International Licensing: Rethinking Theoretical and Empirical Research

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Abstract

This paper contends that international licensing has been neglected by the extant theory as a strategic choice available to several types of firms in the new global environment. Traditional theoretical perspectives in the field of International Business see international licensing as an alternative, low-involvement, low-control, and low-risk entry mode. Nevertheless, globalization challenges many of the assumptions of these theories, and several firms in different industries are now considering licensing as their main alternative to operate in international markets, or creatively combine different methods of servicing foreign markets. There is thus a need for more research on international licensing.

1. Introduction

International licensing is a growing segment of international business. There are basically two types of licensing: technology and know-how transfer licensing; and copyright and trademark licensing (Cavusgil, Knight, & Riesenberger, 2008; Sherman, 2004). Different sources disagree in their estimates of the size of the global market for licensing. Considering only the segment of licensed merchandise and services, the International Licensing Industry Merchandising Association (LIMA, 2016) estimates that worldwide retail sales reached 252 billion dollars in 2015. Latin America accounts for only 3.8% of the total (or 9.6 billion dollars). Brazil is the largest market for licensed merchandise with 40% of the sales in Latin America, followed by Mexico (28%), Chile (9.6%), Colombia (6.1%) and Peru (5%).

Despite the growing importance of licensing, and of the global market for licensed merchandise and services, the extant international business literature has given scant attention to licensing as an international strategy (Brouthers & McNicol, 2009), and even less to the international licensing of merchandise. In fact, licensing is the least researched method of entering and operating in international markets, when compared to exporting, foreign direct investment, and even franchising (also a contractual mode). In addition, theories that examine international licensing have limited application to certain types of firms.

We contend in this paper that the theoretical perspectives that have examined international licensing – the international product life cycle theory, transaction cost economics, internalization theory, and internationalization process theory – have limited application when it comes to study the international licensing activity of many types of firms, and, specifically, of firms operating in certain markets and industries. Part of the reason may be because these theories were developed in the 1960s and 1970s, when it was more difficult for certain types of firms to go international, such as smaller firms and service firms. These theories, in fact, have focused more in manufacturing and larger firms (e.g. Laufs & Schwens, 2014).

This paper intends to examine the following question: "To what extent the main theoretical perspectives in the field of International Business (IB) can explain the international licensing activities of several types of firms in different industries and markets?" The paper proceeds as follows: after this introduction, we discuss the concept of international licensing and the three main theoretical perspectives that examined international licensing. Subsequently, we look at several empirical situations that are not explained or insufficiently dealt with by the three theoretical perspective here examined. Then we present our final considerations on the need for additional theoretical development and empirical research to support managerial decision-making on international licensing.

2. Conceptualizing International Licensing

Licensing has been defined in several different ways, depending on the scope considered by each author. As a result, the same author may present more than one definition in different papers, or in different parts of the same work. Some authors offer more general definitions of licensing, which can apply to activities performed either in the domestic market or in international markets. For example, Sherman (2004) conceptualizes licensing as "a contractual method of developing and exploiting intellectual property by transferring rights of use to third parties without the transfer of ownership"; and Battersby (2013, p.1) as "… any transaction in which the owner of a piece of intellectual property grants another party the right to use such intellectual property, typically in exchange for some form of consideration or payment".

Broader definitions tend to cover all aspects of the transfer of intellectual property rights (e.g. Root, 1982; Bradley, 2005), while narrower definitions tend to focus on one specific type of licensing, such as technology, trademarks, etc. While some definitions are based on the essence of the licensing activity, others focus on the characteristics of the license agreement. However, as pointed out by Johnson and Mottner (2000, p.173), most authors see licensing as "…almost synonymous with the term 'technology transfer'," and therefore do not take into consideration in their conceptualizations the other side of licensing, related to copyright and trademark licensing. Brouthers and McNicol (2009, p.185) list several types of intellectual property that can be licensed, such as "research and development ideas, inventions, formulas, technological know-how, services, brands, art, music, designs and trademarks."

According to these definitions, licensing is: (i) A contractual (non-equity) arrangement; (ii) between two parties, the owner of an intellectual property (licensor) and an entity that wants to use this intellectual property (licensee); (iii) in which the licensor grants to the licensee the rights to use this intellectual property for the purpose of production and/or sale (iv) in a given market and (v) for a certain time, (vi) in exchange for some sort of compensation.

