

Sales of Western Licenses in East

Reasons for increasing importance of licensing trade and related problems are discussed

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INTRODUCTION

1. Officials in East European countries, as well as companies involved in license sales to these countries, predict that the most rapidly growing segment of east-west trade in the future will be the licensing of patents and know-how.



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2. No limits are given in bilateral trade agreements in the field of licenses. Recent decisions by the governments of Eastern countries to the effect that imports and exports of technology are incorporated in the economic plans will also have their impact. So, too, will the general recognition by eastern countries that purchase of existing technology from the most advanced source is often faster and cheaper than developing duplicates within their own R&D resources.

3. However, knowledge and experience of selling western technology to the east is limited, and many western firms are reluctant to share technology with the east, not knowing the risks and having few means of calculating the possible rewards and costs for marketing to be deducted.

4. It is therefore evident that a need exists for information and guidance in the form of direct declarations from eastern countries on their policy in purchasing licenses.

5. This paper will try to pinpoint some of the obstacles and problems encountered in the sale of licenses to the eastern countries and, based thereon, will indicate the most obvious ways to provide guidance in these matters.

6. Due to its complicated nature and the problems involved, the purchase of licenses in the west has been limited mostly to very large enterprises which have the capacity to deal with these obstacles. With more information and guidance, as well as the use of western intermediary organizations who can provide the necessary capacity and experience, it will also be possible for small- or medium-size companies to make available their innovations. It is often the case that innovations seem to originate

more frequently in the smaller entities.

7. It would be correct to state that today all trends point to the increasing importance of technology transfer in the area of *technology per se*, and not only as the instructions and know-how for the running and use of a particular process in connection with a hard ware delivery of process equipment. In particular, this holds true for the state planned economies, where the aim is to create the means of production for the future for the country as a whole and not merely to have an installation started.

8. The sale of know-how in connection with the sale of equipment has been a commonly-used practice, but, as such marketing is closely related to that of hardware sale, most of its marketing and sales problems derive from such "turnkey" deals, and will not be dealt with in this paper.

9. Western enterprises are realizing more and more the *value of their technology as a product*. In particular, when selling to the east, the attitude of regarding the technology as written off and paid for in the internal operation is changing as the market for technology develops and the cost for development increases as new technology tends to be more complex.

10. The license trade to Japan, which for a long time has been the best developed in the world and in addition has been very well documented, gives proof of this tendency of increasing license payments also relatively measured (as a part of the production or as royalty in percent of the net sales value). Thus, in a study¹ of the Japanese license trade made by the Swedish Technical and Scientific Attaché in 1973, it is shown how in later years (1969-1971) almost one-third of all license agreements to purchase technology have a royalty rate of above 5% and, further, out of these, one-fourth have above 8% royalty. This is to be compared with the conditions of the license agreements in 1950-1965, where, with a few exceptions, no agreements ran at a royalty higher than 5%.

The main problem

11. The change in attitude when selling therefore necessitates a more *internationally-recognized method of evaluating the value* or of setting a price on a license agreement. It is evident that some of the most experienced purchasing bodies in the world must be the state organizations that administrate the purchase of western technology. A standard has emerged, no doubt from both necessity and from experience gained, in establishing what could be paid for specific technology. It would therefore be most useful to have these standards explained and possibly establish ways of transcribing or relating them to the standards of evaluation that are slowly being established in the west.

12. For some time such parameters as cost for development, technological complexity, etc. have been

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parameters when evaluating. As license fees rise and development costs increase, *more and more western companies* have been forced to *use the market value as a main parameter*. Since this is based on the financial possibilities of the resulting product and its competitiveness on the market, it gives realistic limits for an optimal license payment.

13. It has been stated that the companies or entities in the member countries of the Council for Mutual Economic Assistance (CMEA) use the same means of establishing what is the fair rate for license payments as are used in the west.

14. The *importance and value of the invention*, i.e. its *technical value* based on the degree of innovation, its *production parameters* such as necessary investment, further running costs and raw material costs compared with alternative conventional techniques, are the first parameters.

