

8.4: Licensing

Learning Objectives

After reading this section, students should be able to ...

1. define licensing
2. explain the advantages and disadvantages of international licensing

Licensing gives a licensee certain rights or resources to manufacture and/or market a certain product in a host country.

Licensing

Licensing is a business arrangement in which one company gives another company permission to manufacture its product for a specified payment. Licensing is defined as the granting of permission by the licensor to the licensee to use intellectual property rights, such as trademarks, patents, brand names, or technology, under defined conditions. The possibility of licensing makes for a flatter world, because it creates a legal vehicle for taking a product or service delivered in one country and providing a nearly identical version of that product or service in another country. Under a licensing agreement, the multinational firm grants rights on its intangible property to a foreign company for a specified period of time. The licensor is normally paid a royalty on each unit produced and sold. Although the multinational firm usually has no ownership interests, it often provides ongoing support and advice. Most companies consider this market-entry option of licensing to be a low-risk option because there's typically no up-front investment.

For a multinational firm, the advantage of licensing is that the company's products will be manufactured and made available for sale in the foreign country (or countries) where the product or service is licensed. The multinational firm doesn't have to expend its own resources to manufacture, market, or distribute the goods. This low cost, of course, is coupled with lower potential returns, because the revenues are shared between the parties.

Licensing generally involves allowing another company to use patents, trademarks, copyrights, designs, and other intellectual in exchange for a percentage of revenue or a fee. It's a fast way to generate income and grow a business, as there is no manufacturing or sales involved. Instead, licensing usually means taking advantage of an existing company's pipeline and infrastructure in exchange for a small percentage of revenue.

An international licensing agreement allows foreign firms, either exclusively or non-exclusively, to manufacture a proprietor's product for a fixed term in a specific market.

To summarize, in this foreign market entry mode, a licensor in the home country makes limited rights or resources available to the licensee in the host country. The rights or resources may include patents, trademarks, managerial skills, technology, and others that can make it possible for the licensee to manufacture and sell in the host country a similar product to the one the licensor has already been producing and selling in the home country without requiring the licensor to open a new operation overseas. The licensor's earnings usually take the form of one-time payments, technical fees, and royalty payments, usually calculated as a percentage of sales.



Figure 8.4.1: Batman (Copyright; author via source)

Batman

The Batman character has been licensed to many companies, such as Lego.

As in this mode of entry the transference of knowledge between the parental company and the licensee is strongly present, the decision of making an international license agreement depend on the respect the host government shows for intellectual property and on the ability of the licensor to choose the right partners and avoid having them compete in each other's market. Licensing is a relatively flexible work agreement that can be customized to fit the needs and interests of both licensor and licensee. The following are the main advantages and reasons to use international licensing for expanding internationally:

- Obtain extra income for technical know-how and services.
- Reach new markets not accessible by export from existing facilities.
- Quickly expand without much risk and large capital investment.
- Pave the way for future investments in the market.
- Retain established markets closed by trade restrictions.
- Political risk is minimized as the licensee is usually 100% locally owned.

This is highly attractive for companies that are new in international business. On the other hand, international licensing is a foreign market entry mode that presents some disadvantages and reasons why companies should not use it because there is:

- Lower income than in other entry modes
- Loss of control of the licensee manufacture and marketing operations and practices leading to loss of quality
- Risk of having the trademark and reputation ruined by an incompetent partner
- The foreign partner also can become a competitor by selling its products in places where the parental company has a presence

? KEY POINTS

- Licensing is a business agreement involving two companies: one gives the other special permissions, such as using patents or copyrights, in exchange for payment.
- An international business licensing agreement involves two firms from different countries, with the licensee receiving the rights or resources to manufacture in the foreign country.
- Rights or resources may include patents, copyrights, technology, managerial skills, or other factors necessary to manufacture the good.
- Advantages of expanding internationally using international licensing include: the ability to reach new markets that may be closed by trade restrictions and the ability to expand without too much risk or capital investment.
- Disadvantages include the risk of an incompetent foreign partner firm and lower income compared to other modes of international expansion.

Terms

- *Licensing*: A business arrangement in which one company gives another company permission to manufacture its product for a specified payment.
- *License*: The legal terms under which a person is allowed to use a product.

Examples

- Suppose Company A, a manufacturer and seller of Baubles, was based in the US and wanted to expand to the Chinese market with an international business license. They can enter the agreement with a Chinese firm, allowing them to use their product patent and giving other resources, in return for a payment. The Chinese firm can then manufacture and sell Baubles in China.

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