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07120

ID

Distr.
LIMITED

ID/WG.228/7
16 August 1976

ENGLISH
Original: SPANISH

United Nations Industrial Development Organization

National Consultations on Licensing, Patents and Transfer of Technology

Montevideo, Uruguay, 20-24 September 1976

CASE STUDY NO. 1

TECHNOLOGY AGREEMENT IN THE FIELD OF LEATHER GOODS 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.

id.76-4306

A law regulating licensing contracts came into effect in Argentina in January 1972. Pursuant to this law, contracts in force at that time were submitted for "automatic registration".

The law gave enterprises two years to adapt contracts to its provisions (annex).

Among the contracts submitted was one from enterprise A which had been manufacturing suitcases and leather articles since 1960, and which in 1966 had signed a contract with the Italian enterprise I whereby the latter authorized the licensee to use the brand name "I" and undertook to provide it with information on the manufacture of leather suitcases, belts, briefcases, wallets and clothing, in the following areas:

1. Production

(a) New technological information on manufacture and assembly processes;

(b) Assistance in obtaining the personnel required from various sources;

(c) Assistance in the design and planning of A's new plants;

(d) Assistance in management analysis, plant organization, improvements in the training programme and cost control.

2. Sales

(a) Information concerning prices and conditions on foreign markets;

(b) Samples, design data and information on sales of articles in the ranges represented by enterprise I to help solve A's sales problems.

3. Finance

(a) Assistance in the design and introduction of a suitable accounting system;

(b) Permanent assistance on costing systems and the analysis of critical financial operations;

(c) Assistance in the formulation of a financial and legal policy.

4. Purchasing

(a) Assistance in procuring materials within the country and materials which are obtained on advantageous terms by I;

(b) General assistance in the procurement of machinery, spare parts and materials outside the country, including assistance to A in determining its requirements;

(c) General assistance in the handling of technical documentation and the movement of articles produced, purchased or sold by A.

There was and is no capital linkage between the two enterprises, and the contract authorized enterprise A to export goods to Uruguay, Chile, Bolivia, Paraguay, Peru, Ecuador and Venezuela.

The contract was to run initially until 1999 - that is, for 34 years - with the possibility of further extensions for periods of twenty years if neither party objected.

The royalties on net sales established by the contract were to decrease over time as follows:

From 1 January 1966 to 31 December 1979	2.5 per cent
From 1 January 1980 to 31 December 1985	2.25 per cent
From 1 January 1986 onwards	2 per cent

In addition, the contract obliged the licensee to spend at least 5 per cent of the value of its sales on publicity.

Sales and profits made and royalties paid over the years were as follows (in thousands of dollars):

	Total sales	Total profits	Sales of products manufactured under licence	Profits from products manufactured under licence	Royalties paid	Royalties + profits from products manufactured under licence
1969	2,864	51.6	2,322	41.8	58.1	99.9
1970	2,979	56.6	2,415	45.9	60.4	106.3
1971	3,098	(3.4)	2,736	(2.7)	68.4	65.7
1972	3,392	21.2	3,090	19.5	77.3	96.8
1973	3,451	36.1	2,611	27.4	65.3	92.7
1974	4,013	101.4	3,090	76.0	77.3	153.3

In order to give a clear picture of the quantitative relations between these variables, the following ratios can be calculated:

	(1) Profits / Sales (%)	(2) Profits from products manuf. under licence / Sales of products manuf. under lic. (%)	(3) Profits from licensed products + royalties / Sales of licensed products (%)	(4) Royalties / Profits from licensed products + royalties (%)
1969	1.8	1.8	4.3	58.2
1970	1.9	1.9	4.4	56.8
1971	(0.1)	(0.1)	2.4	104.1
1972	0.6	0.6	3.1	79.9
1973	1.1	1.1	3.6	70.4
1974	2.5	2.5	5.0	50.4

Certain conclusions can be drawn from these figures:

(a) The profit level is the same for all the products produced by the enterprise. It is likely that the licence contributes towards improving the general efficiency of the firm.

(b) Royalties have consistently absorbed more than half of the total profit margin (column 3).

The loss registered in 1971 was due entirely to the payment of royalties.

(c) While the number of years analysed does not permit one to draw final conclusions, no obvious trend towards increased efficiency and profits is observable.

In addition to the foregoing, the agency responsible for the evaluation made the following observations:

(a) Enterprise A had not requested assistance in solving its technical problems from enterprise I during the last five years. The assistance was provided in the first three years of the contract. In reality, the royalty had become a payment for the right to use the brand name "I".

(b) The value of the royalties earned easily covered the value of the know-how that had been transferred. Henceforth, the royalty should be considered as payment for the transfer of innovations introduced by plant I and for the use of the brand name.

(c) The compulsory allocation of 5 per cent of sales to publicity "made it possible to regulate marketing" and was, consequently, inadmissible. Indeed, this clause of the contract prevented the plant from developing an independent marketing policy.

(d) The type of technology involved did not justify such a long-term contract. The payment of a royalty over such a long period of time made it impossible for enterprise A to mount an independent product development effort.

It was accordingly recommended that the contract should continue in force until 1985 - that is, for 11 more years - but with the following rates of royalties:

1974-1975	2 per cent
1975, 1976 and 1977	1.5 per cent
1978-1985	1 per cent

This scale was accepted by the parties, who also agreed on the deletion of the clause concerning the 5 per cent for publicity.

/UNIDO pub/. /Case study/ of a /technology transfer/ /contract/ in the field of /leather goods/ production — [redacted]

(1) outlines case of assistance by an Italian firm to an Argentine enterprise in /knowhow/, personnel, plant design and organisation, XXX sales, financial and accounting systems, purchasing, etc., XXX authorising use of supplying firm's /trade mark/, and export of goods produced (2) covers /licensing/ provisions, sales, royalties, /profitability/ calculations.

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