

## Research on the Evaluation Pattern of Intellectual Property Pledge Financing

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**Abstract.** Intellectual Property Pledge refers to a financing activity in which the intellectual property rights holders obtain funds from banks or other financial institutions by taking their property rights in the intellectual property as subject matter of pledge. The property rights, such as legally owned patent, exclusive rights to use registered trade marks and copyrights, are subject to evaluation and pricing before their holders can get the funds and the rights holders are bound to repay the principal and interest of the funds on time. This paper analyzes the participants in the evaluation of intellectual property pledge financing, the purposes of evaluation, the definition of the evaluation pattern. Finally, it describes how to build the evaluation pattern for intellectual property pledge financing.

**Keywords:** Intellectual property; pledge financing ; evaluation pattern

### 1. Introduction

Intellectual Property (IP), refers to the rights holders' exclusive rights to their own creations of the mind. Broadly speaking, intellectual property includes the all the creations of the minds, while narrowly speaking, intellectual property are divided into two categories: industrial property and copyright.

In this paper, Intellectual Property is a general term for the rights to the creations of the mind legally enjoyed by the creators and the rights to the marks legally enjoyed by the participants in the industrial and commercial activities.

Pledge means that the debtor or a third party transfers his movable property (rights) to the creditor, providing a warranty on the creditor's rights. If the debtor defaults, the creditor is entitled to a preferential repayment by the money obtained from pricing, auctioning and selling the movable property (rights). Intellectual Property Pledge refers to a financing activity in which the intellectual property rights holders obtain funds from banks or other financial institutions by taking their property rights in the intellectual property as subject matter of pledge. The property rights, such as legally owned patent, exclusive rights to use registered trademarks and copyrights, are subject to evaluation and pricing before their holders can get the funds and the rights holders are bound to repay the principal and interest of the funds on time. Intellectual property pledge has to follow at least two key procedures: evaluation of intellectual property and registration of intellectual property pledge, but this does not change the possession status of intellectual property.

In the era of knowledge economy, the production of knowledge and knowledge goods can not be done without financial support, thus financing becomes the most important financial management issue. New economic growth theory also reveals the funding issues hidden behind the science and technology-driven economic growth. Intellectual property pledge is a financing activity in which enterprises pledge the intellectual property owned by them order to obtain funds. It is a specific way of intellectual property

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financing. For enterprises, intellectual property pledge is a financing guarantee which can prove or strengthen corporate credit; for banks, the use of intellectual property as pledge object can serve a function in compensation of value and reduce the risks of banks; for intellectual property itself, pledge can separate possession of rights from exertion of rights and is helpful to the asset management of intellectual property in the process of financing.

## **2. Collateral Value of Intellectual Property**

Value is one of the attributes of goods and refers to general and homogenous human labor congealed in the commodity. Labor congealed in intellectual property is principally mental labor. But its value not only depends on the consumption of mental force, but also is influenced by a lot of other factors. The influence is dynamic, which makes the value of intellectual property changeable. From the perspective of enterprises that enjoy or use intellectual property, such factors as technological level, production quality, reputation, market operation will affect the value of intellectual property.

Collateral value of intellectual property is embodied in the following aspects: when setting a pledge over intellectual property, there is no need to possess or transfer securities or documents of title. It focuses on the property's exchange value; after a pledge is set over intellectual property, the pledgee needn't take care of tangible property as pledgee s of movable property do, saving the pledgee a lot of trouble; the pledgor needn't transfer its property and still can use and benefit from it; when intellectual property pledge is implemented, the pledgee shall be get paid from the value of pledged rights. When the debtor fails to repay the debt, the pledgee is entitled to dispose the pledged rights according to legal procedures, which means that the creditor's rights could be satisfied by the disposal incomings. When the value of the pledge object is lost, the pledgee's rights can not be realized

