

Licensing and Smaller Enterprises

Regulations of various governments and developing nations make licensing difficult for small firms

BY PIERRE HUG*

It is a trivial to say that licensing can contribute to the economic development of an enterprise. The advantages are well known:



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- Save R and D expenses by sharing them with others
- Generate additional return
- Save time by taking over a license
- Keep markets otherwise lost (exchange control, duties, etc.)
- Avoid enlarging capacity
- Buying back licensed products
- Indirect advantages by cooperation

The problem is whether licensing is *as a result positive, moneywise, and marketwise*. It is amazing to find that

many even larger companies do not know whether a licensing venture has been profitable overall or not. They are satisfied to find that there is an income from licensing, but they do not account for all the expenses, direct or indirect, made for licensing.

There are *three main rules* in licensing:

- Never endanger your own home operation by licensing
- Never endanger your home market by licensing
- And, less obvious but nevertheless crucial, do not rely on licensing income to save your enterprise.

So, if we contemplate the economic and legal realities and at the same time want to observe the above rules, we have to ask whether we still can consider licensing. This problem has to be checked more thoroughly.

The Economics of a Licensing Operation

Let's first look at the cost side:

- Cost for preparing the licensing offer
- Cost for negotiation
- Preparing the licensing package, including technical documentation, commercial documentation, and legal documentation, e.g. industrial property rights and cost thereof
 - Cost of training of personnel and delegating personnel
 - Invested working time of management and staff
 - Cost for receiving advice (necessary for small companies)

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- Financial risks in view of warranty clauses. Then let's look at the return side:
- Down payments to cover expenses for licensing and as security for future payments of royalties
- Royalties
- Do not forget to deduct taxes at the source of up to 50

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percent

- Possible supplies to the licensee
- General advantages of cooperation as, e.g. improvements.

Of course on both sides you may add further items, but as a consequence we will certainly find that, more than others, smaller enterprises should make a budget, compare the results with the budget, draft agreements carefully, and carefully consider the local requirements which may have a large influence on the return. It is unthinkable, for example, that a mechanical workshop would produce any product without a budget, without comparing the cost (which is normally very carefully determined) with the return, and though the consequences. How can we imagine that a licensing venture could be treated otherwise?

Economy of Licensing to Developing Countries

If you consider licensing as an activity which must be profitable as any other activity of a company, licensing into developing countries seems almost impossible these days. In fact the local prescriptions which are very stringent indeed do not allow sufficient return to the smaller enterprise as a licensor. A recent example in India has shown that, although we had a very good tool to license which not only could be used on the Indian market but also exported into certain countries, we were unable to obtain any down payment. Neither could we obtain a reasonable royalty which, after deduction of local taxes, would be more than roughly 1 percent. Last but not least, we were unable to obtain any guarantee for the quality or the price of the goods to be returned to Europe. I had to advise my client to drop the case since this is exactly the kind of ventures which really do endanger the local operation — the viability of the home enterprise. I think that the developing countries are completely wrong with regulations which will keep small enterprises from granting license on their processes and/or products. The developing countries lose the opportunity to get very practical know-how and information from a large number of smaller enterprises, which may be exactly the know-how they need most badly.

For many enterprises the return on licensing is merely an additional income helping to write off past R and D

expenses and thus allowing more money for new development. This means that such an enterprise may as well renounce licensing if there is any danger to its proper market.

As you may know, the EEC Commission and the High Court in Luxemburg have developed a practice and jurisdiction concerning the free flow of goods within the Community which makes it impossible for many enterprises to even consider licensing. The theory of exhaustion of rights says that, if a patented product is put on the market in any of the EEC countries with the consent of the patentholder his rights are exhausted all over the EEC and he is prevented from any further control over such goods.

This means two things:

- The licensor cannot grant any more exclusive sales rights for an individual member country of the EEC.

- He cannot avoid the sale of the goods of his own licensee into his own home market.

