



Unlocking  
IP-backed  
Financing  
Series

# Country Perspectives **Japan's Journey**



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# Disclaimer

The views expressed in this publication are those of the authors and do not necessarily represent those of WIPO. The Japan Patent Office programs and projects, including the IP business evaluation reports, mentioned in this publication are based on information available as of February 2022.

# Acronyms

<b>INPIT</b>	National Center for Industrial Property Information and Training
<b>IP</b>	Intellectual property
<b>IPRs</b>	Intellectual property rights
<b>J-PlatPat</b>	Japan Platform for Patent Information
<b>JPO</b>	Japan Patent Office
<b>M&amp;A</b>	Mergers and acquisitions
<b>R&amp;D</b>	Research and development
<b>SMEs</b>	Small and medium-sized enterprises

# Japan's journey

## Introduction

In Japan, the development, use and management of intangible assets, notably know-how and intellectual property (IP), are becoming increasingly important in business strategies, particularly for small and medium-sized enterprises (SMEs), which form the backbone of economies worldwide. SMEs may account for more than half of global employment, but many lack access to a key requirement for their further development and growth – funding. For many SMEs, traditional avenues for financing their growth strategies are blocked because they lack “hard” assets, such as real estate, that corporate lenders or investors may demand as security or collateral for financing. For businesses whose value lies in what they invent and create, new options are emerging to break through this financing barrier and achieve the backing they need to flourish. By leveraging their IP, including patents, industrial designs, trademarks and other intangible assets, firms can unlock funding.

In Japan, all assets that are critical to a business are evaluated to explore their capacity to support access to financing. There are schemes and government initiatives, including those of the Ministry of Economy, Trade and Industry (METI) and the Japan Patent Office (JPO), to promote IP-backed financing. Although such financing methods are yet to become mainstream, efforts to promote them have yielded many positive results.

This report highlights projects and frameworks initiated in Japan in recent years to facilitate IP-backed financing. One example is the JPO's IP Finance Promotion Project. It focuses on strengthening the capacity of regional financial institutions to raise awareness among SMEs of the importance of intellectual property rights (IPRs) as they develop and grow. JPO's IP finance promotion project introduced IP business evaluation reports. These reports are not monetary valuations of IPRs, but rather qualitative evaluations conducted by third parties to deepen a lender's understanding of a borrower's business and its potential for development. The reports facilitate clear communication between borrowers and lenders and serve as a foundation on which to further build business strategies.

In 2021, the Tokyo Stock Exchange issued a revision of the country's Corporate Governance Code,<sup>1</sup> which introduced a provision on the role and responsibilities of company boards in developing policies for IP investment. That was a milestone in Japan, where corporate understanding of the importance of IP continues to lag. Banks and other lending institutions have also worked to improve their knowledge of companies' IP assets. For example, they are using the JPO's IP business evaluation reports and patent databases to better understand how IP can help to open up business opportunities.

Despite the development of JPO financing frameworks since the 1990s, when IP-backed finance was mainly provided to SMEs, including venture companies, the growth of IP finance in Japan has remained limited. A number of government-led initiatives were put in place and discussions on IP financing took place. In the private sector, companies

increasingly started to recognize the importance of valuing intangible assets in their accounts and they have done so even without stock market regulation or laws such as the Companies Act. Such voluntary management reporting of intangible assets led to the formulation by the Ministry of the Economy, Trade and Industry of its intellectual asset-based management reporting system in the early 2000s. The aim of that system was to capture a company's IP assets and ensure that they are managed in such a way as to promote corporate growth. However, the 2008 global financial crisis curtailed progress in Japan in the area of IP finance, including financing backed by intangible assets, and slowed the adoption by Japanese companies of management reporting systems for intangible assets.

Statistics on the volume of IP-backed finance in Japan are scarce but the general perception is that it is not widely used. Several explanations exist for the relatively small volume, both prior to the financial crisis and now. There are some difficulties in identifying SME financing needs and in highlighting the advantages that IP-backed financing might have over traditional loans. Japan has no established secondary market for intangible assets as it does for other assets. The range of IPRs deemed suitable for use as collateral is narrower than in many other rich economies. There are also cultural obstacles to acquiring IPRs for financing and to liquidating such rights. Those obstacles include widely used cross-licensing agreements between patentees, a lack of IP brokers and trading platforms, and weak links in some companies between their overall business and specific IP strategies.

This publication describes the development of IP-backed finance in Japan and initiatives adopted by government agencies and regional financial institutions, and highlights the importance of roles played by both, particularly in increasing SMEs' access to the IP system. Japan has almost 3.5 million SMEs, accounting for 99.7 per cent of local corporations.<sup>2</sup> Regional financial institutions, which include regional banks, Shinkin banks and credit cooperatives,<sup>3</sup> are working harder to facilitate their growth by evaluating their businesses more effectively.

## Types and sources of IP finance

Lenders group financing into three broad categories or approaches: corporate finance, which focuses on the creditworthiness of corporations; asset finance, which focuses on the value of their assets, usually fixed assets such as real estate but also including moveable assets and IP; and project finance, which addresses future cash flow to be generated by the proposed project (figure 1). When it comes to IP-backed financing for SMEs, lenders in Japan usually look at corporate finance; use of the other two approaches is limited.

**Figure 1 Categories of financing methods**

Corporate finance	Equity Finance	Financing by capital participation with stocks.
	Debt Finance	Financing by lending through monetary loan agreement.
	Mezzanine Finance	Financing that falls between the above methods (subordinated loans, subordinated bonds, preferred stocks, etc.).
Asset finance	Securitization	Financing method that converts assets into cash by sale or securitization.
	Asset-backed Finance	Financing with collateral value of assets (typical example is real estate backed finance; movable assets and monetary claims can also be used as security).
Project finance		Financing with future cash flows generated by a project.

Source: Mitsubishi UFJ Research and Consulting.

Typical types of corporate financing are loan agreements and equity participations through the acquisition of stocks. Both focus on the overall creditworthiness of a corporation. For loans, financial institutions assess whether a corporation can continue to operate and secure the sales needed to meet their repayment commitments. Specifically, the lender reviews whether the borrower is sufficiently robust to maintain its activities and grow, taking account of the market environment; the business's competitive advantages against rivals; and whether it has the necessary management resources and internal structure in place. The lender will then assign a creditworthiness score. Generally, the higher the score, the greater the confidence in the borrower. That means lower perceived risk, which often translates into lower interest rates and borrowing costs. In the case of equity investment, more emphasis is placed on corporate value and business growth, but the basic approach is the same.

