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CASE STUDY NO. 2

TECHNOLOGY AGREEMENT IN THE FIELD OF FOOD INDUSTRIES (VEGETABLES) 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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1. In 1973 the agency regulating commerce in technology was presented with the case of an enterprise which had obtained a licence in 1969 for a vegetable dehydration process used in the production of foodstuffs. The licence covered the supply of the technical know-how needed for the process, engineering support in the building, procurement and assembly of the equipment, and the technical assistance required to put the plant into operation.

Under the contract, the licensee enterprise was to pay $US 35,000 as an initial payment for the basic information package, and then $US 5,000 each year over a ten-year period - that is, from 1969 to 1978.

2. When the contract was submitted for evaluation, the enterprise stated that, in 1969, it had been offered the same license by the licensor for royalties of 2 per cent.

Although this proposal had appeared financially favourable, it had been rejected by the licensee because, economically speaking, it would have endangered its profit level, given the narrow profit margins customary in the industry.

The method of payment that was accepted, on the other hand, did not jeopardise earnings, as can be seen in the following tables:

Table 1

Year	Total sales	Total net profits	Initial lump-sum payment*	Royalties	Total payment
	In thousands of dollars				
1969	338	-26	6.65	5	11.65
1970	1,436	-76	6.3	5	11.3
1971	2,468	-28	5.95	5	10.95
1972	5,204	-21	5.6	5	10.6
1973	8,268	93	5.25	5	10.25

* The sum has been divided by 10, and 1/10 of the sum has been attributed to each year plus 10% annual interest.

Table 2

Year	Profits/Sales (%)	Total payment/Sales (%)
1969	-7.69	3.45
1970	-5.29	0.79
1971	-1.13	0.44
1972	-0.40	0.20
1973	1.12	0.12

It is clear from these figures that the payment of the amount agreed on in advance decreases in relative importance over time due simply to the increase in the sales figure.

Thus, in the year preceding the submission of this contract, payments for technology amounted to only 0.12 per cent of sales, while profits amounted to 1.12 per cent. Profits proper accounted for 90 per cent of the total profit margin while royalties absorbed the remaining 10 per cent (table 2) in 1973.

In table 3, in which there is a comparison of the two alternatives originally considered, it will be seen that the royalties arrangement would have resulted in a total cost six times that actually incurred with predetermined payments.

Table 3

Year	Total actual payment	Capitalized value in 1973	Payment with royalties (2%)	Capitalised value in 1973
	In thousands of dollars			
1969	11.65	15.06	6.76	10.89
1970	11.30	16.54	28.72	42.05
1971	10.95	14.57	57.36	76.35
1972	10.60	12.83	104.08	125.94
1973	10.25	11.28	165.36	181.90
		70.28		437.13
	Index, base = 100			622

Furthermore, even if the full amount of the initial lump-sum payment of $US 35,000 is charged to the first five years of the contract, the result is a total expenditure for those years of about $US 90,000, which is less than 25 per cent of the amount that would have been paid with the arrangement involving royalties of 2 per cent.

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