Smaller Businesses and Licensing

Recent data show licensing is not preserve of large firms; information exchange is needed

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(EDITOR'S NOTE: The following paper was recently made available to the LES U.S.A./Canada Small Business Committee. the surveys reported on had the direct or implicit support of state government entities in those areas. Further information is available from Dr. Townsend, who is an LES member.)

Once thought to be the exclusive preserve of large firms, licensing has been found to be not that at all. Recent data tend to confirm earlier conclusions that smaller businesses have considerable interest in licensing. The financial dimensions of that interest suggest that greater governmental assistance would not be amiss.

BACKGROUND

Understandably, the literature has not focused equally on the three forms of foreign trade — exporting (and importing), ownership abroad (or investment, if we may use the words interchangeably), and licensing. The first two have enjoyed the attention that activities of their dimension naturally generate. Licensing has run a poor third in the literature and has been accorded neither the scope nor the depth of coverage of the other two.

We can define licensing as a contract to use some intellectual property such as know-how and/or a patent. Although there is reference material on licensing and the subject has been given some literary scrutiny, most writing seems to fall into the "how-to" category. Journal articles extol the virtues of licensing and make occasional reference to some of its pitfalls, but any general examination of the literature makes one wonder about the hard facts that must pertain to the activity.

Legal journals and their antitrust references to licensing tend to suggest that only very large firms license. Any such premise is false, however, since smaller companies are far more innovative than large, and one prime source noted that over a decade, smaller companies were responsible for half the licensing activities reported.

The first hard data on licensing among smaller businesses was obtained by Maxwell and Townsend in a survey of licensing in the state of Kansas, where manufactured goods are a third of the state's $2 billion in exports. That data is presented in a paper "Licensors and Nonlicensors, I: A Survey of Kansas Exporters," presently being reviewed by the *Journal of International Business Studies.* We wondered who licensed what, and we asked if a firm had to be of a certain size or possess a certain sales figure to license.

We were interested in the extent of licensing as well as the amount of interest in licensing on the part of nonlicensors. We sought to know where exporters licensed, how they started, if licensing were profitable, what future plans licensees had, what nonlicensors perceived as obstacles to licensing, and so on. We found interesting data, heretofore unknown and rather surprising to us, which is shown below. Caution asserted itself and suggested that comparison elsewhere was in order. This paper presents that comparison, based on preliminary data.

We furnished a one-page copyrighted questionnaire, franked and addressed on the back, to cooperating agencies in Iowa, another Midwestern state and Texas. Respondents were required only to check responses to most of a series of short questions. Anonymity was assured. A cover letter provided the rationale for the questionnaire. A printed reminder postcard followed the questionnaire in an effort to increase response.

Mailing

In Kansas our mailing totalled 388 firms, all known exporters, the entire frame, not a sample. All were exporters. We received 142 returns, a 37% response rate. Since our mailing and our returns showed almost identical profiles of product SIC (Standard Industrial Classification) groups and size of firms, we considered our returns fairly representative of all the frame of exporters.

The Iowa mailing was to 1,018 firms, again the entire frame. This mailing, however, was extended to cover potential exporters as well as confirmed exporters. One-hundred-sixty-two returns provided a 16% response rate. The Kilmogorov-Smirnov 5% critical test on size of firms showed no significant difference in profile between the mailing and that of the returns. The profile of SIC numbers for returns differed significantly from the profile for the entire mailing. Since we can suggest no acceptable hypothesis to explain this seeming contradiction, we believe that the test result is one of the 5% of cases in which such tests show false significance through sampling probabilities. We feel it reasonable to consider Iowa returns as representative of the entire frame.

The Texas mailing to 912 exporters in three major cities, not a sample and not an entire frame, could not be profiled on a like basis and hence can be suspect. Given our experience in two other states, it does not seem unreason-

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able to believe that its 139 returns, a 15% response rate, could be taken as representative of all response rate, could be taken as representative of all exporters. We do not maintain that it is, however, and an appropriate caveat is therefore inserted into our conclusions.