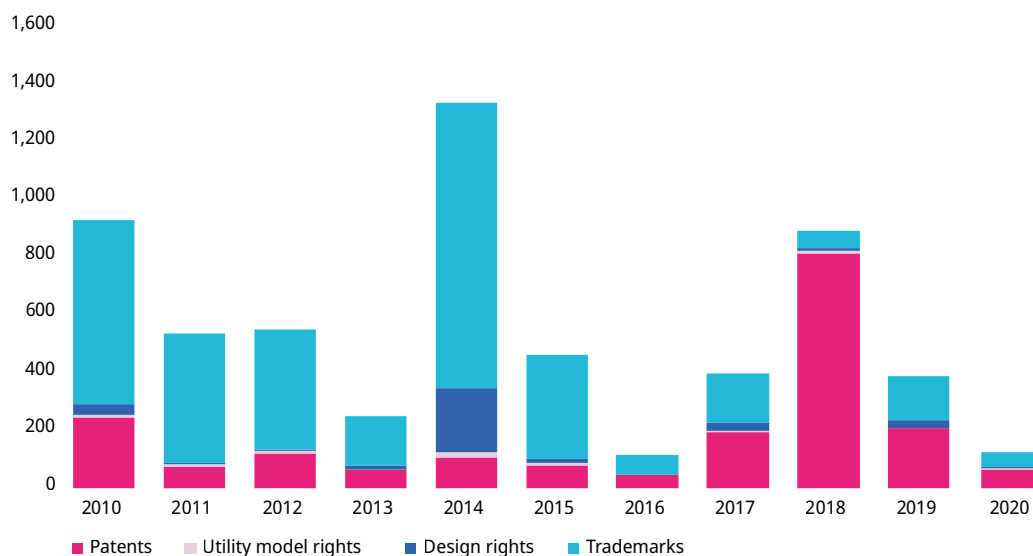
IP is an intangible asset and can be used for asset-based financing. IP-backed financing is quite common in the United States and China but remains little used in Japan. It involves a security interest being established over an IPR. In the event of a default or failure to meet repayment terms, the borrower gains rights over the collateralized IP, which can be liquidated to recoup the amount lent. In practice, security rights in Japan generally involve mortgage rights for physical properties. The use of pledges or mortgages for IP is uncommon.

A pledge is a typical security interest provided for in the Japanese Civil Code. It allows lenders to recoup loaned amounts by seizing any property and receiving payment from the property ahead of other creditors. When a pledge is set on an IPR registered with the JPO, an application to register the pledge can be made as part of the procedure for transferring the rights. Once the application is accepted, the pledge is published in the Patent Gazette.

Unlike pledges and mortgages, chattel mortgages are not provided for as a statutory security right under the Civil Code; they are, however, recognized in case law. The creditor sets a temporary contractual security right on the debtor's property and returns ownership upon repayment. In case of default, ownership is transferred to the creditor. Chattel mortgages can be set on assets that are transferrable and movable – monetary claims and property rights, including IP, can be used in addition to real estate. Pledges must be registered with the JPO, but there is no such obligation for chattel mortgages, which have been used in some instances for security in IP-backed financing.

The number of pledges varies significantly by year (figure 2). In 2014, it exceeded 1,300, but in 2020, the year the COVID-19 pandemic struck, it was just 121. Most relate to patent and trademark registrations, with few utility models or designs. Not all represent IP-backed financing, but the figures give an indication of its volume. Chattel mortgages are created by individual contract, so there are no official statistics.



**Figure 2** Number of registered pledges on IPRs, 2010–2020

Source: Mitsubishi UFJ Research and Consulting, based on JPO data.

An early example of IP-backed financing was a loan by the Development Bank of Japan to a company in 1995. Since then, it has made many IP-backed loans to other companies. Some of the financing was provided in the form of syndicated loans with regional banks and other entities. In the 2000s, some large and regional banks also provided IP-backed financing, but the number of operations fell after the collapse of Lehman Brothers in 2008. Many of the transactions apparently involving IP-backed financing in that period, however, seem on closer inspection to have been based more on expected overall business growth rather than on the cash-conversion value of the IPRs alone. The creation of securities over IPRs seems, therefore, to have been more of a formal exercise and the worth of the rights may often have been assessed as “zero” by the lender.

Another financing approach often used in the past was the “securitization” of IPRs. That involves transferring future claims, such as the value of IPRs or royalty income generated by such rights, to a special entity or special purpose vehicle (SPV), which then issues new securities backed by those assets. One of the most famous examples of securitization were the “Bowie Bonds” that British rock star David Bowie launched in 1997. He sold US\$55 million of 10-year securities backed by 25 of his albums recorded before 1990. Securitization enables companies to secure funding from a wide range of investors. It generally involves IPRs that are critical to a business as underlying assets and which are expected to generate stable license income.

An early example of securitization using copyright in Japan was that of video game company Konami, which, in 2000, targeted investors for video game production and sales. Another well-known example is that of film-maker Shochiku. In 2002, Shochiku securitized the broadcasting rights for a movie series before it was released on television. In those cases, although the market value of copyrighted content could not be assessed, the companies were successful in targeting niche investors interested in the future returns that the content could generate. As financing schemes developed more widely in the early 2000s, the securitization market also expanded and various securitization products, including IPRs packaged with traditional assets, were launched on the financial market.

Despite that initial growth, the market contracted following the collapse of Lehman Brothers and securitization transactions have largely continued to decline.

