

Outward Foreign Licensing

Such activity may take back seat to other strategies in some companies, and that is a mistake

BY DR. LAWRENCE S. WELCH*
and ROBERT T. CARSTAIRS**

Companies rarely use foreign licensing of technology and know-how as a primary method of expansion into international markets. In the main, it tends to be employed in a secondary or supportive role to other market development strategies. Evidence from the United States, Australia and West Germany¹ indicates that a large proportion of aggregate licensing income is paid between affiliated companies in different countries. The role of foreign licensing in such a context appears to be tied to such functions as the transfer of funds, the reduction of taxes, and as an additional element in the armory of control mechanisms.² It acts only in a subsidiary way as a market-development factor.

Even apart from the foreign investment connection, though, foreign licensing is frequently adopted only as a secondary or residual strategy when other, more preferred international operation methods are constrained.³ This approach contributes to a lack of commitment to and planning for its use in international development. It also helps to explain the poor results which are sometimes produced by licensing activity. As a consequence, we would argue that the potential of licensing as an international marketing strategy is considerably under-exploited: that licensing can instead play a useful and even creative role.

Therefore, in this article we examine ways in which foreign licensing can make a positive contribution to foreign market expansion. In addition, we consider some of the key marketing issues involved in developing a successful foreign licensing program—both in the short run and the long run. The article draws upon

*Visiting professor, Norwegian School of Management, Oslo, Norway.

**Lecturer in Economics and International Business, Darling Downs Institute of Advanced Education, Australia.

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a study of outward foreign licensing of technology by a sample of 43, mainly smaller, Australian companies which was conducted by the authors (see Appendix).

MANY ROLES

As a means of exploiting foreign market possibilities, licensing has been used in a variety of roles. The type of contribution which it makes to the internationalization process of a company does of course depend very much on the role to which it has been assigned. The more important ways in which outward foreign licensing was utilized by the Australian companies studied were:

1. It was frequently used as a means of generating income from residual markets or residual technology. Where export markets were considered too small to justify the effort to mount an effective export campaign, licensing was considered as a cheap way of obtaining at least some return from the markets in question.

Likewise, when new technology was developed within a company that was far removed from its mainstream activities, licensing was employed to generate some income from the knowledge asset for little effort, and because it caused little distraction from main income earning operations. In both cases, the companies were clearly seeking to commit as little as possible to the marketing exercise, while their preoccupation existed elsewhere, so that only limited foreign market expansion, if any, could be expected from such an approach.

2. The most frequent use of licensing was as a secondary strategy to exploit foreign markets when exporting was restricted by high freight costs or import restrictions in the foreign country, while foreign investment was considered to be too costly and risky. In many cases, the licensing or foreign investment choice was forced on the company after it had been exporting to a particular foreign market for some time, and licensing was usually regarded as a backward, though necessary, step in market involvement.

The danger of adopting licensing as an only or last choice strategy, at any stage of foreign market involvement, is that it will lead to insufficient commitment and support by the company to ensure that positive results are forthcoming. As later evidence will demonstrate, successful licensing requires a deeper commitment, both in the short and long run, than most companies realize at the outset.

3. Over the long run, some companies were able to use foreign licensing as a positive and constructive link in the process of penetrating a given market more

deeply. There were cases, for example, of licensing acting as a stepping-stone between exporting and foreign investment. Licensing represents an indirect means of obtaining foreign manufacturing and servicing facilities as well as the local market knowledge of the foreign licensee.

A company is able to limit its commitment in the short run, and yet test the ground and prepare the way for deeper involvement in the future. For this to be effective, though, there needs to be a more positive and longitudinal view of the strategic value of licensing in opening up foreign markets.

4. Another aspect of the contribution of licensing to the opening up of foreign markets is the way that it often leads to associated sales of plant, equipment, component parts, raw material inputs, or service contracts. In a study of Finnish companies licensing to independent foreign licensees, it was found that the aggregate value of exports of associated plant and inputs was more than double that of licensing income.⁴ In the Australian study, just over one-third of respondent firms indicated that licensing had produced sales of associated products. Thus, in cases where a foreign market is blocked to exports of final products, licensing can act to create export possibilities for intermediate products, which are acceptable because of their link to the licensed operation.

5. Reciprocal licensing arrangements and other forms of cooperative deals with foreign licensees not only offer scope for broadening the technological and product base of a company, but can also provide avenues for new foreign market ventures. For example, one Australian company was joining with its American licensee in a joint-venture operation in South America.

