

LICENSING OF INTELLECTUAL PROPERTY ASSETS; ADVANTAGES AND DISADVANTAGES

1. One of the key challenges for businesses today is to remain profitable in a slowing but increasingly global economy. They are under pressure to create new opportunities and new revenue streams from existing assets. Often businesses need new or original innovations and/or creative expressions to create new products, enhance existing products, and explore new markets. These crucial innovations and expressions, which are increasingly valuable economic assets in today's economy, need to be protected by using the tools of the intellectual property system before revealing or sharing them. Only then can a business leverage these economic assets as intellectual property (IP) assets for gaining and retaining competitive advantage.

2. There are four main options open to a business to use IP assets to gain and retain its competitive edge; it can: (1) Do everything in-house to create the needed IP in a stand alone mode; (2) create a spin-off or a start-up business to nurture its IP in a focused manner; (3) merge with or acquire another business which has complementary IP; (4) share or team up with others to share IP assets for mutually beneficial results.

3. Most businesses and entrepreneurs choose to share or team up with others for mutual benefit. This can be done in various ways such as outsourcing, joint ventures, consultancy, arms-length licensing, or entering into strategic alliances for one or more business purposes. Businesses enter into these types of partnership arrangements as part of their endeavor to do everything legally and ethically possible to improve their bottom line and sustain or increase profits. Many of these situations require formal contractual arrangements that involve "licensing in" or "licensing out" of one or more types of IP. Often businesses do both; engaging in "cross licensing", where both parties license IP to each other.

4. While the mechanism of licensing provides enterprises with a wide variety of possibilities for improving their market position, it has its pitfalls and risks. Therefore, from a business perspective, it is important to weigh the advantages of licensing against its disadvantages in comparison with other alternatives for commercializing products and services. This article analyzes the main advantages and disadvantages of licensing, but primarily in the context of technology licensing, which generally cover patents, patentable inventions, trade secrets, know-how, confidential information, copyrights in technical material, and layout designs of semiconductors; although, at times, trademark licensing may also be included.

What is a License?

5. The word license simply means permission – one person grants permission to another to do something. A license agreement is a formal, preferably written, document recording the circumstances under which a promise shall be legally binding on the person making it. There are at least two essential parties: the licensor, the party who owns the IP and is agreeing to let it be used, and the licensee, the party who receives rights to use the IP in exchange for payment. Therefore, a license agreement is a partnership between an IP owner (licensor) and another who is authorized to use such rights (licensee) under certain conditions, usually for a monetary compensation in the form of a flat fee or running royalty that is often a percentage or share of the revenues gained from use of the invention. Simply put, a license grants the licensee rights in property without transferring ownership of the property.

6. For a license of IP to be effective, four basic conditions must be met:
 - the licensor must have ownership of relevant IP or authority from the owner to grant a license;
 - the IP must be protected by law or at least eligible for protection;
 - the license must specify what rights with respect to IP it grants to the licensee; and
 - the payment or other economic or IP assets to be given in exchange for the license must be clearly stated.

7. There are many different types of IP licenses such as technology licenses, publishing and entertainment licenses, and trademark and merchandising licenses.

ADVANTAGES OF LICENSING FOR THE LICENSOR

8. Many companies have a portfolio of patents, utility models, proprietary know-how, trademarks, and other IP assets that can be licensed. There are many reasons for a company to license out some or all of its IP rights in some or all of its IP assets in such a portfolio.
 - A company that owns rights in a patent, know-how, or other IP assets, but cannot or does not want to be involved in the manufacturing of products, could benefit from licensing out of such IP assets by relying on the better manufacturing capacity, wider distribution outlets, greater local knowledge and management expertise of another company (the licensee).
 - Licensing out could also help a company to commercialize its IP or expand its current operations into new markets more effectively and with greater ease than on its own. If the licensor's trademark is also licensed for use in the market along with other IP, then the licensee's marketing efforts essentially benefit the licensor's reputation and goodwill. In fact, a trademark license agreement is the heart of any merchandising program, because it delineates the relationship between the owner of a trademark (the licensor) and the producer of the goods or services to which the mark is to be affixed (the licensee). While the licensor is not involved in the manufacturing of the products, he must ensure that the licensee conforms to all conditions concerning maintenance of the quality of the product in relation to which the licensed trademark is used.
 - Similarly, licensors with experience in the field of research and product development may find it more efficient to license out new products rather than take up production themselves. A company that owns IP rights in a technology that it cannot afford to manufacture could consider licensing out the IP rights over that technology for manufacturing and selling products embodying the technology in a specific manner for a specific time and region. Thus, the licensor continues to have the IP rights over the technology and has only given a defined right to the use of that technology. An example of such a business model is a “fables semiconductor” company, where the company uses all its resources essentially for doing research, design and development work.

- Licensing out may be used to gain access to new markets, which are otherwise inaccessible. By granting the licensee the right to market and distribute the product, the licensor can penetrate markets it could not otherwise hope to serve. The licensee may agree to make all the adaptations required for entering a foreign market, such as translation of labels and instructions; modification of goods so as to conform with local laws and regulations; and adjustments in marketing. Normally, the licensee will be fully responsible for local manufacture, localization, logistics and distribution.