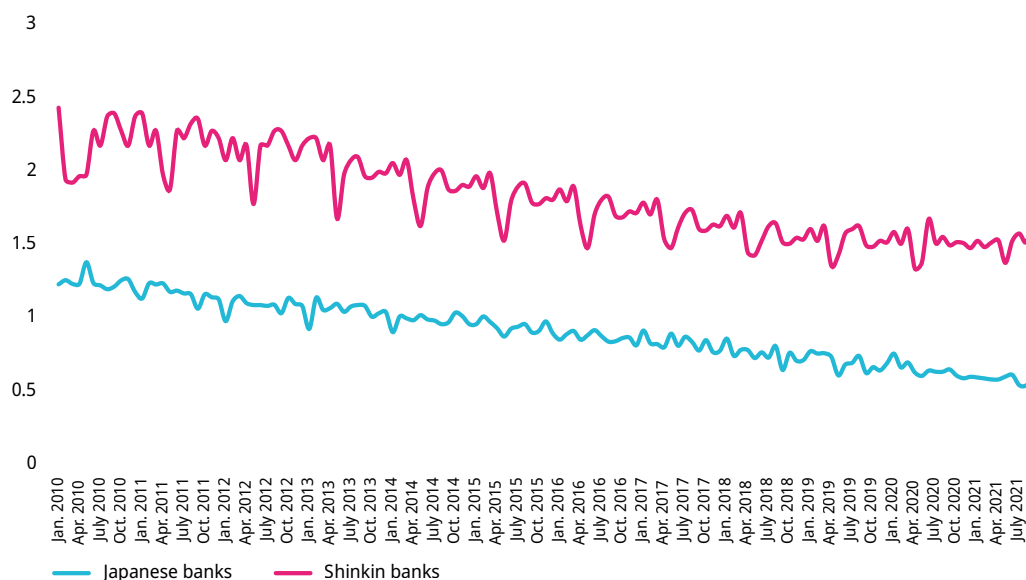
## Promoting IP awareness

The JPO began implementing its awareness and capacity-building program, the IP Finance Promotion Project,<sup>4</sup> in 2015. The project's aim is not to put a value on any IPR in itself; rather, its focus is on evaluating the overall business of companies that use IP. The idea is to help regional financial institutions to better understand the business of their corporate customers and the issues that they may face, thereby enabling those institutions to support their customers' business growth, including through loans. Under the project, seminars and individual consultation are offered to educate regional financial institutions about IP financing. Recently, its focus has shifted to strengthening their capacity to support their corporate customers' main business. In that way, they can guide SMEs in becoming more fully aware of the role and importance of IPRs.

According to the JPO's IP Finance Committee, established for the project, IP business evaluation refers a qualitative business evaluation rather than an evaluation of the monetary value of IPRs, and is conducted to deepen understanding of the business and growth potential of SMEs and others from the perspective of IP assets. It can also be used to supplement credit analysis and credit management, with the monetary value understood as a mere reference.

Many firms providing business evaluation services had already been advocating a qualitative analysis approach to IP. An evaluator firm would assess a business's expected revenues and the contribution of IPRs to sales in order to derive present and future values for those rights. The method attracted attention as several regional banks introduced schemes that referenced the economic value of IPRs in approving loans, including IP-backed financing, prior to or around the time of the launch of the JPO Finance Promotion Project.<sup>5</sup> Some financial institutions continue to prefer economic value assessment. The JPO's program is centered on qualitative evaluation of a company's overall business. In recent years, IP business evaluations have become increasingly sought after, because they help to identify areas where financial institutions can support a company's overall business.

Two significant trends can be identified. First, the Financial Services Agency, which oversees the Japanese financial sector, has gradually, but strongly, promoted business feasibility evaluations by regional financial institutions. That has resulted in a change of behavior by those institutions. Second, they have reached a turning point by strategically exploring other revenue streams. In the low- or negative-interest rate environment that has persisted in Japan for the past two decades, banks have struggled to boost revenues by the traditional means of interest earned on loans. That has led to intensified lending competition among financial institutions holding excess funds in a stagnating regional economy.

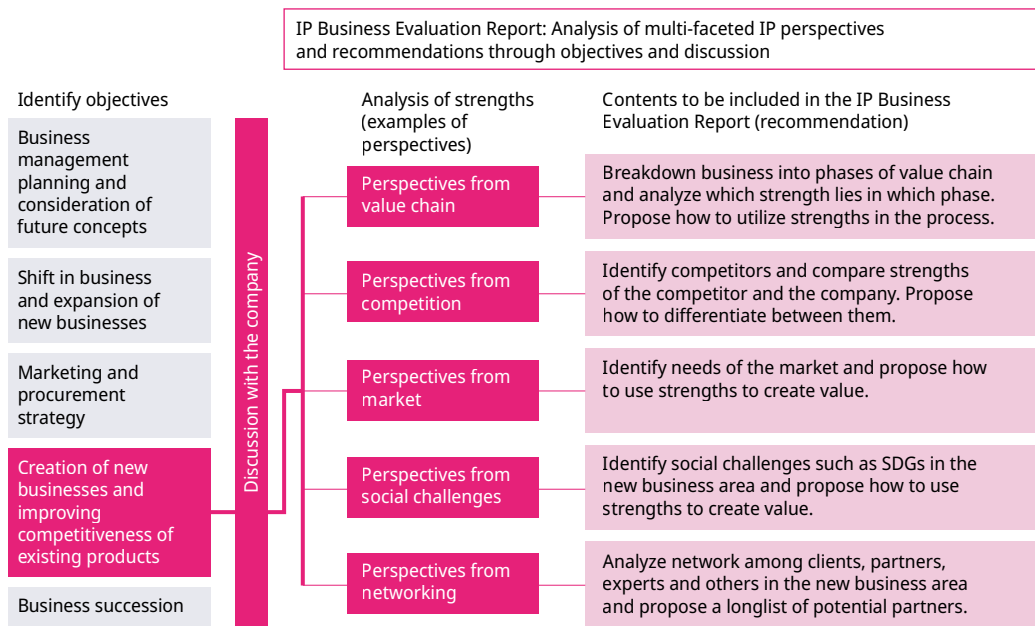
**Figure 3 Average Japanese loan interest rates, 2010–2021**

Note: Includes short-term (less than one year) and long-term (one year or more) loans.

Source: Mitsubishi UFJ Research and Consulting.

Against that background, the JPO is providing support to deliver IP business evaluation reports, which banks can use to assess a customer's business. The content of the customized reports can vary greatly depending on the objective, whether it is to review management planning, enhance the competitiveness of existing products, including marketing and supplier strategies, review new business opportunities or examine business succession. Once the objective is set, a holistic analysis is conducted. That is followed by recommendations on how to respond to the business management challenges, including with regard to IP and other intangible assets of the target SME.

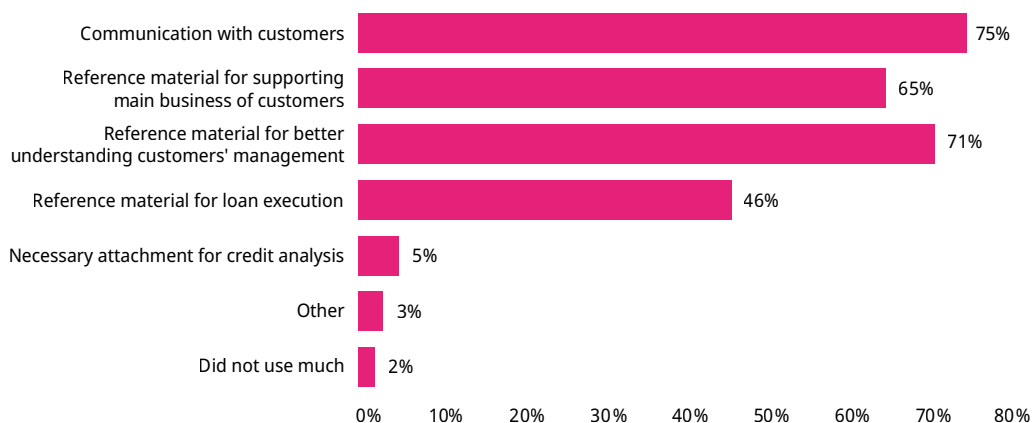
The reports are prepared by evaluating firms, such as patent offices, auditing firms, and market research and patent data search companies. Although there is no standard format for the reports, and their contents differ by evaluating firm, analyses are conducted using the 3Cs (customer, competitor and corporation) strategic model of business analysis to identify the target company's business profile and strengths. The analyses take full account of relevant IP information. Some evaluating firms rely on publicly available patent information (patent maps) and others may conduct more detailed research. Many evaluating firms use a SWOT (strengths, weaknesses, opportunities and threats) framework to analyze a company. Many reports also include analysis of related issues for the target company, such as general economic risks and obstacles that could affect its development and growth.