The conceptualization of international licensing differs somewhat from the generic view of licensing due to the focus on cross-border activities. In fact, definitions of international licensing are scarce and far from reaching a consensus. In the field of International Business (IB), most authors see international licensing as an alternative mode available to the firm entering a host market. Conceptualizations extracted from the IB literature characterize licensing as a low-involvement, low-control, and low-risk entry mode (e.g. Aulakh, Cavusgil, & Sarkar, 1998; Hill, Hwang and Kim, 1990; Johnson & Mottner, 2000). In spite of the dominant view of licensing as an entry mode, Johnson and Mottner (2000, p.172) contend that, at least to some extent, such a view is too limited. In fact, these authors suggest that licensing should rather be seen as "part of a firm's overall international strategy." In fact, when one considers international licensing under a broader strategic perspective, licensing may be seen not merely as an escape from risk, or a choice of low involvement and low control of international operations, but rather as an active and strategically relevant approach to internationalization, which may increase shareholder value by generating new sources of revenue or market opportunities.

3. Theoretical Perspectives on International Licensing

Different conceptualizations of international licensing tend to be associated to different theoretical perspectives embraced by the authors. Indeed, although most of the literature mentions licensing as an alternative entry mode, few theories have examined licensing in more depth. Among the theoretical perspectives that explicitly mention licensing are the International Product Life Cycle theory, theories based on the market failure paradigm (such as Transaction Cost Economics and Internalization Theory) and Internationalization Process Theory (also known as the Uppsala model). More recently, Brouthers and McNicol (2009) have discussed the potential application of institutional theory to the study of licensing, but we found no studies using this perspective. In this paper, we focus on three different theoretical perspectives to reach a better understanding of international licensing: the International Product Life Cycle (IPLC) theory (Vernon, 1966), Internalization theory (Buckley & Casson, 1976; Rugman, 2006), and the Internationalization Process (IP) Theory (Johanson & Vahlne, 1977, 1990).

- *The International Product Life Cycle Theory and International Licensing*

Inspired by previous work on the technological gap between developed and underdeveloped countries and on the "life" of a product (Ietto-Gilles, 2005), Vernon proposed the IPLC theory. This theory intended to explain when international trade and, in particular, international production would take place as a product matures in terms of technological innovation.

The basic assumption behind the theory is that "enterprises in any one of the advanced countries of the world are not distinguishably different from those in any other advanced country, in terms of their access to scientific knowledge and their capacity to comprehend scientific principles" (Vernon, 1966, p.191). The economic force behind the application of scientific principles to a new product is the result of entrepreneurial talent, which, although available in any country, needs two conditions to be successfully applied: geographical proximity to the market, and the resulting ease of communication. In more developed countries, consumers have a higher per capita income and are thus more prone to adopt new innovative products. Moreover, the cost of labor is high. Therefore, entrepreneurs from developed countries show more awareness and promptness to transform scientific innovation into marketable products. As pointed out by Ietto-Gilles (2005, p.70), in her review of Vernon's contributions to the understanding of why and how firms enter international markets, in IPLC theory the disposition of the entrepreneur is "associated with the market conditions in which entrepreneurs operate; this makes [market] knowledge inseparable from the decision-making process about its use."

Based on the idea of evolutionary steps toward international markets, which assume the development, diffusion, and maturation of a product, Vernon proposed four main stages in the international life cycle of a product originating in the U.S.: (i) Introduction of a new, innovative, and premium-priced product in the domestic market; (ii) Growth, a stage characterized by product standardization, mass production, economies of scale, declining prices, and exporting to high-income consumers in other countries; (iii) Maturity, when the technology or know-how becomes accessible to foreign firms that manufacture the product to serve their own markets, thus forcing U.S. firms to start production abroad; and (iv) Decline, when production is carried out in lower-income countries, and the U.S. market is served by imports.

Licensing in Vernon's theory is a complementary mode for the innovator in the early stages of domestic production if there is demand from a foreign market that cannot be reached by exporting. Nevertheless, the "licensing alternative may prove an inferior choice because of inefficiencies in the international market for technology" (Vernon, 1979, p.257). In his 1979 paper, Vernon presents empirical support for this contention, showing that U.S.-based multinationals used international production more often than licensing, especially after the product matured.

Vernon's theory stands up for its simplicity and fit to the data on multinational activities of U.S. based-firms at the time. However, his theory preceded the impact of globalization; advances in information and communication technologies, as well as the reduction of travelling costs, undermined some basic assumptions of the model. Vernon (1979) himself noted later that changes in the global market impacted the speed between a new product inception and its diffusion across different countries. Other authors, such as Cantwell (1995), criticised Vernon's theory on several aspects, including the fact that firms use more often the three different entry modes in international markets – exporting, international production, and licensing – as complementary, not alternative, entry modes.

