Update on Licensing in India

Review by government official of formal restrictions and practical considerations in implementing them

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India has made significant advances in development of industry and industrial technology during the past three decades. From a narrow base of traditional industries such as cotton and jute textiles, plantation, light engineering and consumer goods industries established prior to the achievement of independence in 1947, a stage of near self-sufficiency has been attained in many basic, heavy and consumer goods industries.

Admittedly, India does not have an open-door policy which welcomes all foreign technology. Nevertheless, the country's policy is flexible and pragmatic. With India's present technological and industrial capabilities, she now seeks collaboration and importation of technology in sophisticated fields, in areas where critical production gaps exist, and in export-oriented industry. There have been over 7,200 collaboration agreements, mainly with European, American and Japanese companies, during 1957-82. Today, more than 1,200 foreign companies are operating in India as joint ventures or through licensing arrangements with Indian companies. Foreign investment is of the order of about $3 billion (U.S.).

FOREIGN PORTFOLIO INVESTMENTS

While foreign investment is permitted generally only if it comes in a package with a sophisticated technology or is intended for an export-oriented project, two exceptions have been made in recent years. First, equity investments up to 40% are permitted freely, in priority and export sectors, from the oil exporting developing countries. Second, liberalized facilities have been provided for nonresident Indians interested in making portfolio investments in India.

Foreign investment is permitted in cases where there is a need for continuous association of the foreign companies. But to encourage the Indian company to take the lead and initiative—for the manufacture of the item under the guidance of the collaborator as well as for material improvements in the product—the foreign investment is generally limited to 40% of equity. However, in specific cases, where the technology is highly sophisticated, there are limited sources of technology, or the project is primarily export-oriented, higher investment by the foreign collaborator even to the extent of 74% can be permitted. For hundred percent export schemes, foreign investment up to 100% can be considered.

GUIDELINES

To assist entrepreneurs, guidelines have been laid down. These specify:

1. They should, to the fullest extent possible, explore alternative sources of technology, evaluate them from a technoeconomic point of view and furnish the reasons for preferring the particular technology and the source of imports.
2. The Indian party should be free to sub-license the technical know-how/product design/engineering design under the agreement to another Indian party on terms to be mutually agreed to by all the parties concerned, including the foreign collaborator and subject to the approval of the government.
3. The royalty wherever allowed will be calculated on the basis of the net ex-factory sale price on the product exclusive of excise duties, minus the cost of the imported components, irrespective of the source of procurement including ocean freight, insurance, custom duties, etc.
4. There should be no requirement for the payment of a minimum guaranteed royalty regardless of the quantum and value of production.
5. Clauses which in any manner bind the Indian party with regard to the procurement of capital goods, components, spares, raw materials, pricing policy, selling arrangements, etc. should be avoided.
6. To the fullest extent possible, there should be no restrictions on free export to all countries.
7. The use of foreign brand names will not be permitted for internal sales.
8. The government does not favor requests for extension to the duration of collaboration agreements. All efforts should therefore be made by the Indian party to assimilate the technology within the initial duration of the agreement.
9. Suitable provision should be made to train Indians in the fields of production and management. There should also be adequate arrangements for research and development engineering design, training of technological personnel and other measures for the absorption, adaptation and development of the imported technology.
10. Consultancy services required to execute the project should be obtained from Indian consultancy firms. If foreign consultancy is also considered necessary, an Indian consultancy firm should be the prime consultant.
11. If the proposed item of manufacture is covered

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by a patent in India, it should be insured that the payment of royalty/lump-sum payment for the duration of the agreement would also constitute compensation for the use of patent rights till the expiration of the patent and that the Indian party would have the freedom to produce the item, even after the expiration of the collaboration agreement without additional payments.

12. Collaboration agreement will be subject to Indian laws.

13. It is desirable that approved/registered Indian engineering, design and consultancy organizations should be associated right from the start in any evaluation, selection and negotiation conducted for the purchase of overseas technology.

14. It is desirable that inquiries to overseas parties should be made on the basis of separate quotations for technology (license fees, know-how, royalty, R&D assistance, etc.) and design and consultancy services not available in the country.

Application

On the basis of these guidelines, the entrepreneurs negotiate with prospective foreign collaborators for the import of know-how including process know-how, basic and detailed engineering services, consultancy services, drawings and designs, etc. and submit an application with all relevant details for consideration by the government.

The proposal is scrutinized with reference to the indigenous availability of the proposed technology, its level and suitability, the need and priority of the proposed technology, the competence of the collaborator for providing the know-how, engineering services, other guidance in implementing the project, the terms of collaboration including payment involved, the services to be rendered by the collaborator and also the guarantees to be fulfilled in terms of materials and services inputs, production and quality, etc.

