# Establishing An International Licensing Strategy

BY WESTON ANSON*

*Pan-European strategies are more important than ever as market-place reorganizes; old, new plans need review*

It is increasingly obvious that licensing is part of most corporate business strategies. The need to set Pan-European or Pan-Asian licensing strategies is increasingly relevant, and corporations increasingly are thinking about global licensing strategies for their intellectual property. In this context of looking at the global village, or large sections of the global village for licensing opportunities both with third parties and with related companies, the need for accurate and defensible royalty rates becomes imperative. And, most importantly, clear strategies for managing intellectual property are needed for these major markets.

## THE SIZE AND MAKE UP OF THE EUROPEAN MARKETPLACE

One of the key questions we are often asked is: Why is a European licensing strategy needed?

It's critical to remember that the EEC represents more than 300 million people. EFTA represents another 60 million, and the old Eastern Bloc nearly as many as the EC and EFTA together. Unless an effective strategy is structured to address this market, these 700 million people, who represent 40% of the world's GNP, will be bypassed. Treating this market on an *ad hoc*, situational, or country-by-country basis, is shortsighted in the extreme.

The genesis of this growing unification goes back to the 1957 Treaty of Rome and the gradual growth of the Common Market. From there we can jump ahead to the 1985 White Paper approved by the Common Market members, and finally to 1987, when the Single European Act of 1987 was passed. What it means for licensors is increasing unification of key European markets.

In addition, we've watched the changes in Eastern and Central Europe over the last few years. As they draw closer to their Western European neighbors, their interest and need for licensing increases. Today, with a population roughly 50% greater than in the U.S., the level of licensing revenue in Western Europe is only 10-15% that of the U.S. level. Consequently, the opportunity for growth of licensing is substantially higher than in North America.

As the U.S. market matures, major changes are beginning to take place in the U.S. licensing industry. This will substantially affect licensing in Europe, and each company's European strategy for its intellectual property and its licensing program.

## FACTORS UNDERLYING CHANGES IN EUROPEAN LICENSING

Major changes are afoot in the licensing industry, creating competitive factors that are forever changing the face of European licensing. There are more multiple and dynamic changes occurring in licensing on both sides of the Atlantic that will affect the European market:

- The U.S. licensing market is maturing and growth is slowing.
- The sheer size of the European market, at 700 million people and 40% of the world's GNP, makes it compelling that an effective strategy be in place.
- U.S. licensors and holders of intellectual property are increasingly aggressive and looking for additional growth from overseas markets.
- Per-capita licensed product sales in Europe are far less than in the U.S., offering tremendous revenue growth.
- The growth rate of Western Europe's GNP is faster than that of the U.S., Asia, or Latin America.
- The licensing agent's role and compensation is changing, particularly in Europe, and will be substantially reduced over the next five years.
- The increasing emergence of the multi-country licensee, manufacturing and selling across European borders, is a key factor.
- The type of property being licensed is changing and becoming more international and more adaptable to the European marketplace.
- Europe is finally and fully entering the revolution in the television age that we have experienced in America over the last 10 years. With the growth of satellite and cable television in Europe, growth and change in consumer and industrial marketing will come hand-in-hand.

In summarizing these factors, it's apparent that U.S. property holders and licensors have a clear-cut advantage over their European counterparts — in terms of sophistication, marketing savvy, staffing, aggressiveness, and properties held. All of this means that, given an adequate pan-European strategy, a U.S. competitor faces substantial opportunity over the next five years. However, without a clear European focus, U.S.-based licensors will quickly lose this edge.

## MAXIMUM FINANCIAL RETURN FROM INTERNATIONAL LICENSING

As laymen, not as attorneys, it is

*Chairman, Trademark and Licensing Associates, Inc., LaJolla, California.

clear to us that one of the key factors driving the growing need for realistic licensing strategies and defensible royalty rates is the U.S. IRS and its Section 482 requirements. Parenthetically, however, foreign tax authorities also are increasingly enforcing 482-type restrictions, and are scrutinizing arm's-length and inter-company royalty rates and transfer prices. The tax implications can be enormous to any company operating in the multinational arena: A 1% swing in a large multinational company's royalty rates can mean tens of millions of tax dollars annually.