Kansas licensors provided 15% of the returns and nonlicensors 85%, compared to Iowa's 10% and 90%, respectively. The percentage of licensors among Texas returns was much larger at 27% than either of the other two states. We had silently hypothesized a higher percentage of licensors in Texas, given the obvious attraction for licensees of more sophisticated technologies.

RESULTS

Licensors vs. Nonlicensors

In all three states firms with large annual sales produced proportionately more licensors than firms with small annual sales. Here all states were significant at the 5% level. Licensor returns were invariably largest in the largest sales group, and nonlicensors ranged downward from that. In like manner it was also found that in each state the number of employees bears heavily on the inclination to license, licensors reporting substantially larger numbers of employees than nonlicensors.

A congruity was found in the lack of appreciable difference in product SIC groups between licensors and nonlicensors. Reported classifications ranged from 20 through 39. Kansas and Texas were almost alike in that SIC 35 was most frequently reported. Iowa reported SIC 34 more frequently, with SIC 35 a very close second.

We are inclined to attribute that possible disparity to some unanticipated problems in Iowa returns, where an extra frame unknown to us was inserted. In Iowa we found no statistical dependence between licensing and exporting, nor did annual sales nor number of employees have any significant effect on the interest of potential exporters in licensing.

Iowa and Texas confirmed initial findings that licensing tends to be associated with firms of larger size and larger annual sales. Saying that is not to foster the prevelent belief that licensing is a privilege of great size. What it does say is that a firm of 20 employees is more likely to license than a firm of 10 employees.

Nonlicensor returns

We were aware that the cover letter might persuade a nonlicensor that licensing is an advantageous strategy. Chagrined, the respondent might well seek to justify his actions by answering affirmatively any question which justified not licensing. Having cemented his position in this way, the nonlicensor would tend to maintain that status rather than to consider licensing on its own merits. For that reason we asked what respondents wanted to accomplish before beginning licensing, a roundabout but more carefully considered way to determine obstacles to licensing that an array of excuses (I do not license because . . . check one of the above, etc.)

Kansas nonlicensors found the main obstacle to be a lack of information (30%), or "learn more about licensing." Similar reports were made from Iowa (58%) and Texas (33%). The next greatest obstacle to Kansas firms was to "expand domestic market" (27%), just as it was to Iowa firms (24%). Thereafter were "make more contacts that could lead to licensing" (Kansas 12%, Iowa 17%), and "expand size or assets of firm" (Kansas 8%, Iowa 15%). Dissimilar Texas ranked contact (23%) over the expansion of either market (15%) or firm size (8%).

The size of a firm's domestic market or of the firm itself does not decide its ability to license. Largeness is not a prerequisite to licensing. Thus, perceptions of market or firm size as obstacles to licensing should be taken as a need for (more) information. "Making more contacts" also indicates an information need. In consequence, we viewed the Texas returns as generally showing a lesser need for elementary licensing information than either the Kansas or Iowa returns but a greater need for more advanced information.

Open-Ended Questions

We reached no firm conclusions about the returns (highest in Kansas with 10%) which responded variously to the entry "Overcome something standing in the way at present (Please specify)." The sixth, open-ended as "Other," invited write-in answers such as product unsuitable, no technology to license, not interested, etc.

There were more general negatives in Texas (30%) than in either Kansas (20%) or Iowa (16%). If, as we believe, Texas firms do offer more sophisticated technologies and perhaps have greater resources, the greater negative response in Texas may be attributed to the assertive belief that licensing is not the preferred route to international trade for firms with more sophisticated technologies and much greater resources.

This hypothesis and the one previous, that Texas respondents appeared to need less information, appears confirmed by the further specifications of information needs. Iowa (54%) and Kansas (29%) led Texas nonlicensors (28%) in expressing a desire for a seminar on licensing. Likewise, more Iowans and Kansans than Texans wanted to meet with an active licensor (46% and 22% vs. 21%). More Iowa (65%) firms expected to be licensing by 1985 or though it "could go either way" than did Kansas (55%) or Texas firms (52%). Whatever the differences, we could see a potential for international licensing among smaller businesses that exceeded anything reported heretofore.

