

For the majority of inventors, licensing is the better choice of the time and financial resources needed to start a new business

Licensing the better choice

By Lawrence J. Udell

WHAT IS A LICENSE?

A license is a contractual business relationship between a seller (licensor) who authorize a buyer (licensee) to use the seller's patent, trademark, copyright or any other form of "intellectual property" (IP) for compensation.

Thousands of times over the last half century inventors have asked me about the value of licensing the right to their business to produce and market the product. For the majority of inventors, licensing is the better choice because of the time and financial resources needed to start a new business. There are no real secrets to successfully licensing a new product/technology, but it does require unbelievable patience and lots of research time.

Almost anything in which there exists a protectable property right can be licensed. Most familiar are industrial processes, patent, trademarks, copyright, trade secrets, methods, formulas, customer lists and manuals. In each case there is a form of legal right, such as the property right granted by the U.S. government to an inventor when a patent is issued. The technology covered by the issued patent becomes a valued property for a period of 20 years from the date the patent application was filed.

A license grants to the licensee limited rights to the property, usually for a fixed period of time, and often for a specified use or market, you can sell real property, such as a car or house, only once; however, you can license a valued possession of knowledge or value hundreds of times, and in many cases, simultaneously. For example you can license the rights to your intellectual property to licensees in different regions of the country and/or different countries.

Licensing can provide a licensor with income for a long time, with much less risk and commitment than is involved with raising investment capital, manufacturing, and everything else that is required to establish and own a company that produces and sells a product. However, the licensor will only receive a small percentage of the profit from the sales of a licensed product or technology, since the risk is considerably less. The licensee must make the required investment in establishing everything necessary to produce the finished product and get it to the buyer or end user.

Licensing to an established corporation provides numerous advantages because the corporation has an existing ability to manufacture the "new product" as well as the means of distribution, an established customer base, advertising experience, immediate penetration of domestic and possible foreign markets, and name recognition of the company. This becomes an almost "no risk" position for the licensor, providing the license is properly drafted, with minimum guaranteed royalties, and benchmark performance criteria defined.

Efforts at licensing should not be attempted without expert legal assistance. The licensing activity is a business function. When all of the parties have agreed upon the details the details of the license, the final written record of the activity forms a legal document called a "license agreement," In simple terms, it serves as a special kind of contract, which has mutual benefit to both parties.

There is no standard licensing agreement that can be used as a universal guide. License negotiations and the document drafting should be custom designed to fit the specific business situation or the technology.

Determining the Value of the IP

The ownership of your intellectual property provides you with an asset whose value is determined by what a potential licensee will pay you for it. Also, whether the license is exclusive or non-exclusive can have an effect upon its value. Remember that the value of the patent is determined by what a reliable corporation or individual is willing to pay, either in royalty form or licensing rights. But how is that value determined?

To determine the value of the IP, it is critical that the owner conduct extensive research into the potential market to learn who is in it, how big it is, who is going to be hurt financially by licensing to a specific company, what are the advantages to each of the companies in the market, etc. there is no way to determine value or to negotiate a license until an experienced and reliable organization or individual does an in-depth market research study.

Once the value has been determined and a licensee has expressed interest in the IP, remember this: Never do your own negotiating unless you have previous experience that resulted in a successful conclusion. If you have no experience in dealing with or negotiating a business agreement, you should not represent yourself. I have seen hundreds of inventor destroy opportunities for success because they either got greedy or wanted to do everything themselves. "Million dollar ideas" have died with their creators. When it comes time to negotiate, either have your patent attorney approach a potential licensee or hire an individual or firm that knows the process and has enough experience to gain you confidence.

Recognize your limitations and don't attempt to approach or even be involved in the negotiation, except as a technical expert. It is better to have experts and legal advice from the very beginning rather than have to hire them when you desperately need it. And remember: Personal greed must never rear its ugly head to kill the opportunity.

When should you license?

In most cases, a protectable idea increases in value as the following events take place.

1. A raw idea is formed; this has a very low, if any, value.
2. A U.S. patent application is filed to cover the idea.
3. A working model or demonstration of the viability of the idea is made.
4. If funds are available, foreign counterpart patents are filed.
5. The U.S. patent issues; now the IP has moderate value.
6. The idea/invention is commercially market, or it has been reduced to practice and recognized experts support the technology. The value is increased.
7. A license is arranged with an established, financially sound corporation. Now there is a high value.
8. Additional licenses for either other uses or geographic parameters is now instituted. The original idea now has a very high value.

As stated previously, the value of anything is determined by what someone is willing to pay for it. The true value of a licensable technology, idea, patent, or whatever, must be based upon the perceived value to the licenses. If they recognize how it fits into their business, and what it

would do for their sales and profits, the results will be a mutually beneficial and rewarding relationship. It might also be the answer to their ability to diversify into other areas or new markets.

How do you find a licensee?

Do your homework; in other words research. Unless the product fits into a niche market, you must find the logical, financially stable corporations and learn everything you can about them, including their five or ten year stock value, along with their marketing procedures, the stability of their officers, who serves on the board, and a great deal more. All of this information is available, but requires intensive research. In many cases the number two company in the industry will find your technology of greater value if they perceive that you IP will help them gain an edge on number one, who is also their greatest competitor.

The research objective is to compile a list of potential licensees and to prioritize them based upon their potential value to you. Large corporations quite often do not seek or have any interest in acquiring technology from outside their own research laboratories. It is also extremely important to carefully consider who will present the opportunity. Inventors are most often ignored, and must gain sign release documents before ever having an audience with a company official. The business of licensing is very serious and must be approached and recognized as an opportunity with great rewards if handled properly and professionally.

Determining Royalty Rates

Establishing a value consist of a myriad of factors. In general, a license royalty should not be so high that it either discourages a potential licensee or reduces the profit margin of their expected returns on the investment. Remember, “they” are taking the risks, which means they should receive the largest percentage or portion of the profits.

Royalties commonly are expressed as a percentage of the licensee’s “net sales price” of the licensed product. They can also e expressed as an equivalent thereto, such as \$2.00 per ton of paper products under a license on a paper machine. A very important factor that will influence the royalty rate is the strength and scope of the patent protection and any additional values, such as a trademark. Another factor that will contribute to the value of the IP is its stage of development, such as, how much money must be invest in more research to determine the finished product.

The royalty can also vary depending upon whether the license is exclusive or non-exclusive. What, if any, are the geographic limitations and parameters? Are you licensing U.S. rights only or rights to the whole world? (note: You can only license right outside of the U.S. if you have IP protection in other countries. A U.S. patent, for example, is only valid in the U.S.) What are the licensor’s competitors going to do when “your” new technology is introduced> can they improve on it and avoid an infringement suit? Will they consider a sub-license from your licensee, instead of creating a competitive technology situation? These are only a few of the questions that have to be answered, not only a few of the questions that have to be answered, not even considering the value of the market today, and in the future.

A “successful inventor” is one who has earned more money than he expended on the idea or patent. Over the 50 years that I have been assisting inventors, out of the thousands I have spoken to or helped in one way or another, only a handful have truly reached the plateau of independent wealth.

I can balance that by saying the opportunities to become rich with an idea/patent are far greater today than at any time in history because the world is hungry for new products and devours them at the rate of more than 20,000 a year. Many do not have any protection, but they succeeded because they were “the first with the moistest.”

Licensing may or may not be for you. Read several books on the subject and discuss it with your attorney and advisors. Be realistic about the value of your brainchild; your invention/innovation/patent is of absolutely no value until someone wants to pay for it or for its use.