Most of us are aware that there is an absolute need to satisfy the IRS and overseas tax authorities as to the reasonableness of royalty rates. In addition to the IRS, there are a number of foreign tax authorities who very carefully review the level and method of establishment of royalty rates. Some foreign tax authorities are more lenient than others. Nonetheless, it is imperative that licensing royalties be realistic, objective and market-based.

In our own experience with U.S. clients, we have found that some countries scrutinize royalty rates far more rigidly than others. We have worked with clients on royalty-rate issues in France, Germany, Brazil, South Africa and Japan, among others. We strive always to ensure that our clients are able to maximize the financial benefits from their intangible property, while being able to defend any license on a rational basis.

### ◄ More Reasons ►

However, there are other key reasons for companies to establish and maintain accurate royalty rates among their affiliates and subsidiaries, and unrelated licensees. Among those reasons are six key factors, beyond the IRS and tax considerations, that make it increasingly imperative to U.S. and foreign-based corporations to set accurate royalty rates:

- In order to facilitate future related company transactions, accurate, real-world royalty rates need to be set today.
- To maximize cash planning, cash savings, and optimal cash flow, inter-company royalty rates have to be used carefully, strategically, and often aggressively.
- In order to set a firm base for future acquisition and divestiture deals, today's royalty rates can be of great value.
- To set more precise and accurate balance sheet (or off balance sheet) values for intellectual property, realistic royalty rates can be an invaluable tool.
- Market-based, inter-company royalty rates provide a firm foundation for third-party negotiations.

## SPECIFIC EUROPEAN LICENSING ISSUES

One cannot and should not oversimplify, however. There are issues that one faces in European licensing that are not faced anywhere else in the world. Pan-European licensing may be simple in concept, but a strategy has to consider carefully some of the underlying issues.

The single most important issue is the need to decide on the best form of management for the European licensing arena. That decision is critical, whether it be single country agents, Pan-European representation, an EC subsidiary, direct management, master licensee, or country managers reporting directly to U.S. management.

An effective Pan-European licensing strategy needs to address that issue, along with the following:

- The impending end to territorial exclusivity for licensees in the EC.
- The inability to limit licensing agents on a geographical basis.
- The effectiveness and legality of restricted agreements such as rolling 90-day terms, linguistic controls, or product language content is increasingly being questioned. However, there is the need to maximize control, planning and product protection increases.
- Maximizing income from European licensing beyond just royalties, including fees for advertising, design, product development, distribution, etc. is important.
- The currency implications for 1992 and beyond, and how it may substantially affect the relationships between EC and EFTA licensees, must be addressed by each licensor.
- Finally, accurate prioritization for the major European markets is a key factor underlying an overall strategy.

Now is the time for these issues to be addressed. The fully integrated Common Market is just around the corner. It will be followed in short order by the integration of former members of the old Eastern Bloc into the mainstream European "Mega Economy." Developing a Pan-European strategy, we believe, is time-critical for future success.

## FAMILY APPROACH TO INTELLECTUAL PROPERTY LICENSING

The strategy to establish an effective plan and attainable royalty rates for a company is not simply one of mechanical or statistical analysis. Rather, the analysis needs to look at all components of an intangible property family within the organization, as they relate to the marketplace and the real world. We believe that in both the short-term and the long-run, the family approach addresses licensing strategy issues most effectively. In addition, we have developed a number of proprietary techniques and approaches to setting marketplace licensing tactics. These include:

- The bundle of rights which implies a royalty rate covering more than one type of intangible property.
- An alternative approach is the technical bundle of rights applied to patents, training, know-how, etc.; and/or the marketing bundle of rights applied to trademarks, brand names, designs, copyrights, etc.
- We also have further developed the concept of parallel brands in establishing marketplace royalty rates.
- The regional royalty rate concept is also effective in some cases.
- Geographic bundles of rights to one or more trademarks or patents, etc. across borders can be a useful technique.
- Finally, the blended-royalty rate technique is one that we believe in for certain clients.