9. A license agreement may also provide:

- A useful tool to reach a market for which the licensor's own production or marketing resources are insufficient. It is sometimes better to find a local partner than to set up a new establishment in a foreign country so as to speed up the entry into a new market, ahead of competitors.
- A means for the licensor to gain rights in improvements, know how, and related products that will be developed by the licensee during the term of the contract; however this cannot always be demanded, as a matter of right, by the licensor.
- A means for turning an infringer or competitor into an ally or partner by avoiding or settling an IP litigation, which may have an uncertain outcome or may be costly and/or time consuming.
- A solution when a product sells best only when it is incorporated or sold for use with another product; or if a number of IP assets, for example patents, owned by different businesses, are required simultaneously for efficient manufacturing or servicing of a product.
- Some degree of control over innovations and also over the direction of evolution of technologies where interoperability is important. This is often the reason why many companies choose to work closely in the setting of technical standards by national and international standards setting bodies. The licensing of patents becomes obligatory when patented technology forms part of an industry standard.
- Licensing out of IP that a business owns but does not need in its own business can be an excellent source of additional revenue that goes straight to improving the company's bottom line. This is one of the principal reasons for performing a periodical audit of a company's IP portfolio. A firm may have the resources to exploit its IP through only one product, but the IP may be applicable to other related or unrelated fields of use, products and/or services.
- Last but not the least, a license agreement allows the licensor to retain ownership of the IP and at the same time to receive royalty income from it, in addition to the income from its own exploitation of it in products and services that it sells.

DISADVANTAGES OF LICENSING FOR THE LICENSOR

10. The risks of licensing include:

- The licensor's own investment can sometimes generate better profits than operating only or through a license agreement.
- A licensee can become the licensor's competitor. The licensee may "cannibalize" sales of the licensor, causing the latter to gain less from royalties than it loses from sales lost to its new competitor. The licensee may be more effective or get to the market faster than the licensor because it may have fewer development costs or may be more efficient.
- The licensee may suddenly ask for contributions, such as technical assistance, instruction of personnel, additional technical data, etc. All this may simply prove to be too expensive for the licensor. It is important that the license agreement clearly define the rights and responsibilities of the parties, so that any future disagreements can be quickly and efficiently resolved.
- The licensor depends on the skills, abilities and resources of the licensee as a source of revenue. This dependence is even greater in an exclusive license where an ineffective licensee can mean no royalty revenues to the licensor. Contractual provisions for minimum royalties and other terms can guard against this, but it is still a concern.
- Specific consideration should be made when licensing out the right to use a trademark. The principle function of a trademark is to distinguish the goods and services of one enterprise from that of another, thereby often identifying the source and making an implied reference to quality and reputation. This function is to some extent prejudiced if the trademark owner licenses another enterprise to use the trademark through a trademark license agreement. Therefore, the trademark owner is well advised, often required by law, to contractually ensure that the quality standards are maintained so that the consumer is not deceived.
- A license agreement can be disadvantageous when the product or technology is not clearly defined or is not complete. In such a case, the licensor may be expected to continue development work at great expense to satisfy the licensee.

ADVANTAGES OF LICENSING FOR THE LICENSEE

11. There are various ways in which a license agreement can give the licensor and licensee the possibility of increasing revenues and profits and enlarging market share:

- There is often a rush to reach the market with new products. A license agreement that gives access to technologies and brands which are already established or readily-available can make it possible for an enterprise to reach it on time.
- The licensee will benefit from superior technology to produce better quality products, or established trademarks to better market his products.

- Small companies may not have the resources to conduct research and development that is necessary to provide new or superior products. A license agreement can give an enterprise access to technical advances, which would otherwise be difficult for it to access.
- A license can also be necessary for the maintenance and development of a market position that is already well established but is threatened by a new design or new production methods. The costs entailed in order to follow events and trends can become daunting and quick access to a new technology through a license agreement may be the best way to overcome this problem. However, this can increase the product cost and affect the market price in unpredictable ways.
- There may also be licensing in opportunities, which, when paired with the company's current technology portfolio, can create new products, services and market opportunities.

DISADVANTAGES OF LICENSING FOR THE LICENSEE

- An IP license may add a layer of expense to a product that is not supported by the market for that product. It is fine to add new technology, but only if it comes at a cost that the market will bear in terms of the price that can be charged. Multiple technologies added to a product can result in a technology rich product that is too expensive to bring to market;
- Licensing in technology may create a technological dependence on external technology and/or limit the possibilities for growth and expansion (e.g. into new markets) of the licensee according to the provisions stipulated in the licensing agreement;
- The licensee may have made a financial commitment for a technology that is not "ready" to be commercially exploited, or that must be modified to meet the licensee's business need;

12. Licensing of IP may run into problems for both licensor and licensee if government regulatory agencies consider it to be anti-competitive or collusive in nature. And of course, licenses are complex and, if all material terms are not carefully studied and reviewed by legal counsel, licenses can be damaging. However, with advance preparation and legal counsel, IP licenses are an essential business tool that can have benefits for both parties.

CONCLUSION

13. Merits of licensing intellectual property rights are convincing and licensing should be a vital component of the business strategy of all companies. Still, it is important to consider the very preliminary question as to whether licensing is the right strategy to adopt or not. Even though there is much to be gained from a license agreement by both parties involved, the risks with it cannot be neglected. A license agreement can be seen as an instrument for the distribution of risks between the licensor and the licensee.

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