EEC Countries

If, instead of licensing, an enterprise sells into individual EEC countries through exclusive dealers a reasonable price policy is still possible since each of the dealers will pay the same price for the goods and therefore will not be able to make considerably cheaper prices than anyone else. There is a reasonable market protection as a reward for the dealer's efforts, according to the Regulation 67/67. On the other hand, there is no protection whatsoever for the licensor or his individual licensees since each one becomes the competitor of the other one just next door. Furthermore, some of the licensees may be located in low-salary countries or have advantages in raw material or they may be countries with state trade monopoly. In each of these cases, there is the possibility of producing and selling at lower prices, which is absolutely in order for the local market. But the licensee can export at such low prices that it becomes ruinous for the licensor.

The consequences are heavy. Although the licensor may have a good patent protection which, by the way, has cost him a lot of money, although he may have trade secrets, there is no way to license without eminent danger, except if the product is unadapted for export or transport. Small companies furthermore have no financial possibility to fight the competition by their own product.

I may add in this connection that the "Bagatelle Announcement" of the EEC Commission is useless. Who would buy a license for a product which has not better prospects than getting less than 5 percent of the market? Furthermore, in many cases a relatively large partner may be necessary to put a project through or the licensor wants to set up a system of license agreements with different countries. In each of these cases the limit of 15 million units of payment is pure theory. As a first thing the market share allowable should be raised and furthermore the limit in terms of money should be more specific and concern only the licensor.

The same difficulties as mentioned above and resulting from the EEC Regulations, apply to the very absolute request by the developing countries to obtain unlimited export rights.

In the present inflation and high exchange rates of

certain currencies many markets may be lost for an exporting enterprise. Licensing may be an excellent thing to keep such markets, but it must be carefully considered and prepared. Licensing is not a solution "as a last resort to earn money."

It is also dangerous to rely on license income and to overload liquidity in view of such future income. The present recession has shown catastrophic consequences for certain companies who have done so. A certain drop in royalty income often is followed by a complete financial breakdown. This of course touches again especially the small companies which cannot afford any overloading of liquidity and which will have difficulty obtaining bank credits.

As a rule, unless your activities are mostly driven to licensing as a main effort, consider income from licensing as an additional income which may one day be stopped by the circumstances over which you have no control.

Licensing and Market Strategy

Licensing is a useful complement to a smaller company's market strategy. In principle, such company will produce and sell at home and in certain cases have subsidiaries in surrounding countries for such markets. It will furthermore of course try to export through agents or distributors. Licensing will be a useful complement in countries where the above solutions are not possible because of characteristics of the product itself (e.g. the distance/weight ratio, the local requirements and standards) or for reasons of local policy (high duties, import restrictions, lack of foreign currency). Besides the pure licensing there is the possibility of forming joint ventures, but there must be reasonable possibilities of recovering your money after a certain lapse of time. I have recently found that the possibilities of licensing to South Africa have become extremely tight in view of the new government policy regarding licensing conditions. Especially in this country joint ventures can be considered if the right partner is chosen. As a result, licensing can be a useful complement to round out the marketing activity of the enterprise, if the three rules mentioned above are kept in mind.

The Unsatisfactory Situation of Smaller Enterprises

There are therefore quite a series of disadvantages for smaller enterprises:

- Antitrust regulations always tend to consider the licensor to be the stronger partner, which is mostly wrong.

- The one year period for patent priority is short and puts the small licensor at the mercy of the larger partner if he needs the licensee's contribution to patent expenses (it is a fact that patent legislation is not designed for smaller people!).

- The licensor cannot protect himself against the risk of having the patents attacked by its own licensees and therefore his risk is much larger with a large partner who may have the means to destroy the patent and thus to challenge the agreement.

- Sometimes territorial restraints are essential for the small licensor to protect his own market and he is kept from doing it because of antitrust regulations.

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boundaries as the most convenient and sensible procedure for this purpose.

Fourth, it can be demonstrated to have played a major role in some industries and a significant role in others, but its potential and actuality has spread right across the manufacturing and commercial spectrum of the developed countries.