**Figure 4 Example of an IP business evaluation report**

Source: IP Finance Promotion Project website.

Many regional financial institutions are leveraging the JPO project to conduct IP business evaluations. According to JPO data, 214 institutions conducted such evaluations up to the financial year 2020, and 2,188 participants attended JPO-sponsored seminars and symposiums on topics relating to IP finance. A follow-up survey for institutions that had used the IP business evaluation guidelines showed that 83 institutions granted 154 loans for a total of 7.83 billion yen, although that may not capture the full figure. The loan total may not seem significant, but as the loans involve small businesses and relatively small amounts in each case, the method can be considered as having gained wide acceptance by those institutions.

The IP business evaluation report is not only for qualitative analysis of a business, but also a communication tool. A JPO survey of more than 100 financial institutions that had used the IP business evaluation report revealed that 70 per cent of them believed that the report facilitated better communication with customers and deepened their understanding of management operations and structures. Furthermore, while less than half of respondents said that they had used the report as reference material for financing operations, about 65 per cent said that it was an important reference in assessing overall support for their customers' business.<sup>6</sup>

**Figure 5 Utilization of IP business evaluation reports**

Source: IP Finance Committee.

The type of business support extended using the IP business evaluation report varies by regional financial institution. In one case, an employee of such an institution (case study 1) proposed a joint industry-academia research project after technical challenges facing the customer SME had been revealed in the report. The project led that business to launch a new product. The institution used the evaluation report to capture the state of a customer's business, identify the issues facing it and make proposals that helped to resolve its IP issues, rather than merely evaluating the firm's IP as the basis for loans. In this example, financing was provided for research and development (R&D). Further financing might be needed for capital expenditure (such as machinery, equipment and plant expansion) if the new product is successful. In that way, the institution used the evaluation report to create financing opportunities.

Often, the evaluation reports make the financial institution and the company's management more aware of how resolving IP-related issues is critical to achieving the latter's goals. Many SMEs have applied for support through comprehensive IP helpdesks,<sup>7</sup> which provide business growth support and IP-related advice from patent attorneys, lawyers and other experts free of charge, mainly to SMEs. The helpdesks were established by the National Center for Industrial Property Information and Training (INPIT). In one example, a leading regional bank supported a company financially and strategically. The bank had prepared an evaluation report in which IP concerns that needed to be addressed were identified. The company concerned was applying for a patent but there were issues regarding design rights and trade secret management. The bank recommended consulting the helpdesk. Following discussions with the helpdesk, the company succeeded in developing a new product for export. In another example, an SME was developing a new business using robots. A business evaluation report was prepared on the suggestion of a visiting Shinkin bank representative. That led to expert support being provided by the helpdesk and the Yorozu Support Center,<sup>8</sup> as a result of which the SME signed a joint development agreement with a large corporation and took the product to market. The Yorozu Support Center, which provides advice and support to SMEs on sales route development, financing and other business and management-related issues, is part of the Small and Medium-sized Enterprise Agency and the Organization for Small and Medium-sized Enterprises and Regional Innovation of the Ministry for Economy, Trade and Industry.

Collaboration between the private and public sectors is increasingly facilitating growth for companies that previously lacked IP awareness or experience in new businesses. IP business evaluation reports create opportunities to utilize public programs offering a wide range of support for SMEs. They can also lead to business matching of production and/or sales partners and joint production ventures.

According to the Ministry, maintaining a competitive advantage in the modern economy requires effective management of corporate intangible assets, including IP. "In the age of the knowledge economy, differentiation is vital for corporations to achieve sustainable growth. In order to be different from others, it is increasingly important to manage intangible assets, such as human resources, technology, organizational skills, customer networking and brands, which no one can imitate easily," the Ministry states in its guidelines on intellectual asset-based management.<sup>9</sup>

Companies are increasingly becoming aware of the need for intellectual asset-based management. That means recognizing a company's strengths, its own value creation method and the intellectual assets that facilitate them. Management also has to implement strategies that take full advantage of those assets. SMEs can use intellectual asset-based management reports to manage their IP assets and financial institutions can use them to evaluate those assets qualitatively. Apart from its guidelines, the Ministry has issued tools to help SMEs to prepare reports, including check sheets for itemizing and evaluating assets listed therein. Some regional financial institutions have held free seminars and supplied experts to broaden SMEs' understanding of this management approach.

The reports were intended initially to enhance asset management by SMEs. However, some regional financial institutions have come to view them as potential business support tools for their corporate customers.

## Regulations and evaluation approaches affecting IP use

Against a background of discussion of corporate governance worldwide, Japan revised its Corporate Governance Code in June 2021. One revision concerning the role and responsibilities of the board underlines the “importance of investments in human capital and IP”. With regard to disclosure and transparency, the Code stipulates that listed companies should provide information on investments in human capital and IP “in an understandable and specific manner”.

Following the revision, the Cabinet Office published four guidelines<sup>10</sup> for listed companies that are relevant to IP asset usage: understand and analyze IP and intangible assets that can strengthen the business model of the company; consider adopting a sustainable business model using IP and intangible assets; put together a strategy for maintenance and improvement of IP and intangible assets that can sustain competitiveness; and build governance structures for implementing that strategy. The revision may shift current views in Japan on the extent, purpose and use of IP assets.