- *Transaction Costs Economics, Internalization Theory, and International Licensing*

The rationale behind TCE is strongly based on two behavioral assumptions: bounded rationality and opportunism (Williamson, 1985). The concept of bounded rationality assumes that although humans make rational decisions, there are limits to rationality as a result of physical characteristics (such as the ability to process information) and these limits are reached in certain situations, such as those with high levels of uncertainty or complexity. Opportunism implies that a potential partner is expected to behave in ways that protect his own self-interest; it "refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse" (Williamson, 1985, p. 47). Faced with the potential opportunistic behavior of economic agents, firms may choose to use their own structure (hierarchy) to manufacture their products, instead of using a third party (market). In some cases, firms may choose a hybrid form (such as a strategic alliance). Internalization (the choice of the firm's own structure) has thus been conceptualized as "the process of making a market within a firm" (Rugman, 2006, p.7).

The choice between alternative ways of servicing a market is mostly determined by three factors: uncertainty, asset specificity, and frequency of transactions. Asset specificity implies that certain assets employed in a transaction cannot be redeployed in other productive activities without losing at least part of their value. Uncertainty interacts with asset specificity, since uncertainty about the ex-post behavior of a partner becomes a more serious problem when there is a substantial investment in transaction-specific assets. Finally, the frequency of transactions refers to "large transactions of a recurring kind", which permit to recover more easily "the cost of specialized governance structures" (Williamson, 1985, p.60).

Internalization theory is rooted in Transaction Cost Economics (TCE). Internalization theorists see the multinational corporation as a firm that extends its boundaries beyond national borders, choosing to internalize markets by establishing production subsidiaries in a foreign country, in response to externalities such as export tariffs, restrictions to patent protection, etc. MNEs are assumed to possess unique firm competitive advantages, such as knowledge, marketing, or managerial skills, that can be more successfully transferred to other countries by using its own hierarchy than by using external markets (Buckley & Casson, 1976, 2009; Casson, 1979). Internationalization theory aims therefore to be a general theory that explains the very existence of the multinational corporation, as a response to market imperfections (Rugman, 2006). It is not, however, limited to the MNE, but it is “a general principle that explains the boundaries of organisations” (Buckley & Casson, 2009, p. 1566).

Licensing differs from FDI because of the “externalization effect” (Buckley, Pass, & Prescott, 1993, p.277). When a firm licenses another in a different country, it transfers the right to use a technology, know-how, or trademark to produce and distribute products, while in FDI these functions are internalized. Rugman (2006) sees licensing as a risky choice; he claims that licensing, as well as other non-equity contractual arrangements, has “the potential to destroy the firm specific advantage of the MNE” (p.4). The author demonstrates that, given certain assumptions, licensing tends to be the least profitable choice, compared to exporting and FDI, an argument earlier posed by Caves (1971). If the host country imposes high tariffs to exporting, which is often the case, FDI would be then the best choice for the MNE. The costs of licensing include: (i) first and foremost, the potential dissipation of the firm’s competitive advantages; (ii) the potential loss of control over its use; and (iii) the need to monitor the use of the license. Firms would therefore prefer foreign direct investment “when exporting and licensing are unreliable, inferior, or more costly options” (Rugman, 2006, p.8).

Internalization scholars recognize, however, that firms may choose licensing under specific market and cost conditions, and that changes in entry modes can be triggered over time by changes in such conditions (Buckley & Casson, 2009). In fact, in a recent paper, Buckley (2014, p.233) argues that “context matters”, that is, not only market imperfections, but also “the cultural, social, and political context in which the firm is embedded” impacts the decision to internalize or not.

Internalization theorists have given special attention to knowledge-intensive industries:

> “An important special case […] is where the intermediate product is a knowledge-intensive flow arising from an intangible asset. In this case, the MNE can be viewed as a firm that builds a system to exploit a temporary monopoly arising from an innovation. It does so by internalizing markets in relevant intermediate goods and services to maximise the private returns from the exploitation of the innovation. It substitutes for a theoretically perfect external market a system of knowledge creation and dissemination…” (Buckley, 2014, p. 228).