15. Even if most of these parameters are difficult to define in themselves, it is possible for experienced people, irrespective of country and economic system, to give them a certain value. These parameters do not usually make it difficult to reach agreement on economic terms.

16. The parameters which illustrate the problems and hence have to be examined are those which depend on *market conditions*.

17. As in most cases of pricing, it is market conditions that are decisive when evaluating the rate of license payments. The territorial limits of the rights under the license divide the total value of the technology in question into sections of various sizes and weights.

Depend on Marketability

18. These weights depend on *marketability or to what extent these rights are to be utilized*. It is unlikely that an industry in a state planned-economy will concentrate its future decisions on the activity in an area where the given technology will be utilized on the conditions of any particular license agreement.

19. On the other hand, in planned economies it should be possible to *estimate a minimum use of the technology* at hand *for the next five years*, at least if such parameters could be given through the industry or *through a central information source*, similar to "VINITI", the All Union Institute for Scientific and Technical Information in the Soviet Union.

20. This would greatly facilitate the western firms' task in making the necessary estimations. It would probably also make them less apt to overprice, since they would realize that competitors offering compatible technology would also have this information.

21. In the absence of such information, it would be necessary to use other means to estimate the potential market of the technology.

22. *Analogies* with similar markets in size and conditions as to geography, industry, population, etc. would therefore be a most useful approach. However, it would seem difficult to find parallels to the extent that this analogy would give sufficient aid.

23. Some organizations dealing with import of technology, for example, in Poland, have indicated at international conferences between colleagues in licensing, for example, at the LES Conference in Oslo in connection with the Know-How 1974 Fair, that such a comparison with a

neighboring country would be accepted if a factor were given for the size of the industry in question in each country. This can be obtained from the latest annual statistics as given by official channels. It gives a static picture of the relationship, and this is likely to change since the purchaser has a more universal or widespread use of the licensed technology. But, if acknowledged, this way of evaluating would prove most useful for finding a value of the market potential and, based thereon, allocating the necessary means for marketing to make the technology available.

List of further obstacles

24. A list of the problems involved in licensing to the east, their nature, and some suggestions of how to ease them one by one now follows:

(i) With a different market structure in the east, as indicated above, it is obviously very difficult for the western businessman to establish a working estimate of the potential rewards or the value of the technology, and this has some negative indirect effects. The selling party becomes reluctant to deal with the market and has a tendency to sell also the license rights for these territories to others outside the eastern countries;

(ii) There are still widespread fears in licensing to eastern countries. This originates largely in the thought that in this way a future competitor who will appear on one's own market is created. A typical example of this attitude was the reason given by International Harvester for refraining from becoming involved in the giant truck plant at the Kama River: "We have priceless resources in our heavy-duty truck know-how . . . Why give it away? Why create a competitor for a one-shot deal?"²

(iii) The lack of knowledge of the nature of the cooperation between countries within the CMEA area in questions concerning technology transfer, and to what extent technology is therefore sold to one country or to the whole cooperation, makes the western businessman tend to price his technology as if selling to all of them.

(iv) The ways and forms for active marketing in the eastern countries differ somewhat with their national character and organization, but as a whole there is one general difficulty emerging from the state-planned economy as such. Decisions are taken in three different organizations or at three different levels. The government decides the general course of action, the priorities and the plans. The second level is the Ministry, responsible for this industry, which will allocate the means. The third level is the industry which will provide the technical decisions based on its needs and knowledge. This situation implies three general difficulties:

(a) to obtain the right contacts and sell the technology in the right order, beginning with exhibitions and seminars; then to the industry specialists and developing institutes for a top decision at planning level and follow-up of the process;

(b) the risk of losing touch with the business through lack of information for years and giving up on the grounds that the interest of the poten-

tial buyer seems to have disappeared or that other sources have been found; and

(c) the long time involved, often four to six years, which makes the proposition uninteresting on next approach, in particular as there is no way of estimating the chances of success.

