ADVANTAGES AND DISADVANTAGES OF INTERNATIONAL LICENSING

by

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I. Licensing What

In discussions of licensing, whether international or domestic, we must first decide what are we licensing. In nearly all cases the licensed material may be classified as a proprietary asset, which includes patents and patent applications, trademarks, trade secrets, know-how and copyrights.

It must be kept in mind when discussing licensing, and particularly international licensing, that a United States patent is only effective in the United States and gives you no right in any other country directly. There are techniques whereby you can get a patent of confirmation or importation or some similar right in another country by registering the U. S. patent but, by and large, these are not available in the important foreign countries.

A patent does not give you the right to do anything. In other words it is not, strictly speaking, a monopoly, although it is often referred to as such. A patent gives you the right to keep someone else from doing something, specifically to keep

someone else from making, using or selling a product or from practicing a process covered by the patent. Thus, if you have the basic patent on the telephone it does not necessarily mean that you or your licensee can make or sell a dial telephone, which is better than a non-dial telephone, particularly if someone else has a patent on the dial telephone. On the other hand the owner of the dial telephone patent, or his licensee, cannot make or sell the dial telephone because it would infringe the basic telephone patent. Thus, neither party can make or sell a dial telephone unless he gets a license from the other.

Thus, when you license a patent to someone else, you are really telling them you will not sue them for infringing your patent. Therefore, you must be careful when negotiating with others that both parties clearly understand what is the effect of patents owned by third parties. The rights of the parties should be set forth in the license agreement so that either the licensee understands that you are not responsible for the patents of others, or there is a royalty sharing arrangement of some sort whereby if the licensee is required to pay a royalty to a third party he is permitted to deduct part or all of that third party royalty from the royalties he pays to the licensor.

Often patents are involved in the license; however, it is comparatively rare that the license will be only a patent license. Usually trade secrets or know-how may be just as important, and in some cases more important, as the patent rights and you usually license the package of patents and know-how to the other party.

Another item that is frequently licensed is a trademark. Again, this may be licensed with a package of know-how. For example, many of the shirt companies, such as Manhattan or Arrow, have licensees in many countries of the world that make shirts in accordance with the technology of the licensor and are permitted to use the trademark on the shirt. Thus, Manhattan is a well-known name in many foreign countries in the shirt business and the fact that the trademark is on the shirt tells the customer that it meets certain quality standards.

II. Alternatives to Licensing

Licensing, which can take place in a variety of forms, is still only one way to operate in the international field. There are a number of other alternatives available. Of course, you can export your own products and either market them yourself in the foreign country or market them through others. You can also expand your own operations to establish your own manufacturing and marketing activities overseas which you control. Another alternative is investing in an established company to get partial ownership or, if desired, a majority or even total ownership. There are a variety of joint venture arrangements where your company and one or more other companies jointly make arrangements. At one end of the spectrum the companies can establish a separate entity in which the companies each own a portion of the venture. At the other end of the spectrum the companies merely cooperate with each other and share the profits or losses in some fashion.

II. A. Export--Advantages and Disadvantages

Each of these alternative methods of international operation

has advantages and disadvantages. For example, in a direct export of items to the foreign markets you are in complete control of the manufacture yourself, you can make the product to your own specifications and quality, the labor is a known factor and you do not have to take into account foreign laws, regulations or customs in your manufacturing operation. If you are marketing yourself you again are in complete charge of your operation. You can make the decisions yourself and need not be concerned with convincing others that your way is the way things should be done.

On the other hand there are certain disadvantages in the export market. The products may be made in a comparatively high labor area, such as the United States, and you will be competing in the foreign country with either products made in that country or imports from other countries where labor rates are substantially lower. In some cases it is an advantage to have the product made in the United States because of reputation for quality but in other instances anti-American bias may be a detriment. The export market is also difficult because of certain trade restrictions imposed by foreign governments, by exchange shortages causing difficulty in bringing money back to the United States, the competition in the local country to which you are exporting often has increased substantially and the feeling of nationalism that many of the countries have which makes it difficult to import products, particularly products which the local government may control.

II. B. Foreign Subsidiaries--Advantages and Disadvantages

Establishing your own foreign operation does, of course, involve substantial commitment of company funds in a foreign country. In some instances, of course, facilities have been nationalized by the local government and the American company has had difficulty in recovering its investment. There are certain U. S. Government agencies which will assist an American manufacturer in granting insurance against this, but it is still a messy situation. Often the establishment of a foreign branch will take substantially more management time and investment than is regarded as desirable for the potential return. Also, operating in a foreign country requires an understanding of the local laws, regulations and customs and an American may make important blunders without realizing it. It may also be that the present foreign market is initially too limited to warrant establishment of a manufacturing or marketing arm overseas and that thus substantial investments will have to be made for a number of years before the market develops sufficiently to provide a reasonable return.

Many foreign governments will not permit the establishment of a local subsidiary operation which is controlled by foreigners. This may be an absolute bar to establishing your own operation in these countries.

The establishment of a minority interest in a foreign firm, often by direct investment, is an alternative which does not require the substantial investment that the establishment of a wholly-owned subsidiary requires but still involves problems with local partners, the control of the operation, the government regulation involved in

control of joint ventures, etc. While a joint venture to some may seem to be a reasonable method of entering a country initially others feel strongly that it is not a vehicle for a long-term operation as both your management and the management of the other party changes from time to time and it is often difficult to accomplish your objectives through a subsidiary which is partially owned if control of management is in the local people. It is, of course, possible to establish a company in which you own a minority interest with the remaining interest owned by the local public. This does give you the advantage of practical control but still does not return the complete profit to you and often will require a substantial investment in capital and management time.