**Figure 6** Changes in IP strategies following revision of the Corporate Governance Code

	Extent of IP	Purpose	Ways to use	Expected outcome
Conventional IP strategy	Mainly IPR such as patent rights, utility model rights, copyright	Claim exclusive rights on current business	Injunction of competing technologies and agreement of cross-licence	Averse risk of injunction of own products/technologies
		Monetize unused technologies	Licensing-out and sales of non-core technologies	Raise licence fee and collateralize when financing
IP strategy after revision of Corporate Governance Code	As well as IPR, widely understood intangible assets such as technologies and know-how	Disclose IPR's link between business model and strategy	Visualization of use of IPR and its use in future business	Maintain and improve competitiveness by creating innovation through IP assets
		Disclose information on IP allocation and investment status in a wide sense	Visualization of allocation and investment status of IP such as know-how and confidential information	
		Disclose information of strategic use of IP in a wide sense	Visualization of future prospects of IP such as know-how and confidential information	

Source: Kazunori Suzuki and Masato Maitani, MURC, Quick Management Trend.<sup>11</sup>

In January 2022, the Cabinet Office published guidelines on the disclosure and governance of investment and utilization strategies for IP and intangible assets.<sup>12</sup> They encourage dialogue between financial institutions and investors so that all views are taken into account.

Those initiatives acknowledge IP as a necessary component of the sustainable management of corporations. In terms of IP finance, they could alter the views of listed companies on IP strategy and boost understanding of how to use IP effectively and of the importance of IP in management strategies. Exchanges between companies and investors may reveal other approaches to IP business evaluation.

The increased focus on business evaluation – through the IP Finance Promotion Project, among other initiatives – has encouraged regional financial institutions to work on IP-related initiatives. They include the Japan Platform for Patent Information (J-PlatPat), a patent information search engine for patent rights, utility models, designs and trademarks in Japan, which is provided free by INPIT. Financial institutions can use it to confirm whether customers possess IPRs and are routinely engaged in IP-related activities.

Regional financial institutions are using J-PlatPat not only to understand technological details but also to garner information on what IP activities corporate customers are conducting, who the inventors are, whether applications for design rights and trademarks are being made, and whether there have been joint applications involving other firms. They are using patent information to better understand companies and make appropriate proposals and

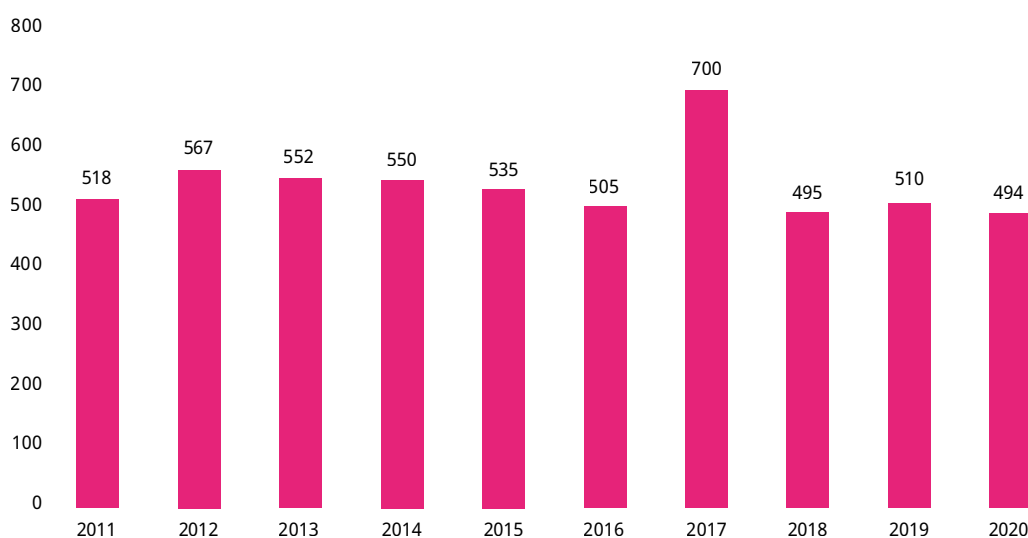
recommendations. For example, where a technology-based firm does not apply for a patent, financial institutions may use the information on J-PlatPat to gauge whether the firm is making a strategic decision to protect confidentiality or whether it is insufficiently aware of IP. Patent application searches may also help a financial institution to understand management's approach to business development. They can reveal whether a company depends on a sole inventor for its patents – often the president when the company is small – or whether it has other reliable researchers. The JPO has been promoting awareness of J-PlatPat among regional financial institutions with a manual<sup>13</sup> on how to use the search engine.

Financial institutions are showing greater interest in understanding the core strengths of their corporate customers, rather than just looking at the raw corporate numbers. They are discussing with management issues critical to fostering growth. In one case, an employee of a financial institution, while consulting J-PlatPat, noticed a patent application on a theme that differed from the company's existing products. The financial institution then obtained from the company's management a better understanding of the business plan for the intended new business, and that led to the agreement of early financing for capital expenditure. In another example, a financial institution employee spotted that the president of a customer company was the only inventor listed on J-PlatPat, and so introduced the company to a joint-development partner to ensure a sound future R&D structure. Such initiatives may have limited impact, but at least 25 per cent of financial institutions are reported to be using J-PlatPat.<sup>14</sup>

## IP insurance: litigation and evaluation

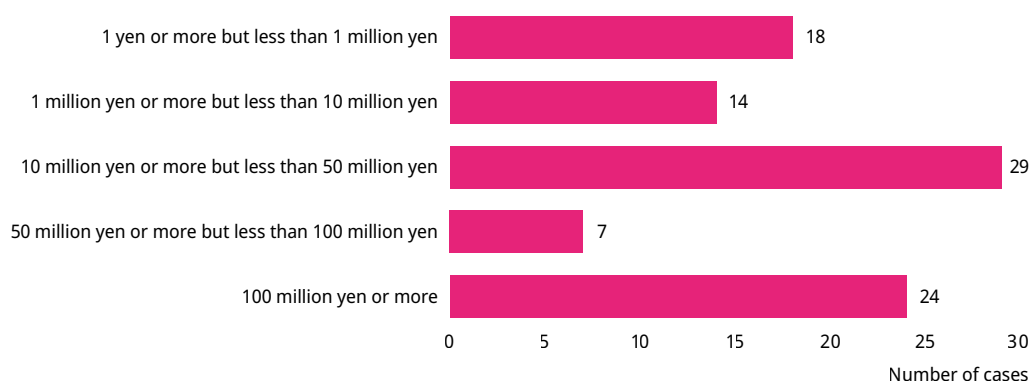
Compared with Europe, the United States and China, IP litigation in Japan is limited and the damages awarded tend to be modest. The number of new civil cases concerning IP brought before district courts in Japan has remained steady at around 500 or slightly above since 2011.

**Figure 7** New civil IP-related cases brought to court, 2011–2020



Source: Based on information from the Intellectual Property High Court.

