

Product Licensing

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Licensing involves obtaining permission from a company (licensor) to manufacture and sell one or more of its products within a defined market area. The company that obtains these rights (the licensee) usually agrees to pay a royalty fee to the original owner.

Why would a company look for products it can produce under license?

In today's world of rapid technological change, new technologies are the key to economic growth. Today, many products have very short life cycles and are readily replaced in the marketplace by new technology. If a company wants to survive, it needs to continually add new products to replace declining products.

Also, a company may want to grow and diversify by expanding its product line to take up excess manufacturing or marketing capacity, level out seasonal highs and lows, or simply add to profitability with a proven product. Companies may not have the internal skills, time, or money to develop their own new products, so obtaining a proven product quickly through licensing may be very attractive.

What are the advantages of licensing?

You get access to the experience and know-how of the company that developed the product. This company may be much larger than yours, with development capabilities that you cannot afford.

You get to break into a new market with this new product, but with the benefit of the experience gained in another market.

It makes competition easier if you're a small company with limited resources.

You minimize your costs and risks:

- it costs less than buying an entire company;
- you don't pay for expensive and time consuming research and development;
- you don't pay development costs up front; you pay royalties when you start making sales; and
- you won't have large losses if the product doesn't become successful in your market area.

What are the disadvantages of licensing?

The license agreement is normally for a considerable period of time and there may be an annual minimum royalty required.

New technology may become available making the licensed opportunity obsolete.

The agreement may force the licensee to accept restrictions on its marketing.

The licensee may lose the capacity to develop its own technology internally.

What does a typical licensing agreement cover?

Subject Matter of the Agreement—may be (1) patent, (2) copyright, (3) trademark, (4) industrial design, (5) trade secret (know-how, technology, experience, etc.)

Granting of Rights—defines what licensor is transferring to licensee

Licensor's Obligation—sets out how transfer is to take place in terms of assistance, support, training and co-operation

Licensee's Obligation—sets out financial requirements, guarantees of licensee, secrecy, costs, etc.

License Fee—fee paid to licensor on signing agreement

Royalty—ongoing share of proceeds paid to licensor for the rights. May be a lump sum, or percentage of proceeds or amount per unit sold, etc., usually a minimum royalty is required.

Term—how long the agreement is to last

Designated Area and Exclusivity—define manufacturing and marketing area of license

Termination—describes rights of both licensor and licensee to terminate agreement

Guarantees—licensor will normally not guarantee the results of using the rights granted. The licensee may be required to provide warranties, public liabilities, etc.

How does a company search and find products that may be available for licensing?

Steps to take:

Prepare a profile of your company

- name of contact person and title;
- reason (i.e. diversification, complement present products, efficiency);
- facilities for manufacturing/marketing;
- present products/services;
- marketing area presently serviced;
- sales volume;

- description of search requirements (i.e. product/process, etc.);
- markets desired for licensed opportunity with special note if different from markets normally being serviced; and
- exclusivity, protection requirements desired.

Search sources

There are a large number of sources that may be used in searching for products/processes, etc., under license that can be contacted:

- licensing consultants with clients offering opportunities;
- international licensing exhibitions;
- publications offering licensing opportunities by subscription;
- Canadian consulates in foreign countries;
- provincial trade offices in foreign countries;
- federal/provincial/state agencies in foreign countries;
- trade directories of manufacturers in foreign countries;
- Chambers of Commerce in foreign countries;
- banks with international branches;
- universities with research facilities;
- research and development companies;
- trade associations;
- trade publications; and
- import replacement.

Providing a profile of your company and its search requirements to any or all of the foregoing would result in you receiving names and addresses of prospective licensors for your direct contact. When contacting prospective licensors, you should enclose your company profile and request assurance that they are prepared to license.

It would be important to ask as well if they have licensed others, and if so, request that they provide the names, addresses, etc., and permission to contact.