The dimensions of that potential are large. Earlier we had reasoned if just half of the nonlicensors in Kansas realized the average potential licensing income ($183,000), Kansas could visualize some $30 million in licensing income. That figure seemed reasonable, reflecting as it did an approximate 5% of the value of manufactured exports. Although Iowa returns included some from identified nonexporters, an interest in licensing was not found to be significant as to whether a firm exports.

Larger numbers of firms with higher annual sales indicated Iowa's licensing potential to be at least $100 million, accepting the premise that potential exporters license as readily as actual exporters when both presently are nonlicensors. A figure in Texas, drawn principally from the Dallas-Fort Worth area, is some $66 million, an amount not to be taken as conclusive since it not only encompasses fewer firms but reflects the fact that far more firms in Texas already licensed.

Licensor returns

Most licensors (up to 80%) in all states had been licensing for five years or more. Roughly 1 in 3 sought the initial licensing opportunity, but more (up to 60%) were contacted by someone who wished to license. Eighty percent reported annual licensing sales as "some, under 10%" or less, generally confirming that we could use a median 5% against annual sales in calculating potential licensing revenues.

Estimates of present licensing income averaged \$340,000 in Kansas, \$400,000 in Texas, and \$600,000 in Iowa. 1990's average anticipated licensing income was \$750,000 for Kansas, with a maximum of \$3 million; \$10.5 million with a maximum of \$20 million for Texas; and \$400,000 with a \$1 million maximum for Iowa. The cornbelt states obviously share a more conservative view of the future.

Where licensors conduct business has no common pattern, nor do licensing incomes coincide with geographical preferences. Kansas licensors exlcude only the Caribbean. Iowans also exclude the Mid East and South Asia.

Texans exclude only Central America. Kansas firms favor licensing in North and South America but realize their greatest returns from the Far East, with an estimated maximum licensing income of \$600,000.

Iowa firms prefer the Far East and then Australia, where incomes are the greatest and range up to \$4.8 million. Texas is inclined first toward Western Europe, then the Far East, and finally equally toward North America and Eastern Europe. Whereas Western Europe overall is the most lucrative area for Texas, the maximum income figure of \$1.2 million is found in Eastern Europe.

Kansas licensors projected 19 expansions into more areas by 1990, compared to 32 for Iowa and 45 for Texas. We have yet to draw any firm conclusions from these data, and we are puzzled by the disparity noted in the estimated average number of employees per licensor firm — 540 in Texas, 415 in Kansas and 236 in Iowa.

CONCLUSIONS

Iowa and Texas data tend to confirm our earlier views, although further refinement with additional data still seems necessary. Exporters carry on significant and profitable licensing activity, and in nonlicensors of whatever persuasion there is the potential for even greater income. This potential is accompanied by an avowed interest in licensing. That interest carries with it a demand for information.

Meeting that demand is not complicated, but there is no place to which a nonlicensor can readily turn for information. Some basic information about licensing, probably via seminar, is clearly needed. Experienced licensors should be made available for workshops. Popular misconceptions about licensing, such as the mistaken association with large size or the fancied relationship between domestic market size and the ability to license, need to be countered.

The need for education is unmistakable and is underlined by our licensors: Those who initiated licensing were equipped with knowledge, and those who licensed after they were solicited might well have adopted an active stance had they had the knowledge. Certainly those planning to expand licensing areas will need at least licensor information.

We believe that the informational burden should rest with the Departments of Economic Development (or equivalent) of the various states. These already have an information net which only needs to be fleshed out in a different direction. The basics and the niceties of licensing can be obtained from those who license for a living — corporate directors of licensing, licensing attorneys, and active licensors.

A vast reservoir of national expertise exists in the form of the Licensing Executives Society and needs only to be tapped. If states with their trade fairs, trade exhibits abroad, and trade missions abroad will pursue licensing as avidly as they pursue exports, licensor information will certainly be forthcoming. The good offices of the Department of Commerce should not be overlooked, but great expectations here would be unwise. The effort devoted there to licensing is slim and in these times might disappear completely.

In brief, the financial potential of enhanced international licensing by smaller businesses and the degree of interest which accompanies that potential urge an information system dedicated to licensing.