a panel of experts, in order to receive **free and confidential first-line advice** within **3 working days**.*

The China IPR SME Helpdesk is co-funded by the European Union.

To learn more about the China IPR SME Helpdesk and any aspect of intellectual property rights in China, please visit our online portal at http://www.ipr-hub.eu/.