The main features of the collateral value of intellectual property are as follows: Difficulty in value assessment. Intangibility of intellectual property determines that it's not easy to make an accurate assessment of the collateral value of intellectual property; the uniqueness of intellectual property determines that there is no reference objects for fair trade and it is difficult to find a scale to measure its value; with the rapid technological advances, new technologies emerge and often lead to depreciation of existing technologies; Lack of liquidity. Compared with the real estate mortgage, there's a lack of mobility of intellectual property as pledge object and its liquidity is limited by time and space, so it's very difficult to handle, especially when intellectual property transfer market is still immature and underdeveloped. Once the enterprise faces operational difficulties and is unable to repay the debt, banks can not take back the funds in time by ways in which tangible assets mortgage is dealt with such as auction, lease, transfer etc; Instability. Although the law provides that there's a protection period for intellectual property — 10 years for trademark right, 20 years for patent and 50 years for copyright etc., with the continuous progress of science and technology and changes in market demand, the original economic value of an intellectual property right is likely to have been impaired or completely lost before the expiry of the legal protection period. This feature is particularly evident on patent. It is the instability of collateral value generated by intellectual property's own characteristics; High cost. The difficulty in value assessment and value's instability result in high transaction costs of intellectual property pledge financing. The interest rates that financial institutions set for risk pricing are much higher than the benchmark lending interest rates. Meanwhile, in order to reduce loan risk, financial institutions require enterprises to provide more detailed assessment reports on intellectual property law and value of intellectual property. Legal assessment is completed by the law firm, while the assessment of the economic value is mainly done by an institution of asset assessment. Currently, those who apply to banks for loan by using intellectual property have to pay agency fees such as assessment fee, lawyer's fees. High transaction cost is determined by the high risk of intellectual property pledge loan and the high cost has increased burden on enterprises.

## **3. The Participants in the Evaluation of Intellectual Property Pledge Financing**

The major participants in the assessment of the collateral value of intellectual property are: the borrowers, banks or other lenders, an independent third party (such as asset evaluation agencies, law firms, patent

agencies, etc.) and the government. The above-mentioned parties play different roles in the assessment of the collateral value of intellectual property and bear different responsibilities for the evaluation process.

Borrowers' responsibility is to provide evaluation agencies or evaluators with the information relevant to intellectual property as pledge object and their enterprises needed for the evaluation and guarantee the authenticity, legitimacy, integrity of the information provided, facilitating obtaining a reasonable assessed value. The duty of valuation agencies or evaluators is to play its advisory function and provide a reasonable evaluation result from the perspective of an independent third party. Banks have a responsibility to appropriately use the evaluation report, consider the company's (the borrower) credit rating status as well as other factors, and determine the loan amount according to its acceptable degree of risk.

As the major competitors in a market-oriented economy, profit and continuous development and growth are the ultimate goal that borrowers, banks or other lenders as well as asset evaluation agencies are pursuing. Therefore, the above three parties, out of their own interests, serve different purposes in the business of intellectual property pledge loans.

The enterprises, as borrowers, aim at obtaining a certain amount of money through intellectual property pledge to maintain its development, and meanwhile pay as a low as possible a valuation fee so as to lower the financing cost. Thus, with the purpose of financing, they expect an overestimate of the pledged assets.

While financial institutions grant pledge loans with the purpose of making a profit, they have to ensure the loan safety and guard against credit risks. The dual features of pursuit of profit and operational risk have always placed financial institutions in a dilemma of choice between profitability and safety. Thus, financial institutions, in order to maintain the loan safety, expect an underestimate of the pledged assets.

There exists an obvious disagreement on the purposes of evaluation between the two parties. Evaluation agencies (or evaluators) serve as a mediator of the conflicts between the borrowers and lenders. Evaluation agencies (or evaluators), as an independent third party, should state the purposes of evaluation and its expected use and impartially determine the value of the mortgage assets, without favoring any party. For the borrowers, a correct and reasonable assessment of the collateral value of intellectual property can justifiably determine the loan amount that they are able to obtain, protecting their deserved rights and ensuring better access to help from the mortgage loans. For financial institutions, a correct and reasonable valuation of the intellectual property as pledge object can help them properly determine the scope of the creditor's rights guaranteed by the collateral, reasonably estimate the risk of cashing the collateral, and effectively ensure the loan safety.

#### **4. The Purposes of Evaluating Intellectual Property Pledge Financing**

The primary purpose of evaluating intellectual property pledge financing is to assess the value of the intellectual property that would be pledged, which provides reference for drawing up financing contracts between the borrowers and the financial institutions. Analyses are made respectively from the perspectives of borrowers and lenders.