Awards for patent infringement granted by the Tokyo and Osaka district courts only exceeded 100 million yen in 24 out of 92 cases brought between 2014 and 2020, and many involved less than 10 million yen or even one million, according to figures published by the General Secretariat of the Administrative Affairs Bureau of the Supreme Court.

**Figure 8** Amounts awarded to plaintiffs by the courts in patent infringement cases

Source: Intellectual Property High Court, "Statistics on Litigation concerning Patent Infringements (Tokyo District Court/ Osaka District Court, 2014–2020)."

Japanese corporations looking to expand overseas recognize the importance of preparing for IP litigation. The JPO has conducted research on litigation overseas<sup>15</sup> and, in 2016, launched its Overseas Intellectual Property Litigation Insurance Scheme, under which it subsidizes part of the premium for IP litigation insurance for SMEs. The scheme is managed by the Japan Chamber of Commerce and Industry, the Central Federation of Societies of Commerce and Industry and the National Federation of Small Business Associations. It is underwritten by Japan's three major private non-life insurance companies. SMEs purchase the insurance from those insurance companies, with half of the premium subsidized at the time of purchase and one third on renewal from the second year. The insurance covers costs incurred, including fees for filing an action, arbitration, evaluation, legal counsel and translation of any documents required for disputes arising with regard to patents, utility models, industrial designs and trademarks.

More recently, some private non-life insurance companies have started offering IP litigation insurance. For example, Sompo Japan Insurance Inc. has a global insurance product covering IP-related damages, which it says covers damages and litigation costs arising from the infringement of third-party patents, trademarks and rights connected with industrial designs and utility models.

The evaluation of claims relating to IP remains a challenge. In Japan, non-life insurance policies are provided for under the Insurance Act, which defines them as insurance policies "under which an insurer promises to compensate for any loss that may arise from a certain contingent event". It specifies, however, that its subject matter is confined to "interests that can be assessed in monetary terms".

In the case of IP-related losses, it is unclear whether contingency can be satisfied by the legal rights secured and the evaluation of interests in monetary terms. Furthermore, establishing the facts of infringement requires highly technical skills. The assessment of losses is a still greater challenge. Some customary practices, such as discounted cash flow or the "rule of thumb", are followed in evaluation processes but there is no uniform method. The difficulties lie in the inseparable nature of IP from a business, and the possible reluctance of evaluators to assess the contribution of IP and know-how to a business or project.

In order to develop evaluators' skills in assessing cash flow from IP, the Japan Patent Attorneys Association organizes training that blends the expertise of auditors with that of IP consultants. It stresses the importance of agreeing on a methodology and the preconditions for the evaluation, and gaining consensus on the evaluation result among the parties. The JPO, in collaboration with the Asia-Pacific Industrial Property Center and the Japan Institute for Promoting Invention and Innovation, has issued a textbook on IP evaluation methods,<sup>16</sup> which is used in its overseas assistance programs.



## Potential for development of IP finance and challenges

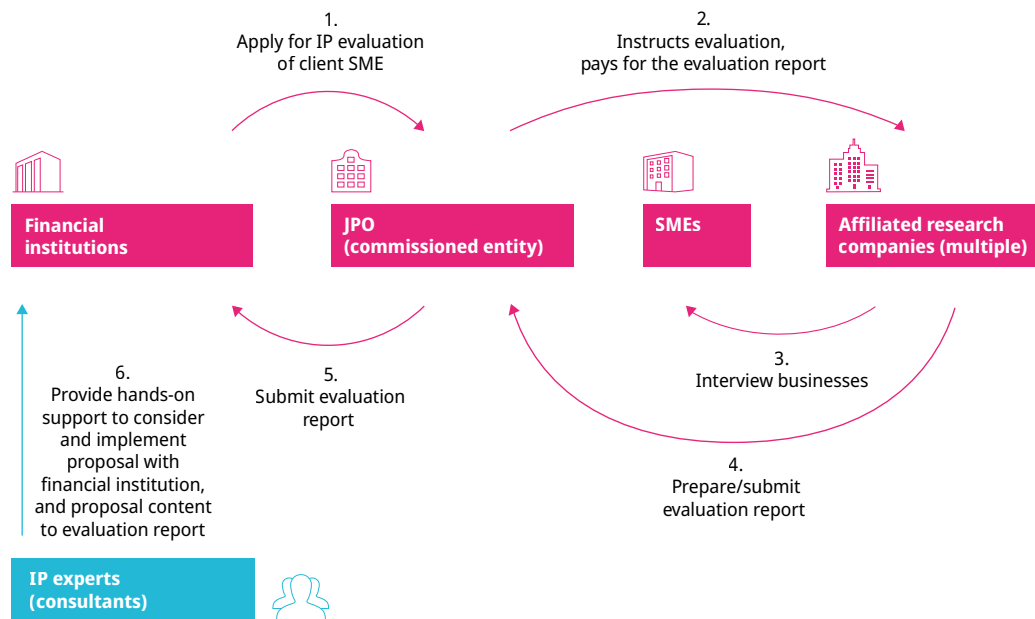
As regional financial institutions focus on business evaluation and support for companies' main business, they are shifting from the conventional approach to credit analysis – making decisions on financing only after a corporate customer applies for a loan – to a more active role in providing continuing support to promote a company's growth. That requires them to enhance their services, such as project planning, business matchmaking, restructuring of businesses, mergers and acquisitions (M&A) and overseas expansion.

The IP Finance Promotion Project is also moving its focus towards catering to overall business support and resolving issues such as how to improve management techniques. That covers anything from IP to fostering capacity to achieve business plans. Rather than merely joining financial institutions to prepare IP business evaluation reports, Project experts now use those reports to look at the broader state of a company's business.

After discussions between the JPO and regional financial institutions, it was decided that an evaluating firm commissioned by the JPO should prepare the IP business evaluation reports. Based on their content, Project experts, together with the financial institutions, present IP business proposals to the SMEs concerned. That may appear to target only a fraction of the institutions' corporate customers, but the support provided by financial institutions based on those evaluations is substantial. If they and their corporate customers understand the benefit of using JPO experts, cooperation may progress further. IP business evaluation will likely not only be seen as a tool for understanding a corporate customer's business, but may also play a greater role in identifying potential problems and analyzing growth factors from an IP perspective (see figure 9).

As SMEs with IP-based assets become more aware of the importance of IPRs and see the strength of their companies from an IP perspective, they will better be able to explain to external parties such as IP evaluators how their IP contributes to their core business. That, in turn, raises awareness in regional financial institutions of IP's importance and thereby, perhaps, will make them more inclined to open IP-backed lending channels. It is a reinforcing cycle.