Each of the above is useful in different situations. On many occasions, we have used more than one technique in working with a specific development program.

Too often we find that a client will focus on only one element of intangible or intellectual property being used on an inter-company basis. For example, a client will ask us to establish a royalty rate for a given trademark in a single EEC country, when in fact there is the trademark, brandname, logo design, copyrighted artwork, and additional elements that may be part of the license, and may need licensing in several EEC markets.

Similarly, on the technical side, we are sometimes asked to establish a royalty rate for a patent, when more appropriately a rate should be established for the patent, proprietary knowledge, technology, formulae, software, etc. Some of the elements that can be included in an all-European transfer for which royalties can be established are: trademarks, corporate names, copyrights, brand names, designs, logos and logo types, technical know-how, mailing lists, formulae, patents, technology, software and technical training. Each, or all of these, can be part of the basis for the royalty rate and license agreement.

## SETTING A STRATEGY: A CASE STUDY

It's always useful to look at examples of real-world approaches to strategic problems. In the world of intellectual property implementing a strategy sometimes is easier said than done. However, companies increasingly are making major moves. For example, there is a very large publicly traded company that is a major factor in character and entertainment licensing, and in corporate licensing. It operates around the world, and for many years it has had licensees in virtually every European country.

The licensor is well known to all of us and licenses its properties in all of the major consumer goods categories here and overseas. The parent company and some of its characters are, literally, household names. There is very high consumer awareness in the U.S. and Western Europe, and there is even growing awareness of the company and its intellectual property in the Soviet Union and Eastern Europe.

The situation prior to establishing its new strategy was a highly centralized one. The licensor operated out of a central licensing office in New York City, and had appointed a licensing agent in major European countries. That licensing agent in turn found licensees for individual products, in the specific country in which they were the agent.

In other words, the French licensing agent appointed a French manufacturer to make T-shirts, and a French manufacturer to make food products, etc. These agents often had multiple licensees in their one country making similar products for different licensed properties. The direction of the licensing program, control, and approvals emanated from New York.

The issues in this case were, first, that they had an inefficient management and implementation system centered in New York City.

Second, increasingly there was cross-border selling by licensees with similar products, and you would find the French T-shirt licensee for example selling its products in Germany or Spain.

The third issue, was that for the same licensed property one would find different products in different but immediately neighboring countries, causing confusion across national borders.

The fourth major issue was that there was uncoordinated and overlapping promotional and advertising plans because each licensing agent ran the program independently within its own country.

Finally, and most importantly, there was a gross underutilization of the various licensable properties, with a resulting under maximization of licensing revenue and net income.

The solution for this licensor was relatively easy. The licensor established a European office with a major Western European capitol with a senior vice-president in charge of European products and development. Under the direction of that senior vice-president the program was consolidated, and the result is a more effective centrally-coordinated and managed system of licensing. Licensees have improved along with product lines, and revenue has been increased dramatically.

## SUMMARY

In sum, major changes are coming in international licensing. With U.S. licensors recognizing these changes just in the EEC alone, the face of European licensing over the next three years will change forever.

Major changes are coming for licensing agents, their compensation, and their role, for licensees, in their geographical coverage and marketing scope, and for licensors, in their management structure and operations.

As an international licensing consultant and management firm, our role is to work with a few key clients, like General Motors, Sesame Street, or America's Cup, providing licensing strategy implementation and management.

In our view, *now* is the time that the issues in European licensing have to be addressed. The fully integrated Common Market is just around the corner. Unless licensing management moves now, it will find its competition outstripping its efforts in Europe. Potentially, a market of 700 million people, stretching from the Iberian Sea to the Ural Mountains will be at least partially lost.

In conclusion, we all know the face of European licensing is going to change rapidly over the next several years, and growth will accelerate. The question now is: Which licensors will be able to most effectively adapt and build a successful Pan-European licensing strategy? Just because a licensor feels that it is doing it correctly now, and it doesn't have any problems now, does not mean that in 1995 it will be able to say the same thing.