III. Licensing--Advantages and Disadvantages

To some licensing has been regarded as the middle approach because it does involve more risk and commitment to the foreign market than merely exporting from the United States but certainly involves less risk and commitment than owning and managing your own manufacturing and distribution facilities. One way to look at licensing is by referring to it as the export of proprietary assets rather than proprietary products. It is a form of investment without the use of dollars and may provide a substantial return for the proprietary asset invested.

In a license the licensor cannot expect to receive the lion's share of the profit for the proprietary asset as the licensee is taking the larger risks of investment, commitment, etc. and should, therefore, retain the major portion of the profit. The licensor, however, has no risk of loss and gets his royalty whether the licensee makes a profit or not in any particular period.

Licensing, of course, is not limited to a direct financial return in the form of royalties. It may very well be that in return for rights in your proprietary asset you will obtain an equity position in the licensee and on occasion even a majority equity position. In addition to the equity position and its share of the profits you may also get royalties on the sales of the licensee. The equity position, of course, has the same disadvantages that a joint venture may have in that you often are at the mercy of another party if you are in a minority position but this risk may be well worth taking. Of course, you can often use your royalties to increase your holdings in the licensee by reinvesting the royalty earnings. Also, you can accumulate your royalties overseas and invest them in other foreign markets.

Thus, a major reason for licensing often is obtaining extra income from proprietary assets. It may help in getting income to partially support the cost of the company research and development programs, or to maximize the returns from these research results.

There are a number of other possible reasons for licensing. It may permit you to retain established markets that may have been closed or threatened by import or other trade restrictions or permit you to reach new markets which are not accessible by export from your existing facilities. It is one way to enter or expand foreign markets quickly with a minimum effort or risk as a number of licensees may be selected in a variety of countries and expansion of sales of the licensed product may take place with a minimum of time. It is a way to gain cost or other advantages of local manufacture without committing your capital abroad and it may be used to augment your limited domestic capacity and management resources for serving the foreign markets.

On occasion licensing is useful to provide services and supplies for important domestic customers who want the services and supplies available overseas for use with their export products. For example, if you are a component manufacturer and your customer does a substantial amount of foreign business he may want ready access to replacement components available overseas and the service that goes with them.

Licensing may be a way to accommodate the military needs of foreign governments. As you are aware, many United States defense firms license foreigners to make defense products for the foreign governments. This often occurs in a situation where the foreign government will not purchase the product from the United States and will not permit the product to be imported to the country involved.

A licensing program may be used to develop the goodwill and reputation and acceptance of your company name, particularly if a trademark license is involved. The acceptance of the trademark may be capitalized upon later on by other licensing arrangements or by your own direct manufacturing or export.

An important fact is that licensing is a two-way street which may permit the American company to get access to a foreign company's technology and expertise and to acquire a new product line for a comparatively small amount of money and in a short time. The American company does not have to establish a research program with the attendant difficulties and need not spend years in developing the expertise and the product line which may be available immediately from a competent foreign company.

Of course, there are reasons for not licensing in the foreign market. One is a limited interest in foreign markets and a feeling that the American company has all it can handle in the United States and does not wish to get involved in the complexities of international licensing. Another reason is that the company may have its own methods of operating in the international field and these may not involve licensing. The company may be perfectly happy with its export operation and is able to compete very well in this manner. On the other hand the company may have decided to operate in the overseas market by the use of wholly-owned subsidiaries and has no need for licensing.

Some companies, particularly those with a strong trademark, feel they cannot adequately control the quality of a licensee's operations and feel that if an inferior product were made, particularly a food product for example, their trademark and their reputation would be damaged overseas and they do not wish to take this risk. They prefer to operate either by exporting their products or by establishing wholly-owned subsidiaries where they have complete control over the operation. In either case the company exercises control over the quality of the goods.

Often a U. S. company may not appreciate the value of a trademark. One difference between a trademark and a patent is that a trademark, with proper use and care, can be renewed and may last forever, whereas a patent has a definite life and once its life is over the patentable item is available to all. For example, the Coca-Cola trademark will last forever if the Coca-Cola Company has

its say about the matter. While I might be interested in learning the Coca-Cola formula, which is a trade secret, I would much rather have rights under the trademark. If I could sell a soft drink which tasted like Coca-Cola but had to be called Blair's Cola it would not sell nearly as well as another soft drink which may not be quite identical to Coca-Cola, but which I could call Coca-Cola.

Thus, a properly handled trademark can support a licensing program indefinitely. If, for example, you have a licensee under your trademark for making shirts, styles can come and go, new techniques can come and go, manufacturing processes are changed, but the trademark goes on forever and thus the royalty goes on forever.

Of course, it may be that a company's overseas operations may involve a variety of different forms depending on the particular situation. The company may have established subsidiaries for certain product lines in certain parts of the world. It may export in other areas and may license in still others.

Of course, a subject as complex as licensing is impossible to cover completely in a short time. In any particular situation experts should be consulted as to the advantages or disadvantages of licensing in the particular situation.

If you decide to license you will need experts to help you with negotiating and drafting the agreement. The normal foreign license is usually between fifteen and twenty pages in length and, while some of the clauses may be fairly standard, I have never run across a standard license agreement. Each one must be designed for its particular situation. Thus, each one involves a complex negotiation

and drafting situation in which it is well advised to invest the time and effort to do it properly so that the maximum return may be realized.