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CASE STUDY NO. 3

TECHNOLOGY AGREEMENT IN THE FIELD OF TEXTILES 1/

by

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1/ The views and opinions expressed in this paper are those of the author and do not necessarily reflect the views of the secretariat of UNIDO. This document has been translated from an unedited original.

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This is the case study of enterprise B, an Argentine enterprise set up in 1970 with a capital of $US20 million to manufacture synthetic textile products.

In 1974, the enterprise signed a contract with Japanese firm J, under which the latter undertook to assist B in the following:

1. Preparation of plans, designs and studies for adapting the plant belonging to B for manufacture of the "products", taking into account local conditions, the availability of labour, transport facilities and other factors relating to location of the plant.

2. Purchase of the additional machinery or equipment considered necessary by B and J. This type of assistance will entail the provision, free of cost to B, of services by the procurement departments of J or its subsidiary or associate firms for the location and purchase of machinery and equipment required, and verification of their condition and suitability. Should J or any of its subsidiary or associate firms sell their own machinery or equipment to B, the price shall be the book value of such machinery or equipment, without profit or commission for J.

3. Provision of technicians and trained personnel, as follows:

(a) J shall make every effort to supply to B on a temporary basis the technicians, skilled workers and other trained personnel which it may require for establishment of the processes concerned, installation of machinery or training of personnel in its plants.

(b) J, at the request of B, shall give access to its plants in Japan, or to the plants of its subsidiary or associate firms, to technical personnel from B so as to enable the latter to familiarize themselves with manufacturing techniques and solve any problems which may arise.

4. Co-operation with B in the location and assessment of sources of raw materials.

5. As regards the supply of information and data concerning advances and improvements in all aspects of the manufacture, marketing and advertising of the products in question, J shall promptly inform B of new methods, inventions, processes, styles and other advances which J or its subsidiary or associate firms may develop.

6. Exclusive rights in the manufacturing territory.

The licensing contract was concluded for a period of six years, with the proviso that, should B use patented equipment, it will continue in force as long as such use continues. This situation has not arisen to date.

The royalties agreed upon were 2 per cent of net sales of the products manufactured under licence during the six years covered by the contract.

B's plans indicated that the products covered by the licence would account for approximately half the enterprise's activities, and this was in fact the case.

The figures for sales, profits and royalties in 1975, and those planned for the future, are (in thousands of United States dollars):

	Total sales	Total profits	Sales of products manufactured under licence	Profits from products manufactured under licence	Royalties (2 per cent)
1975	8,000	547	4,300	290	86
1976	11,300	772	4,700	320	94
1977	12,400	847	5,200	350	104
1978	13,600	929	5,700	380	114
1979	14,800	1,011	6,200	420	124
1980	16,100	1,100	6,800	480	136

In the first year in which the licence was used (1975), the profit from the new products was around 6.8 per cent, i.e. the same as the profit which the enterprise was realizing on its traditional lines in the past. This indicates that the introduction of the licence, while increasing the absolute value of profits, has not reduced the firm's average rate of profit on sales.

This is obviously due to the reasonable level of royalties agreed on at the outset. In the first year, royalties absorbed the equivalent of 30 per cent (the figure used for the projection) of the profits on products manufactured under the licence (in other words 23 per cent of the total of profits and royalties).

The expected total figures for the six years covered by the contract are as follows (in thousands of dollars):

Total sales of the enterprise	76,200
Total profits of the enterprise	5,206
Sales of products manufactured under licence	32,900
Profits from products manufactured under licence	2,220
Royalties	658

This shows that the total cost for enterprise B of introducing the project into its operations will amount to $US658,000, or 22.86 per cent of the margin of profit generated by the products covered by this licence.

The only point on which the government evaluating body had an objection, although it agreed to signature of the contract in its original form, related to the way in which patents were dealt with in the contract. In this respect, it pointed out that if enterprise B were to use patents belonging to firm J after 1980 those patents would have to be subject to independent negotiation and agreement, taking into account their specific technical content, since their value would not necessarily amount to 2 per cent of the value of the products manufactured under the licence covered by this contract.

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