6. As noted already, licensing of foreign subsidiaries or joint-venture operations provides an additional element of control as well as a further avenue for transferring income, although licensing clearly performs only a supportive role to the investment strategy in general. In the Australian study, it appeared that some companies were introducing licensing agreements after their New Zealand subsidiaries had been operating for many years simply as a way of assisting the transfer of income out of the subsidiaries. However, in this article our concern is with the use of licensing as an international marketing strategy in its own right rather than as an accompaniment to a foreign investment operation.

FOREIGN LICENSING: A DEFINITION

With this article, foreign licensing is taken to mean the foreign sale of a right to use certain company assets in a defined way—the most important asset form being knowledge of various kinds (so called “intellectual” or “industrial property”). The asset may have been registered with a public agency, as in the case of a patent, design or trademark, or may be maintained within the firm. The unregistered knowledge asset is referred to as know-how, and is commonly based on operational experience. Know-how may be in the form of technical knowledge regarding products and processes, or in the form of commercial knowledge, for example, regarding management and marketing. The

licensing agreement is the legal agreement setting out what is to be transferred from licensor to licensee and under what conditions.

MARKETING A “LICENSING PACKAGE”

Before undertaking the actual selling exercise, a company must settle exactly what it is that it is capable of licensing, and indeed prepared to license. There are a variety of aspects of a company's operations which are potentially licensable. In fact, there appears to be a growing recognition of the value of building a total package as an object for licensing. Included in the package may be patents and designs, technical know-how and commercial know-how that fit together in a cohesive whole. As part of this “package” concept the number of items or specific objects of licensing appears to have grown. There have been a number of factors which explain this development:

1. By expanding the number of items being licensed, the basis of income generated is enhanced—via separate agreements or a higher royalty.

2. By offering a wider range of components, the total licensing package is made more attractive to the licensee, and it becomes more readily marketable.

3. From the point of view of protecting the firm's intellectual property, while the various parts of the package may have limited strength individually, together with the other parts they make a strengthened whole.

Within the package, it is interesting to note what seems to be the growing importance of commercial know-how as a specific object of licensing. For example, in the Finnish investigation of companies licensing to independent foreign licensees⁵ it was found that, out of the total number of agreements, the proportionate frequency of inclusion of the different objects of licensing was as follows:

Technical know-how	96.1%
Patents	48.0%
Trademarks	36.4%
Marketing know-how	24.7%
Management know-how	11.7%
Design	5.2%

While not specifically tested in the Australian study, the impression gained from interviews was of a growing recognition of the potential for licensing commercial know-how.

Trademarks were likewise stressed as contributing to marketability and strengthening the protection available. In one case, a company had built up a successful export market in Thailand, with strong brand name identification. Because of import restrictions, it was forced to cease exporting and so switched to licensing. In the absence of patents, the right to use the trade name became a major component of the licensing package.

Important Objects

The interrelationship between parts of the licensing package came out most clearly with regard to the most important objects of licensing: patents and technical know-how. In the Australian study, many, especially smaller, companies expressed a poor regard for the

value of patents (typically, they were "too easy to invent around"), so that the investment in international patents was not considered justified. About one-third of respondent companies which were involved in foreign licensing held no foreign patents. Within some companies too there were contrary views on the value of patents: while technically-oriented executives saw little value in them, marketing executives were more positive. Larger and more internationally involved companies tended to have a more positive view of patents, partly because of a clearer recognition of their marketing value.

Most companies emphasized that operative know-how was more important than any patent—both in terms of technology transfer and as a component of a firm's intellectual property.⁶ Know-how was often difficult and costly to reproduce. For example, a number of companies in the Australian study were purchasing licenses from abroad as well as selling them. They stressed that it was feasible for them to get around the patent in various ways, but the cost of replicating the know-how was greater than the cost of licensing. Nevertheless, these same companies were taking out international patents on their own technology. The reasons for so doing had a strong marketing bias. Patents were not just part of the effort to ward off competitors, but were meant to increase the attractiveness of the technology being sold. It was felt that licensees were more assured about what they were purchasing when it was covered by a patent. Companies in the United States particularly seemed to be wary of Australia's technological capabilities, so a patent was often essential to give the Australian firm some degree of technological credibility.

Thus, despite the inherent weaknesses of patents, they performed a useful role, in association with the know-how component, in building a stronger and more marketable total licensing package. In fact, the clear message of the Australian study was that successful licensing first depends on the process of assembling a cohesive and marketable licensing package. Included therein should normally be far more than the unique technology which might have given rise to the licensing possibility.