Determine feasibility of opportunities found

- Licensor should provide licensee sufficient information to determine feasibility of the opportunity in the proposed area.
- Licensor should provide: product brochure, bill of materials and specifications, labour and time, how long marketed and growth, other licensees (where located and right to contact), benefits over competition, estimated total market, warranties, marketing, training provided, financial terms, etc.
- Prospective licensee does a feasibility study based on his area and the market he will have.
- Licensor may require the potential licensee to sign a Confidential Disclosure Agreement before providing a full package of information. If negotiation is lengthy the licensor may request a letter of intent and some partial payment for keeping the opportunity available for a period of time until licensee determines feasibility.
- Negotiating a license agreement
- Usually a licensing agreement will be provided by the licensor once it has established the licensee is serious with regard to the opportunity. The terms of the agreement are negotiable. Using the information obtained from your feasibility study and considering the financial requirements of the licensing agreement, you should be positive the licensing opportunity will provide an acceptable profit and return. Minimum annual royalties should be carefully studied to ensure they can be reasonably met.

- A license opportunity from an inventor, if one is the first licensee should be very reasonable, as the inventor is looking for credibility, which will be established by the first licensee.

What is the procedure if you or your company has a product to license to others?

You've invented something, it has received a positive evaluation, and has a patent pending. Or maybe your company doesn't have the capital or expertise to manufacture and market its product to a global market. Inventors often find it is better to license their technology rather than try to manufacture and market it themselves. Similarly, licensing may be the only practical way for a company to maximize the potential for its existing products.

Licensing companies in other areas of Canada or in other countries expands your potential while minimizing your risk by using companies that have the necessary manufacturing capability and marketing networks already in place.

Licensing can be done by a single company, however if this is not possible, an alternative is to consider a multi-prong approach to your licensing with several component parts being done by different manufactures, final assembly by another, and possibly distribution by yet another. This may divide up the risk if the magnitude of the project is perceived too large by any one licensee.

- Licensing out of a product, process, technology, etc., will follow much the same procedures as licensing in or searching for opportunities. You will need to prepare a formal presentation to explain the functionality and marketability of the concept containing the following:
 - letter of introduction;
 - pictures of the product;
 - product description;
 - manufacturing information;
 - product variations;
 - product benefits;
 - market research results;
 - objectives for your project; and
 - pricing breakdown.

Your presentation should be sent to the same sources listed previously in this handout (see the previous heading Search sources), and you would request that names and addresses of likely licensees be provided to you.

As a licensor, you will be expected to provide the legal agreement that will ensure both parties are fully aware of their respective rights and responsibilities, over and above simply determining royalties. Good legal advice is usually required to negotiate such things as:

- exclusive rights to the invention;
- territories allocated;
- what exactly is being licensed (technology transfer, engineering specs, use of trademark);
- who pays for obtaining patents in licensed territories;
- are future improvements to the product included under the license;
- what resources are available if the licensee is late on payments;
- can either party transfer rights under the agreement to another party;
- who bears liability resulting from injuries sustained from the product; and
- what are termination provisions of the agreement.

Determining an acceptable royalty rate for a product is difficult, as there is no quick-fix percentage that can be applied as a general measure. Although rates ranging from 3% to 8% of net sales are common, each licensing agreement is unique and the only consensus that matters with respect to royalty rates is the one that occurs between the licensor and the licensee as a result of negotiations.

Several factors that may influence the potential royalty rate of a licensed product include:

- if the product is already patented;
- is the product "market ready"; and
- does the licensor have a track record of successful products.

If you are an inventor and wish to approach a large company with your invention, you may find that they have very specific policies on how they will consider unsolicited proposals. Your first response from them will usually be to spell out the terms and conditions of their corporate policy on submissions.

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For further information regarding starting a business, contact the

Canada-Saskatchewan Business Service Centre

#2 - 345 3rd Avenue South
Saskatoon, Sask. S7K 1M6

Phone: **306-956-2323** Toll-Free: **1-800-667-4374**

E-mail: saskatchewan@canadabusiness.sk.ca

Web site: <http://www.canadabusiness.ca/sask/>

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