**Borrower's Standpoint.**The borrowers aim at obtaining monetary fund from banks or other lenders through intellectual property pledge. The assessment of the collateral value of intellectual property should serve this purpose. The borrowers seek the valuation of their intellectual property with the purpose of proving their economic value and profitability. Therefore, from the borrower's standpoint, the purpose of assessing the collateral value of intellectual property should include the value targets of fairness and efficiency. The purpose of the pledge is to ensure the creditor's claim and protect the interests of creditors, which reflects the value target of fairness. Meanwhile, it lowers the debtor's warranty cost through the separation of property rights from the property and also reduces the creditor's monitoring cost, which reflects the value target of efficiency,

**Lender's Standpoint.**Lender's primary concern is the safety of the loan principal and the availability of its interest income. Therefore, from the lender's standpoint, safety forms the core of its value target in the assessment of the collateral value of intellectual property. As the economic value of intellectual property itself can be reflected by evaluated price and market price etc. The legal forms of pledge such as contracts, registration etc. can protect both borrower's and lender's legitimate interests. The realization mechanism of

pledge (when loan repayment is not paid on time, the pawnee may exercise the pledge rights to obtain a preferential repayment) ensures the safety of the creditor's claims and reduces the risk of the transaction. Both the borrower and the lender accomplish their own purposes of assessing the collateral value of intellectual property and achieve balanced interests of both sides through setting targets of fairness, efficiency and safety.

## **5. Defining the Evaluation Pattern of Intellectual Property Pledge Financing**

Pattern is a methodology solving a certain type of problems. That is to say, when the methods of solving a certain type of problems are summarized and generalized to the level of theory, a pattern comes into being. Basically speaking, pattern is a standard style of things and a referential guiding strategy. Good guidance helps to complete tasks efficiently and design a good scheme quickly according to the established train of thought, achieving a multiplier effect and figuring out the best way to solve the problems.

Therefore, the evaluation pattern of intellectual property pledge can be defined as 'a referential guiding strategy of the evaluation of intellectual property as pledge object'. It is a collection of methodologies solving a series of problems in the evaluation process of intellectual property pledge financing. The guidance of such a pattern helps the evaluators design a good evaluation scheme for assessing the collateral value of intellectual property, achieve a multiplier effect and figure out the best way to carry out the evaluation of intellectual property pledge financing, accomplishing the purposes of evaluating intellectual property pledge financing

## **6. Conclusion**

As for the construction of the evaluation pattern of intellectual property pledge financing, what needs considering are the component elements of this pattern and the interrelationships between these elements and form a systematic guiding strategy, which will contribute to a better assessment of intellectual property pledge financing. Based on the foregoing discussion, it is suggested that the evaluation pattern of intellectual property pledge financing be constructed by taking the following steps:

The first step is to determine the purposes of evaluating intellectual property pledge financing. The primary purpose of evaluating intellectual property pledge financing is to assess the value of the intellectual property to be pledged, which provides reference for drawing up financing contracts between the borrowers and the financial institutions.

The second step is to identify the participants and the factors to be considered in the evaluation process according to the purposes of evaluating intellectual property pledge financing. The participants in the evaluation of intellectual property pledge financing probably include evaluation companies, law firms, patent agencies, experts etc. According to the characteristics of intellectual property pledge financing, various factors need to be considered in the evaluation process, such as technical factors, economic factors, legal factors, management factors, risk factors etc.

The third step is to consider the bases and hypotheses of evaluating intellectual property pledge financing according to the purposes of evaluation and the factors influencing the collateral value of intellectual property. These bases and hypotheses can ensure the reliability and practicability of the evaluation results. Those bases are likely to include laws and regulations, industry standards, various criteria etc., while hypotheses possibly include some general hypotheses and also some special hypotheses characteristic of evaluation of pledge financing

The fourth step is to determine the method of evaluating intellectual property pledge financing according to the purposes of evaluation, influencing factors, bases, hypotheses etc. The evaluation method should give a comprehensive reflection of the interests of stakeholders and a comprehensive consideration of all-round influencing factors. Therefore, a method combining fuzzy synthetic evaluation and multiple regression should be taken into account since it reflects the interests of a number of stakeholders and gives a comprehensive consideration of the weight that many of the influencing factors carry in the evaluation process. It incorporates a lot of individual methods. Meanwhile, the results of multiple regression reflect the

impact of each factor in the cases of current evaluation. And then it assesses the value of the target intellectual property to be pledged for financing through further coefficient adjustment.

Finally, the above process can be embodied in a whole set of procedures for the evaluation of intellectual property pledge financing, which can be further standardized into a pattern serving as a guiding strategy of evaluating intellectual property pledge financing. In intellectual property pledge financing, a specific scheme is devised based on this guiding strategy to assess the value of the intellectual property to be pledged.

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