TIMING

The decision about when to begin foreign licensing of technology developed within the company is often not strategically determined, because of the intervention of outside initiating factors such as government-imposed trade barriers or simply through external change agents. In some cases too the licensing step comes well after the technology has been developed, when it could almost be considered dated, apart from markets within the less-developed countries. There were companies in the Australian study that had successfully started the licensing of technology that had been operational for as much as 20 years, one example being solar power technology.

In general, though, where a company was in a position to control the timing aspect, it was found that potential licensees were best approached with proven technology, where performance could be shown under actual manufacturing and marketing conditions.

Without this the marketing exercise became far more difficult. As well, the greater the operational experience, the better equipped was the firm to sell a full package of know-how. Nevertheless, in areas of rapid change in technology or fashion it was not always possible to wait for full commercial proving so that early licensing became necessary.

LICENSEE SELECTION

Perhaps the most crucial phase in the marketing of a foreign licensing package is that of actually finding and selecting a suitable licensee. In essence, the success of the chosen licensee determines the success of the licensor. Of course, many of the problems of licensee choice are circumvented when a company has had operations in a given foreign market previously and so has a good idea of potential licensees, or even a working relationship with one. In the Australian study companies generally concluded, sometimes after bitter experience, that the selection of a good licensee was far more important than obtaining a tight licensing agreement. As companies extended the number of licensing agreements they tended to place greater emphasis on the selection process.

In the Australian study, the approach to searching for potential licensees seemed to follow along similar lines to that of an export development exercise. Country choice was influenced by cultural factors in a broad sense, while the government's trade assistance service was much used in the short listing process. When it came to the actual choice of licensee, a number of criteria were employed. However, stronger emphasis was placed on the companies to avoid rather than on the positive features to look for.

Based on the Australian companies' experiences, the types of licensees to be avoided would be:

1. Licensees who are marketing a competitive product. Personnel associated with the product under threat may not wish to see the new technology replace their own. In addition, competitive companies purchasing this technology may effectively lock it away.
2. The established leader in the field. Technical personnel within these companies will be hard pressed to find merit in the new technology.
3. Companies which have invested large sums of money attempting to achieve what the licensor has already achieved.
4. Companies which have overextended themselves on other projects and will not be able to push the licensor's product.
5. Relatively large companies, as the licensed business will often seem so small in their overall activities that little marketing support is considered justified.
6. Companies with a past history of uncompleted projects.
7. Companies with production and marketing resources already stretched to the limit, or with only a temporary decline in demands on available capacity.

On the positive side, characteristics to look for in potential licensees tended to center around the licensee's ability to market and distribute the product which incorporates the licensor's technology and

handle any servicing needs of customers. These characteristics were often found in licensees producing complementary products. In general, the licensed activities should be important enough for the licensee to be prepared to effectively support them. A most attractive licensee is one that is contemplating moving into the product area which utilizes the licensor's technology. In company interviews, though, positive characteristics were often put in less concrete terms. For example, trust and compatibility were stressed. This followed from a recognition of the need to work well *with* a licensee over a long period if licensing was to be successful. However, in this regard no simple guidelines are available, which is why considerable time and care in selection are normally necessary.

NEGOTIATION

Neither the literature nor the Australian survey evidence provide a simple blueprint on how to approach negotiations for an acceptable licensing agreement. The need to be "reasonable" was stressed by many Australian companies and there was an absence of resort to secrecy agreements. An important requirement was to be able to clearly demonstrate what the technology could do for the licensee: intrinsic value was not enough.

It is in this area that the whole issue of information disclosure before an agreement is signed can pose significant problems. Some companies lost potential sales because of an overriding concern about revealing too much information. The company with a well-rounded package of patents, know-how, trademark, etc., was in a stronger position to sell in the preagreement negotiation situation.

Most successful of all was the company that had undertaken wide-ranging market research within the licensee's market. The hand of the licensor was considerably strengthened in negotiations when able to talk with assurance about market prospects and likely profits resulting from use of the licensed technology.

ROYALTIES

The most common royalty payment tended to be that based on sales, while rates varied around a common rule-of-thumb of 5%, although the type of industry had a bearing on the rate struck. For example, pharmaceutical, chemical and engineering products (with low turnover) were able to attract far higher rates. Once again, though, licensors spoke of the danger of pushing for too high a rate and thereby encouraging disaffection in the licensee.

In some cases, Australian companies had reduced or even waived royalty payments in the initial stages of an agreement's operation in order to assist the licensee in establishing the new business. In so doing, these companies were looking for long-run profitability rather than short-term gains.