The JPO continues to enhance the IP Finance Promotion Project. Although its basic aim is to provide financial institutions with IP business evaluation reports,<sup>17</sup> the growing focus on overall management support means that it is now also supporting the preparation of IP business proposals to assist SMEs in a broader sense. The JPO has thus become increasingly focused on management support. The key is that financial institutions aim to help SMEs to resolve their issues, using IP business evaluation reports to analyze and leverage the SMEs' corporate strengths. Following such evaluation, financial institutions can draft proposals for strategies and activities to optimize leverage of IP assets.<sup>18</sup>

**Figure 9 JPO IP Finance Promotion Project (2021)**

Source: JPO annual report for 2021.

## Changing IP culture

Japanese SMEs are not as active in acquiring IPRs as their counterparts in the United States and other countries.<sup>19</sup> The general perception among the business community is that only a small number of patents and other rights acquired by SMEs have high individual value. Even large corporations have tended not to see a need to conduct stand-alone evaluations of patent and other rights, except in the medical and biotechnology industries. That is partly due to the extensive use of cross-licensing. Generally, IPRs are highly appreciated when they are critical for business operations, function as entry barriers to other businesses or enable advantageous business alliances.

IPRs gain significant individual economic value where there is a secondary market for them, as is the case for patent transactions in the United States or China. Several obstacles stand in the way of improving the liquidity of IPRs in Japan. Three of the principal barriers are the culture of cross-licensing between patent holders already noted, a lack of IP brokers or trading platforms and a lack of clearly defined linkages between overall business strategies and IP strategies. If companies align the two to make effective use of those rights, business plans are more likely to succeed. The initiatives taken by financial institutions in recent years show that the possession of useful IPRs and the capacity to explain objectively how they contribute to companies' business plans helps them to secure financing.

When the potential advantages of IP for financing become more widely established, more companies may be encouraged to review their approach to acquiring IPRs. Greater awareness by corporations of the advantages of holding IP or a portfolio of such rights could also generate momentum to create a robust secondary market. The revision of the Corporate Governance Code may also help to improve IP awareness among Japanese companies by linking IPRs more directly with business strategies.

## Role of IP in loan due diligence

When reviewing a loan application, financial institutions may carry out business due diligence, involving a qualitative business evaluation of the potential borrower. In the past, management consultancies and corporate planning units of companies generally did not take IP data or perspectives into account in their analyses.

Business due diligence is widely used to calculate the value or soundness of a target entity, such as in an M&A transaction. In the case of corporate financing, it is performed by a third party rather than the financial institution that is considering the loan application. An extensive analysis is required within a limited time. There is no standard evaluation method, but the basic approach is to identify growth factors and possible issues by analyzing the target firm's external and internal environments.

The cost of due diligence varies according to the content and level of detail, but even a relatively simple analysis done by the lender institution routinely costs several million yen. In the case of SMEs, management details may be less accessible compared with those of large, listed companies, thereby complicating the task. With the revised Corporate Governance Code, however, cultural attitudes to IP may change, making SMEs' IP management more transparent and facilitating due diligence for financial institutions.

The use of data analysis and artificial intelligence may help to reduce the cost of analyzing IP information and the corporate stance on IP will probably evolve as a result. Strategic use of IP information is still limited to some large corporations and sophisticated SMEs, but its use in due diligence is likely to bring IP business evaluation more into the mainstream. In turn, corporations with unique technology may also come to be better understood. As financial institutions focus more on technology and IP in their business evaluations, the efficiency and effectiveness of business development financing may also improve. To that end, the JPO has published the "Intellectual Property Due Diligence Standard Operating Procedures and Commentary",<sup>20</sup> which focuses on risk analysis, IP value and visualization. Its aim is to support venture companies in financing and in M&A activities. More widespread use of those methods is expected to foster smoother financing for a wide range of companies.

Under the Japanese collateral system, different collateral rights apply for each type of property, such as mortgage rights for real estate, chattel mortgages for movable property and pledges for claims. In contrast, the United States has a single collateral system for all types of property, including movable property, intangible property and claims. In Japan, consideration is being given to the possibility of establishing security on all the types of property used for specific business operations rather than for individual property rights, and of executing collateral rights against them all. Such a legal framework could increase the importance of valuing IP in a business, which in turn could increase the role of IP in financing.

# Case studies

## Case study 1:

Chukyo Bank (as at September 30, 2021)

### Name

Chukyo Bank, Ltd

### Deposit balance

1,914.0 billion yen

### Total loans

1,520.6 billion yen

### Number of branches

87

### Number of employees

1,101

This case study involves use by Chukyo Bank of the JPO's IP Finance Promotion Project and IP business evaluation report. In February 2018, Chukyo extended a loan to Mie Chemical Industry Co., Ltd (Matsuzaka City, Mie Prefecture) using an evaluation report prepared by the evaluation entity commissioned by the Promotion Project. Chukyo Bank was conducting business evaluations focused on IP held by customer SMEs and obtained the IP business evaluation report for Mie Chemical Industry as part of that activity. The report highlighted the company's strengths and revealed a technical challenge that it was facing. Chukyo Bank proposed and coordinated an industry-academia collaboration with Kinki University to address certain technical issues. That resulted in the development of a new medical product and a loan was secured to fund its development. Mie Chemical Industry produces and sells work gloves, work protection goods and refrigerant-related products. With the collaboration proposed by Chukyo Bank and the subsequent development of medical and nursing care products, the company is pursuing new growth opportunities, including through the launch of a medical equipment brand.

## Summary of Chukyo Bank's use of the IP business evaluation report

Company Name	Mie Chemical Industry Co., Ltd
Representative	President and CEO: Daisuke Yamakawa
Location	262-1 Okuchicho, Matsusaka City, Mie Prefecture
Industry	Work gloves, work protective gear, refrigerants/refrigeration equipment, medical equipment production
Capital stock	23 million yen
Number of employees	43 (October 2016)
Incorporated	December 1956
Loan agreement amount	30 million yen
Business summary	Production and sales of work gloves, work protective goods and refrigerant-related products. Has the largest share in Japan for cold-proof gloves in the work gloves segment. Newly launched medical equipment brand "Medi-an" based on industry-academia collaboration for new product development in the area of medical and nursing care equipment.

Source: Chukyo Bank.

## Case study 2:

Kanagawa Shinkin Bank

### Name

Kanagawa Shinkin Bank

### Deposit balance

1,330.9 billion yen (as at September 30, 2021)

### Total loans

604.2 billion yen (as at September 30, 2021)

### Number of branches

50 (as at January 16, 2021)

### Number of employees

N/A

This case involved a loan by Kanagawa Shinkin Bank to Surf Engineering Co., Ltd (Ayase City, Kanagawa Prefecture) using the JPO's IP business evaluation report. It is an example of a Shinkin bank developing an IP-related business with a new customer, whereby the evaluation report helped to improve mutual understanding about the steps to take.