After the terms of the approval are communicated to the entrepreneur, he executes the agreement and submits copies to the relevant production Ministry, which scrutinizes the agreement and asks the entrepreneur to revise clauses that do not conform to the government's policy. It is only after the agreement is taken on record that the Department of Economic Affairs authorizes the Reserve Bank of India to permit the remittances.

NUMBERS

Out of a total of 7,211 foreign collaborations approved in 1957-82, 1,640 involved companies in U.K.; U.S. and German (FRG) companies with 1,416 and 1,282 agreements were the second and third highest, respectively. Only 639 collaborations involved foreign equity participation.

Duration of Agreements

Ordinarily, approvals are given for foreign collaborations for a period of eight years. This is broadly on the assumption that the gestation period of a project is about three years. Excluding this period, the foreign collaborator would be able to get royalty for a period of five years. In deserving cases, a duration of up to 10 years is approved. Some 53 cases involving royalty payments for more than five years were approved in 1980 and 1981. In 1982, there were 29 cases in which royalty payments for more than five years were approved. A few agreements have been approved with a duration exceeding 10 years, also. The duration of the collaboration is not significant where equity participation alone is involved. A foreign collaborator can hold the equity without a time limit. Similarly, duration is not of much importance where a one-time, lump-sum payment for know-how is involved.

PAYMENTS

In regard to fees payable under collaboration arrangements, the approach is to approve lump-sum payments and royalty separately where necessary. The royalty rate is ordinarily up to 5% for domestic sales. Rates up to 7% are also considered for exports. Where, however, lump-sum and royalty are allowed together, the guideline is to restrict the total outgo to 8% of the production for the base period of five years. A higher royalty and a longer duration can be considered, and have been allowed in special cases. In 1980 and 1981, royalty exceeding 5% was approved in 28 such cases. In 1982, nine cases were approved where royalty was more than 5%.

Remittances

Free remittances of royalty, technical fees, interest and dividends on capital invested in India are allowed. Similarly, capital investment can be repatriated, with capital appreciation, freely at any time after payment of taxes. Lump-sum payments, royalty and dividends are subject to tax at the rate of 20%, 40% and 25%, respectively. With respect to lump-sum payments, the parties can agree that the taxes would be borne by the Indian party. In 1980 and 1981, 60 such approvals were issued. Remittances on account of foreign collaborations have increased from Rs.807 million in 1971-72 to Rs.1640 million in 1978-79, an increase of over 100%.

EXPERIENCE

Implementation of the guidelines has not caused serious difficulty. Sometimes the guidelines strengthen the bargaining power of licensees. Undesirable and restrictive provisions have been avoided. Limiting the duration of agreement to five years (with exceptions in a few special cases involving highly sophisticated technology) has had a salutary effect in forcing licensee entrepreneurs to make maximum effort to absorb the imported technology effectively as rapidly as possible.

Royalty payments are usually adjustable within the limits prescribed, though in some cases these have been accompanied by fairly high initial lump-sum fees. Avoidance of restrictive export provisions has caused some problems which have usually been satisfactorily resolved. Special sub-licensing provisions initially provoked some controversy, but most foreign licensors now accept that the government's insistence is primarily to insure that similar technology shall not be imported through numerous foreign technology agreements, all at considerable costs. Repetitive purchases of technology receive greater attention, but it is still too early to evaluate the potential benefits of such a clause vis-a-vis the commercial obstacles in enforcing it.

UNPACKAGING OF TECHNOLOGY

High priority is increasingly assigned to unpackaging of imported technology in order to insure that only the essential constituents of a technology package are imported. It is sought to insure that indigenous capabilities are fully utilized for gradual elimination of dependence on imported technology. The national registry which is in the process of being set up is expected to establish a data base regarding these aspects of import of technology among others and to appropriately advise the government.

Horizontal Transfer of Technology

Closely allied to the need to unpackage imported technology is the desire to promote horizontal transfer of technology from one company to another. Although almost all collaboration agreements contain a clause permitting technology transfer from the licensee company to another Indian company, it has not been found practicable or feasible to make use of it for promoting horizontal transfer of technology on a major scale.

The government has, however, tried, quite successfully in a few cases to see that the same foreign collaborator supplies technology to more than one party on reasonable terms. This has to some extent taken care of the problems generated by repetitive import of technology. Technology for automobile tires, dry batteries and storage batteries has been imported on this basis.

THE BARGAINING POWER OF THE LICENSEE

The capabilities of the buyer of technology depend not only on his technological, commercial and managerial abilities in a narrow sense, but also on the information he possesses about technology markets. The less the information, the greater the extent of market imperfection he confronts, and the greater the chance of his paying monopolistic prices.

The weak information and bargaining position of Indian buyers of technology has been improved by strengthening of the national institutions relating to research, development and dissemination of information regarding technology. This has been further strengthened by regional and international cooperation, particularly through the activities of UNCTAD and UNIDO.