In addition to ongoing royalty payments, all companies desired a lump-sum payment at the outset. However, the licensor needed to be in a position of considerable strength to argue for both. About one-quarter of agreements in the Australian study included lump-sum payments. Of course, insistence on lump-

sum payments makes the negotiation process that much more difficult and can be seen by the potential licensee as a lack of faith and commitment on the licensor's side.

MARKETING AND NEGOTIATION COSTS

The Australian and Finnish evidence indicate that most companies, especially at the outset, tend to underestimate the cost and time scale involved in finding suitable licensees and negotiating acceptable agreements. Managerial time is an important implicit cost which is often not included in the assessment of the costs of developing a licensing strategy.

In the Finnish study, licensing executives were asked to provide details of their own and subordinates' activities concerning licensing and the time spent in each. The time spent was then costed at the appropriate salary level. Not only did these "time costs" constitute a major component of total licensing costs, but they meant that the initial licensing agreement at least was an unprofitable exercise. Only with additional agreements did licensing become truly profitable.

Over time some aspects of licensing costs tended to diminish as a result of the benefits of learning and experience. Many firms were able to standardize their licensing agreements and generally sell a similar package in different countries so that parts of the initial costs were not repeated. Despite these reductions, however, a growing awareness of the need to "get things right at the outset" led some of the Australian companies to actually increase the time and effort put into the selection and negotiation phases, with a consequent impact on costs.

In addition, maintenance costs were not inconsiderable: on average these represented about 29% of total foreign licensing costs for the Australian companies. Such aspects as back-up services, technological updating, audit of licensees, continuing market research and defense of industrial property were involved in this area. These maintenance costs demonstrated that there were continuing demands from licensing beyond the signing of the licensing agreement.

LONGER-RUN ISSUES

Despite the importance of care in the signing up of suitable licensees, successful licensing in the long run involves far more than this. The experience of the Australian companies studied, and results of recent Swedish research,⁸ point to the need to view licensing in terms of a long-run working relationship, involving continued licensor-licensee interaction at various levels.

The quality of the continuing licensor-licensee relationship emerges as a key variable in the success of licensing in the long run. Servicing of the licensee must be maintained even after the initial transfer of technology has been effected. If the licensee is to remain effective in his market he needs to be kept up-to-date with the latest technical and commercial developments by the licensor, perhaps with additional training or frequent visits, both ways. By developing

an efficient interaction, the licensee tends to become even more dependent on the licensor, and the licensor achieves a degree of control over the licensee's activities in a positive way.

At a strategic level, the long-run perspective should in fact condition the way licensing is initially approached. Licensing can sometimes lead on to other modes of operation in foreign markets, especially foreign investment. It therefore needs to be employed with a view to its potential contribution to these operational alternatives. For example, it may be prudent to insert an option-to-buy clause in the licensing agreement, where feasible. The licensor may later wish to buy into the licensee's operation.

In a sense, licensing can be seen as an experimental phase of foreign activities: testing the foreign market and the licensee as to the possibilities of deeper involvement. Likewise, the licensor should seek to ensure that his trademark is used by the licensee so that the goodwill is attached to the licensor's name. It may even be appropriate to continue market research within the foreign market after the licensing agreement has been signed in order to retain contact and awareness of the broader prospects.

In general, the success of licensing as an international marketing strategy in the longer term:

1. Requires effective interaction with the licensee at the least, and
2. May require its use in a bridging role, building toward other, deeper foreign market commitments.

CONCLUSION

In an overall sense, outward foreign licensing tends to take a secondary place among international marketing strategies for most companies. However, it has the potential for performing many useful roles in international market development: in some instances

it is clearly subsidiary or supportive, but in others it is far more important. To be effective, licensing needs to be approached in a far more positive and committed way than is often the case. This means, for example, a far more thorough marketing job, especially in regard to the assembly of a cohesive licensing package and in the process of finding and selecting suitable licensees. As well, in the long-run, considerable work needs to be put into the development of an efficient interaction with the licensee.

NOTE

The authors sought to reach the population of licensing companies, an unknown quantity. In the end, a response by 43, it is believed, fell well short of this objective. The method of contact was via mailed questionnaire, followed by interview. Interviews were possible in 67% of cases. In addition, a number of patent attorneys and lawyers involved in handling licensing agreements were interviewed to provide a check on the information generated from respondent companies. About 72% of the respondent companies had less than 1,000 employees, and 79% had less than six licensing agreements.

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