The international firm may choose to export knowledge-based products from its country of origin, to license its knowledge to foreign buyers (licensees) that detain the control of production/distribution of the flow of knowledge-based products in local markets (therefore potentially putting these advantages at risk), or to internalize (thus protecting its firm competitive advantage) (Casson, 2014). In the last case, "the gains from knowledge internalization can be substantial", due mainly to the fact that a potential buyer may be reluctant to pay the "right" price for a know-how or technology before acquiring full understanding of its potential, and the licensor cannot give the buyer full information without disclosing industrial secrets before signing a formal contract, a problem of information asymmetry (Buckley & Casson, 2009, p.1567). Accordingly, the authors have demonstrated that MNEs occurred more often in knowledge-intensive industries (Buckley & Casson, 1976).

An interesting aspect of internalization theory is relevant to our analysis. Buckley and Casson (1976, 2009) distinguish between two types of knowledge: patentable and unpatentable. Internalization gains are predicted to be higher when knowledge cannot be patented, because in this situation information asymmetry and the risks of dissipation of the firm's advantages are higher. Therefore, when the firm's intellectual property can be protected, internalization gains can be low, and licensing may under certain conditions become a more attractive alternative. Hennart (2010) claims, however, that patents do not fully solve this problem, since patent enforcement poses an additional cost to the firm, and legal enforcement of intellectual property rights is difficult or inefficient in many countries. As a result of these considerations, the transfer of new and tacit knowledge incurs high transaction costs, and therefore this type of knowledge tends to be transferred internally; conversely, explicit, protected, established, and familiar technologies present low transaction costs and thus tend to be licensed.

In summary, internalization theory sees licensing as an alternative entry mode in international business, although a risky one. According to this theory, licensing should be avoided in knowledge-intensive industries, particularly when the firm's intellectual property cannot be patented, due to information asymmetry and potential opportunistic behavior of a partner, leading to inferior gains when compared to FDI. Therefore, licensing would be more acceptable in situations in which the firm does not need to protect its intellectual property, such as when the technology or know-how is already mature.

- *Internationalization Process Theory and International Licensing*

Licensing is only marginally considered by the Internationalization Process (IP) theory, also known as the Uppsala model. Similarly to internalization theory, the Uppsala model departs from the construct of uncertainty. The seminal work of Aharoni (1966), which inspired Uppsala scholars, suggests that uncertainty and risk are major drivers of internationalization decisions. In Aharoni's view, licensing was a less-risk alternative to manufacturing in a foreign country.

The concept of uncertainty is an "important ingredient" of the Uppsala model (Vahlne & Johanson, 2013). The original version of the model (Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975) associates uncertainty to a major obstacle to the firm's internationalization, the lack of market knowledge (Björkman & Forsgren, 2000). Uncertainty is mostly seen, in the original model, as market uncertainty: "… the decision-makers' perceived lack of ability to estimate the present and future market and market-influencing factors"… (Johanson & Vahlne, 1977, p.27). Only direct experience in foreign markets allows the firm to acquire foreign market knowledge. As the firm improves its experiential knowledge on foreign markets, it gradually increases the commitment to foreign operations. Internationalization is thus conceptualized as an evolutionary process of incremental involvement with foreign markets (Johanson & Vahlne, 1990).

Petersen and Pedersen (1997, p.118) argue that "at the operational level (inductive), the [original] model states that incremental commitment is observable through the formation of establishment chains (in the individual foreign market) and in the geographic sequence of foreign country markets…". The establishment chain, as empirically observed by Uppsala scholars in Sweden firms, consists of a linear sequence of stages. At each stage firms may adopt a different entry mode in the foreign country based on increased market knowledge. The stages are evolutionary steps since they require different levels of investments and commitment by the firm. They include: no international activities, exporting via agents, sales subsidiary, and production subsidiary (Johanson & Wiedersheim-Paul, 1975). In addition, some authors have suggested a step previous to manufacturing, consisting of "a mix of export and FDI in the form of a subsidiary with assembly activities" (Petersen & Pedersen, 1997, p.119). The existence of the establishment chain has been challenged by several authors, but other studies found supporting evidence for the hypothesized phenomenon (Hagen & Hennart, 2004).

Licensing was one of the first steps toward the foreign market observed in one of the four Swedish firms in the original empirical work by Johanson and Wiedersheim-Paul (1975). The use of licensing was associated to the existence of barriers to exporting to foreign markets, similarly to the choice of establishing a production subsidiary. However, this entry mode was not included in the four sequential stages of the Uppsala model, possibly because it does not fit the logical sequence of the Uppsala model, as mentioned by Mirus (1980). In fact, no studies, to our knowledge, have examined how licensing fits into the establishment chain, using internationalization process theory. In addition, licensing is virtually absent from the revised Uppsala model (Johanson & Vahlne, 2009; Vahlne & Johanson, 2013).