The conclusions drawn from a case study of acquisition and assimilation of technology by Hindustan Photo Films, Ootacamund (UNIDO Development and Transfer of Technology Series No. 14), are relevant:

1. In an oligopolistic industry, dominated by a few giants from developed countries, small units from developing countries have little bargaining strength in negotiations.

2. In industries where the competitive edge comes from technology, research and development entail huge expenditure, which only a few can afford. This in turn perpetuates the oligopoly. Smaller firms can perform meaningful research and development only with the support of the government.

3. Efficient management is an important requirement at all stages—search for technology, negotiations, installation of the project or its subsequent operations.

RESTRICTIVE PRACTICES

India's policy is based on the elimination of restrictive practices from technology transfer agreements. Yet, actual implementation of this policy is tempered by the enlightened self-interest of the country. Some concessions have, therefore, been given in some individual agreements keeping in view the technology involved and the need to boost exports.

Flexibility of Regulation

Experience in India shows that to the extent that unacceptable restrictions have been defined and exemptions are not automatic, but subject to authorization by the approving authority, a licensor will be more pressed to avoid the inclusion of restrictive clauses.

Adaptation of Technology

The presence of a very large "small-scale" sector in India (having more than half a million units) provides an opportunity for using labor-intensive techniques and wide-range subcontracting by large-scale units. The government has embarked upon a program to foster the growth of small-scale industries by providing them with financial and marketing assistance and to help them in finding a technology or creating efficient technologies. However, the absence of R&D facilities in the small-scale units acts as a serious handicap in this regard. With their size and financial resources they just cannot afford a R&D setup. An attempt has been made to get over this by providing institutional R&D facilities for supporting such technology development programs.

In the large-scale, modern industrial sector, where the scope for major alterations in technology is more limited, the aims of government policies are twofold:

1. To maximize the use of labor consistent with efficient production.

2. To adapt imported techniques as much as possible to local materials, skills and needs.

Exporting Units

A new factor which is emerging is the shortage of foreign exchange. This necessitates setting up industrial units primarily for export. In the past, exports from India consisted mainly of traditional industrial products such as textiles, jute, etc. Now, with the growing demand for foreign exchange, there are efforts to diversify exports. Exports of nontraditional industrial goods such as engineering items, sophisticated industrial machinery items, electrical equipment, etc. require production of these products at internationally competitive rates. This warrants setting up projects in sizes which are viable from the point of view of the world market. The need for such projects has impelled the government of India to relax restrictions pertaining to import of capital goods, technology, and the restrictive practices associated with it insofar as the export-oriented units are concerned.

Contractual Aspects

Apart from the legal aspects of international licensing agreements, there are some important commercial aspects involved, a few of which are discussed below.

India, and for that matter many developing countries, regards technology transfer as a matter that extends beyond the private interest of the licensee. It feels that it should serve the public interest; incoming technology will spread to generate new production and new industries, and develop new technologies.

Exclusivity

In India, there are no specific guidelines on the subject and it is held that exclusivity is a matter of negotiation between the two parties. However, the government insists on the inclusion of a sub-licensing clause which implies that the seller of technology is obligated to permit the transfer of know-how to other Indian parties. This obligation also implies that the first importer of technology cannot insist on keeping it exclusive. The extent to which the sub-licensing clause will affect exclusivity is, however, within the control of the original seller and buyer of technology since, as per standard clause of the licensing agreement, a sub-licensing can take place only on terms mutually agreed upon by all the parties.

EXPORT RESTRICTIONS

Perhaps the most common of the restrictive practices in technology agreements are those that prevent the technology purchaser from exporting the products covered by the agreement.

There is a view in India that the removal of export restrictive clauses may not for obvious reasons, lead to an expansion of exports; it is, therefore, considered better to trade off a relaxation on this account against higher royalties and fees. It is the recognition of such views that have lead the Indian Government to allow permissible export restrictions in some technology contracts.

Tied Purchases

Clauses requiring the technology purchaser to acquire machinery, equipment, materials, and components and services from his licensor or from sources determined by him are also common, but should be avoided as far as possible.

Limitations on the use and Diffusion of Information and Technology Transferred

The most common restrictions are:

1. Clauses preventing the use of know-how and technical information and even the manufacture of products at the expiration of the agreement.
2. Clauses obliging the licensee not to disclose information to third parties after the life of the agreement.

These two clauses are objectionable and should be avoided. In India, these are generally not permitted.

Applicable Laws and Settlement of Disputes

In keeping with the existing thinking on the acquisition of foreign technology, the Government of India insists that the governing law will be that of India and that it should be used in the settlement of disputes. However, exceptions have been made in a few cases, keeping in view the status of the new technology to be imported, and permission has been given to subject the agreement to the laws of U.K. or U.S.A.