(v) The contact with the licensee and the actual manufacturer-to-be is already important at the negotiating stage. It is also vitally important to have the right contact to ensure continuity and mutual confidence. This is the only way of ascertaining the level of the minimum performance or minimum execution of the rights on behalf of the licensee (often critical for an agreement). It is evident that this largely depends on the degree of confidence and also on the future flow of the information on the volume produced. Also, the possibilities for giving necessary guidance and control in the running-in period and adjustments on test runs, as well as any form of guarantees, are dependent upon these early contacts which are often difficult to establish.

(vi) Some minor aspects of the general situation for licensing, due to the different laws and policies, may also provide problems in certain cases.

(a) One is the tendency to give high credit at times to the opportunity³ to effect *payment* in the form of delivery of *products made under the license agreement*.

(b) Another difficulty is the problem of giving information in sales and negotiations on certain chemicals, pharmaceuticals, etc., where *patents on their composition* cannot be achieved in the east due to the law and, hence, the license has to be a know-how license.

Means of overcoming obstacles

25. The tendency to be reluctant to sell because of lack of means for evaluating the potential stake will be overcome as the western businessman learns to appreciate the market one way or the other as indicated under the main evaluating problem.

26. The terms of having the eastern license appear in the home market should be taken into consideration when setting up the license conditions. No information on breach of such clauses exists, and, also, this risk is exaggerated since the needs of the eastern market are big enough in themselves to keep the licensee busy for years following the grant of the license. Even if export to the west is permitted, the licensee would need a great deal of time to set up a sales network.

27. There are examples, however, of such re-exports. The Vaz, manufactured under Fiat license, is marketed in several western countries in competition with the Fiat 124 built in Turin. But, in this case, provisions are made in the agreement for re-export and Fiat has reserved the right to review each case.

28. It is a misconception that further license sales to other countries in the CMEA area might be prevented by selling technology to one of the eastern countries. The technical exchange of information, as declared in Sofia in

1949, was aimed at giving assistance to the less industrialized of those countries but has never been applied to patents or know-how acquired under license contracts with western countries.

29. Handing over of know-how from one eastern country to another would leave the donor with a currency problem and lessen the export to the receiver. There are no known complaints about disclosure to other CMEA countries, but there are several cases where a license in one of the eastern countries has been followed by inquiries and sales of technology to others.

30. However, it would prove most beneficial if the eastern countries actively and officially declared their policy on this point.

31. The more general difficulties resulting from the difference between planned economies and market economies could preferably be dealt with by *information*. Such information, due to the complex mechanism for decision-making within the planned system, should be given *on the status of the project at regular intervals*.

32. Such information should include the reasons for delay and the possible outlook, as well as the timetable likely to be followed under the present circumstances. It is also important that the seller has *a party to turn to for this information*. The language barriers and the difference in thinking alone make this information hard to obtain, not to mention the size of the organizations involved from Branch Ministry to State Research Institute.

33. It is possible to organize a seminar or take part in an exhibition and thus reach some of the decision-makers in the industry. But this is a costly and very time-consuming way and very difficult to motivate in the absence of a good market estimate. The decision-maker in the western company is, therefore, in a situation where he must give low chances and low value to the sales potential.

34. For example, money and energy-saving new technologies are not presented actively at an early stage when the innovation is still important and has a real edge over existing technology. One way to facilitate such presentation and make it less costly would be regularly to *organize innovation fairs* of the same nature as Know-How 1974 in Oslo, INOVA 1975 in Paris or Techno 1975 in Tokyo.

35. There is little information available on the long-term plans to purchase technology now being set up in most countries in the east. Some information on this point, *made available at the company level*, would certainly lead to competition that would itself help greatly to overcome all the obstacles mentioned. It would give a picture of the overall targets and timing and it would provide the *necessary motivation* for overcoming other obstacles by making the accelerating trend in *the growth of license purchase* visible.

NOTES

1. Special Report 1973/9 from the Swedish Technical and Scientific Attache to Japan to the Swedish Academy of Technology, IVA, Stockholm.

2. *Forbes*, U.S.A., Aug. 1, 1971, on Kama River Project.

3. Summary report of U.S. Delegation visit to USSR for study of Soviet Management and Licensing Practices, September 1973. Distributed through Les Nouvelles, Cleveland, Ohio.