Welch (1993, p.67-68) found empirical evidence among Australian firms that "licensing to particular foreign markets was preceded by either no involvement or exporting" (p.67), and therefore was "an earlier stage of international development" (p.68). Firms that adopted licensing frequently showed a passive attitude towards international markets; only in a few cases licensing was part of a joint venture arrangement with a foreign partner. Licensing was often a "residual", or secondary entry mode. Welch (1993) suggests, however, that licensing had the potential of becoming a "springboard" or a "stepping stone" to other opportunities in the international market. Therefore, it should be seen as an experimentation stage in the firm's international development, leading to later adoption of more advanced entry modes. Hedlund and Kverneland (1993) found that several Swedish companies used licensing as an entry mode in Japan before moving to FDI. More recently, Zou and Ghauri (2010) found evidence from case studies that high-tech Chinese firms followed the gradual path predicted by the Uppsala model and used licensing as one of the first entry modes in specific international markets.

- *Comparing the Theoretical Perspectives*

The main theoretical perspectives that examine international licensing in the context of firm internationalization offer sometimes conflicting, sometimes complementary explanations, as summarized in Table 1.

Table 1 – A Comparison of Three Theoretical Perspectives on International Licensing

Aspects	IPLC theory (Vernon)	TCE/ Internalization theory	IP theory (Uppsala model)
Variables relevant to the model	Macroeconomic variables (per capita income, labor costs, capital supply)	Uncertainty, asset specificity, frequency of transactions, opportunism, and bounded rationality	Uncertainty, knowledge, commitment
Entry modes considered	Exporting, licensing, FDI	Exporting, licensing, FDI	Exporting, licensing, sales subsidiary, assembly subsidiary, production subsidiary
Trigger of mode choice	Stage in the product life cycle	Potential dissipation of firms' competitive advantages	Acquisition of experiential knowledge
Role of uncertainty	Not relevant	Key to decision-making	Key to decision-making
Main source of uncertainty	Not relevant	Opportunism and bounded rationality	Psychic distance
Role of knowledge	Unequal access to market knowledge leads to the development of new products by entrepreneurs in developed markets.	Lack of knowledge of potential opportunistic behavior of foreign partners and information asymmetry determines the choice of entry mode.	The acquisition of market knowledge is a key ingredient in the advancement of the internationalization process.
Place of licensing among other entry	Earlier stages of the IPLC, if there is demand in a foreign	Later stages of the internationalization process,	Earlier stages of the internationalization process.

modes	market.	when the technology/know-how is already mature.	
Attractiveness of licensing as an entry mode	Seen as an inferior choice.	Seen as a risky and less profitable choice.	Seen as a lesser-risk, secondary entry mode.
Best conditions to adopt a licensing strategy	Demand for the product in a foreign market in the early stages of IPLC.	Explicit, protected, established, and familiar intellectual properties.	High barriers to exporting, limited market knowledge, and low firm commitment to the market.

Both internalization and IP theories depart from the concept of uncertainty, but while internalization theory departs from the assumptions of transaction cost economics – mainly opportunism and bounded rationality – to explain uncertainty, internationalization process theory emphasizes the lack of market knowledge as the main source of uncertainty when entering international markets. Knowledge plays a key role in the theoretical perspectives examined, but the relevant type of knowledge and the operating mechanism by which knowledge influences entry modes decisions are quite different. Buckley (2016, p.78) claims that internalization theory and the IP model depart from "incompatible assumptions – on technology, on knowledge, on risk". IPLC and IP theories are essentially stages model, but while the first assumes that macroeconomic variables influence the stage of product internationalization, the second proposes a path-dependent model by which firms pass from one stage to another. In addition, internalization theory focuses on the decision between licensing and FDI, while internationalization process theory considers and discusses a broader range of entry modes.

Due to the differences in assumptions, the role of licensing substantially differs in the theoretical perspectives examined. Licensing is central to internalization theory, although as a less attractive and more risky entry mode, while it has only marginal relevance in IP theory, which sees licensing as a low-risk, rather initial, and secondary entry mode, and in the IPLC theory. As a result, the conditions under which licensing would be a desirable or acceptable entry mode also vary, with internalization theory leaving licensing to situations in which intellectual properties can be protected, or are less valuable (as when it is already known), and internationalization process scholars seeing it as a rather initial step in international markets.