Finally, it can truthfully be said to have played an important, special and in some ways, a unique role in the positive economic development of our industries and society today.

Franchising

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ular Tandy departments offering a limited assortment of Tandy articles to the clients. Tandy has set up one of the world's biggest distribution networks.

Amusing Franchise

A rather amusing franchise system is being operated in the U.S.A. by a lady named Mrs. Jean Nidetch. It is the "Weight Watchers" franchise which is a method to reduce a person's weight. The franchisees obtain from Mrs. Nidetch, the founder of the system, the know-how to give particular lessons to clients as to how to attain a slim figure through high-protein food diet. The participants in such lectures congregate every week, step on a scales, and note how much weight they gained or lost. Each period of lectures lasts 16 weeks. In eight years, there were more than 3 million participants. The psychological impact of merely by working together to lower a person's weight is astounding. Many people eat very much because they feel lonely. A Weight Watcher Review with the circulation of more than 500,000 copies reinforces the well-organized system which has been exported to other countries.

Speaking of Weight Watchers I would like to revert once more to the much more important problem of the fast-food restaurants. It is significant to note that only Wimpy and a few of the internationally well-known fast-food systems have been successful in West Germany. The famous Wienerwald restaurants are entirely company owned. Only a few weeks ago, the company announced, however, that it is considering granting Wienerwald franchises in smaller towns, following the trend established by Ihr Platz, Tandy, and Ciro. It should also be noted that McDonald's — which along with Kentucky Fried Chicken is the most successful fast-food chain in the U.S.A. — operates a considerable number of restaurants in West Germany without, so far, turning to franchising.

At this point, a few words about the problem of international franchising may appear useful. The exportation of franchises, mainly from the United States and France, is in full swing and other countries have made some progress, too. Careful franchisors, whether foreign or not, will in all cases have to test their systems in their own enterprises or branch offices before looking for franchisees in a certain country. In several instances, franchisors have successfully operated their business at home but failed or suffered considerable foreign setbacks because they did not prepare their franchising operations carefully enough and neglected to test the new market long enough or consult with appropriate marketing and legal experts. Permanent research and innovation is also an inherent obligation of the franchisor, especially if he operates in foreign countries. A distribution system needs constant improve-

ment and the franchisor, as the leader of the system, must always be ahead of the franchisees in knowledge, know-how, and flexibility.

Thanks to the multiple possibilities franchise systems offer, there is little doubt that national and international franchising will develop rather rapidly in Europe in the next few years. It will facilitate international trading and economic interdependence to a considerable extent and often contribute to mutually advantageous business relationships more than direct investments

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- The smaller company cannot afford to grant licenses into developing countries since, however small he may be, he is considered as the rich partner who must give this know-how away for no money.

- In general the regulations and restrictions concerning licensors have a more stringent effect on the smaller enterprise.

It is therefore a request of the smaller companies:

- To the antitrust authorities to make exemptions reasonable and useful for smaller enterprises and

- To developing countries to make licensing more attractive to smaller companies. Those nations then would have the opportunity to obtain a lot of practical know-how from them.

Technology & The Developing World

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negotiations provide opportunities to hear the developing countries' views with new understanding, and to tell our point of view, with new conviction, to others who are reader, I think, to hear than before.

If all involved do their work well in the weeks and months ahead, the technological fruits of our capitalistic, pluralistic, creative system will be more a part of the developing countries. Likewise, the markets, products and resources of the developing countries will be more equitably available to the developed countries. This will add to the economic and social progress of both.

It will go slowly, and be painful. But the rewards will be worth the effort.

Insights Into People's Republic of China

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Because my company's group did not exhibit machines or equipments, we were not faced with the problem of other Belgian firms which wanted to sell their material on the spot so as to avoid an expensive reforwarding to Belgium.

According to information collected after the Fair, 30 per cent in value of all exhibited equipments were purchased by various corporations.

Appointments

Thanks to the representatives of the Belgian Office for Foreign Trade, appointments with the National Corporations were arranged by the CCPIT. Unfortunately, most of