A Kanagawa Shinkin Bank salesperson, who was interested in Surf Engineering's new business, visited the company when it was not yet a bank customer. The president of Surf Engineering had little experience in original product development and sales and the company was seeking advice on marketing and IP-related actions. The bank introduced the company to the IP Comprehensive Helpdesk, with which it had been working, with a view to obtaining support on the acquisition of IPRs and other IP measures. The bank also had an expert prepare an IP business evaluation report, which highlighted the advantages for the company of a proposed new technology and IPRs. Those actions gave the company confidence to go ahead and also helped its president to better understand the need to secure IPRs.

The bank then worked with other support organizations to help with product marketing and to provide the necessary funding. Analysis of the potential of Surf Engineering's new business would have been difficult without the IP business evaluation report and the support of organizations such as the IP Comprehensive Helpdesk.

The company subsequently began to manage its IP and developed new business leveraging its strengths. It was also able to apply the technology effectively to its existing businesses, bringing benefits such as more inquiries and higher unit prices for orders received.

### Case study 3:

Kiraboshi Bank (as at September 30, 2021)

#### Name

Kiraboshi Bank, Ltd

#### Deposit balance

5,147.9 billion yen

#### Total loans

4,191.1 billion yen

#### Number of branches

164

#### Number of employees

2,556

Kiraboshi Bank has long been interested in intellectual asset-based management. Since 2018, it has operated an intellectual asset evaluation system for loans in cooperation with an SME support agency established by the Tokyo Metropolitan Government. A summary of the system is provided below. Financing for working capital or capital expenditure in amounts ranging from one million to 100 million yen can be provided to parties that (i) present an intellectual asset evaluation document; (ii) receive IP support from the Tokyo Metropolitan Government; or (iii) receive an overseas IP application subsidy by the Tokyo Metropolitan Government.

#### Kiraboshi Bank loan system

Product name	IP evaluation loan system "Chizai-no-chikara"
Eligible customers	Corporate and sole proprietor customers that fall under categories 1, 2 or 3 below: <ol style="list-style-type: none"> <li>1. A party that can present an IP evaluation document (within three years of preparation) drawn up by an IP evaluation organization.</li> <li>2. A party receiving support from the Tokyo Metropolitan Intellectual Property Center under its "Niche Top development 'Hands-On Support' program", or which has received such support in the previous three years.</li> <li>3. A party that has been accepted, within three years from the application date, for any of the Tokyo Metropolitan Intellectual Property Center subsidy programs relating to the cost of applications for patents, trademarks and utility and design rights, and the cost of patent registration, or for its Global "Niche Top" subsidy program.</li> </ol>
Use of funds	Working capital / capital expenditure
Loan amount	From one million to 100 million yen
Loan period	Working capital: within five years (grace period: within six months) Capital expenditure: within 10 years (grace period: within one year)
Repayment method	Loan on deed: equal installment payment of principal Loan on notes: bullet payment
Loan interest rate	Interest rate set by the bank
Security/Guarantor	To be agreed on an individual basis

Source: Kiraboshi Bank.

Kiraboshi Bank has been engaged in the IP Finance Promotion Project from the start and has made presentations at IP finance symposiums on the use of IP business evaluation reports and initiatives in support of companies' main or core business using IP. It is well known for its group-wide initiatives to enhance management support for corporate customers based on business feasibility studies and to strengthen its financial intermediary function by supporting intellectual asset management.<sup>21</sup>

## Case study 4:

Hiroshima Bank (as at September 30, 2021)

### Name

Hiroshima Bank, Ltd

### Deposit balance

8,360.4 billion yen

### Total loans

6,824.0 billion yen

### Number of branches

151

### Number of employees

3,439

Hiroshima Bank is a regional bank known for its financial initiatives based on IP business evaluation reports. It has long engaged in IP-backed financing. In 2006, the bank signed a memorandum of understanding with the Development Bank of Japan regarding cooperation on information sharing and loans and private-placement bond issuance relating to IP-backed financing.

The bank started out by participating in the IP Finance Promotion Project. Understanding that the essence of IP business evaluation reports lies in their feasibility evaluations and main business support proposals, the bank launched a corporate IP utilization diagnostics service in 2017. The aim was to support corporate customers' business growth and development by providing feedback based on their use of IP, as assessed in business evaluations.

It can be difficult for a bank employee without IP expertise to analyze a customer's business and IP use and then make recommendations. The bank has therefore sought to link IP finance support to management and business issues with which bank employees may be more familiar. For example, it has been developing a communication tool for business succession discussions that covers the importance of IPRs and IP assets.



## Case study 5:

Nagano-Ken Shinkumi Bank (as at September 30, 2021)

### Name

Nagano-Ken Shinkumi Bank

### Deposit balance

973.9 billion yen

### Total loans

326.9 billion yen

### Number of branches

52

### Number of employees

718

Nagano-Ken Shinkumi Bank is another regional financial institution that has been systematically engaged in IP financing through the IP Finance Promotion Project.<sup>22</sup> It has used IP business evaluation reports to assess customers' businesses and promoted close relations with local patent offices. It held training sessions for employees with a lecturer from the INPIT IP Comprehensive Helpdesk on how to use J-PlatPat. The bank was the first financial institution in Japan to have a comprehensive cooperation agreement with the Helpdesk. Its stated policy is to help to provide local corporations with IP-related support. It has also held IP-related seminars for its corporate customers.

## Endnotes

- 1 See <https://www.jpx.co.jp/english/news/1020/20210611-01.html>.
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- 3 Shinkin banks are cooperative-style financial institutions established with members' capital. Credit cooperatives are similar, but established under the Small and Medium-Sized Enterprise Cooperatives Act.
- 4 <https://chizai-kinyu.go.jp/> (in Japanese).
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- 13 See <http://chizai-kinyu.go.jp/cms/wp-content/uploads/reference01.pdf>.
- 14 IP Finance Committee, "Final Report on IP Finance Promotion for SMEs Project: Growth and Outlook of IP Business Evaluation".
- 15 JPO, "International Intellectual Property Rights Strategy Promotion Project (Research on Overseas Intellectual Property Litigation) Research Report".
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- 17 See <https://www.jpo.go.jp/resources/report/nenji/2021/index.html> (in Japanese).
- 18 <https://www.jpo.go.jp/resources/report/nenji/2021/document/index/honpen0207.pdf> (in Japanese).
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