4. Limitations of the Theoretical Perspectives Examined to Managerial Decision-Making

IPLC differs substantially from the other two theories because it looks at internationalization from a country's, not a firm's perspective (Cantwell, 1995). Thus, the IPLC model is not very useful to enlighten managerial decisions, compared to the other two theoretical perspectives. As to internalization theory and the IP model, both assume that firms do have a choice among different entry modes, which is not always true. Firms may be specialized in a given stage of the value chain; they may be too small to engage in manufacturing; or they may license intellectual properties that they do not wish to manufacture. In addition, as pointed out by Root (1982), international licensing may be the only possible way of entering a foreign market, due to high export barriers and foreign investment restrictions. Also, an increase in the speed of diffusion of innovations has changed the way many companies, including very large ones, look at licensing. We examine these situations in more detail.

- *Firm Size and Age*

Entry mode decisions of small and medium-sized firms (SMEs) has been largely neglected in the international business literature (Laufs & Schwens, 2014). Based on a literature review of entry mode studies of SMEs, these authors point out that three characteristics of SMEs impact their entry mode decision (including licensing): resource constraints, vulnerability to external threats, and ownership structure. Many small firms may not have the resources to manufacture products they have created, but rather decide to license their intellectual properties abroad. Bradley (2005, p.243) suggests that international licensing is an interesting and viable alternative "for the internationalization of smaller firms that might not have the capital or foreign experience to establish a joint venture or a wholly owned subsidiary abroad." This view is shared by Root (1982) in his pioneering work on entry modes. Buckley & Casson (1993) also point out that licensing can be a viable option to small firms, because it requires less capital investment than FDI and less management resources than a strategic alliance or joint venture. For Buckley, Press, and Prescott (1993, p.277), licensing is an alternative when firms have "limited available assets".

This is also the case of new international ventures or born global firms, that is, firms that entered international markets shortly after their inception. These firms are said to creatively combine different non-equity entry modes to serve foreign markets, taking advantage of their capabilities and overcoming their limitations (Jones, Coviello, & Tang, 2011; Keupp & Gassmann, 2009).

- *Firm Activities*

Certain firms limit their activities to specific stages of the value chain. Even very large and successful multinationals, such as Nike and Adidas, have adopted a business model based on the control of the design and marketing functions, leaving manufacturing and local sales to a third party. Several Italian footwear manufacturers have also adopted offshoring, having their products manufactured by third parties in low-cost countries, while keeping the design and marketing of their products in international markets. Also, a number of firms in several industries are specialized in specific stages of the value chain. For example, there are firms specialized in designing products for other firms to manufacture under a license agreement. As a result, these firms do not consider exporting or manufacturing as alternative entry modes, and tend to have licensing as their single option to enter foreign markets.

Firms may also develop new products or technologies with the explicit intention of licensing their intellectual property. As pointed out by Meyer, Tinney, & Tinney (1985, p.197), some firms may license "trademarks for use on merchandise in product categories that are unrelated to the product for which the trademarks were originally developed", in which case it could be seen as "a diversification move". Examples abound. For example, some firms in the audiovisual industry are established to create content (such as games, movies, or animation), and later license the production of toys, clothes, books, houseware products, bags, etc., based on the characters presented in the content. These firms do not face the choice between manufacturing and licensing, because they do not have the capabilities to manufacture such a broad range of different products, which are in fact produced by different industries, with different technologies, raw materials, etc. Firms in the fashion industry also license their brand names for manufacturers in a large variety of industries (e.g. clothing, houseware, jewelry, etc.). Cavusgil, Knight, and Riesenberger (2008, p.454) claim that high-technology firms "routinely license their patents and know-how to foreign companies." These firms see their core business as the development of technology or content, and not the direct application of their intellectual property in different manufacturing industries.

- *Market and Industry Characteristics*

Some markets present high import barriers, as well as restrictions to foreign direct investment (Buckley, Press, & Prescott, 1993). Although Root (1982) mentioned specifically communist markets in the early 1980s, which are, with rare exceptions, no longer closed, and since then the world has seen a wave of liberalization, there are still certain sectors, particularly in the creative industries, that present very high barriers to exporting and investment, such as architecture, law, and audiovisual, only to mention a few. These restrictions may also apply to industries considered critical to national security, such as the telecommunications or the defense industries.

Several authors have pointed out that licensing may be the only feasible strategy to serve small markets (e.g. Welch, 1993; Buckley & Casson, 1993). Small markets may not justify the investments required to establish a production subsidiary (Brouthers & McNicol, 2009). The IPLC does not ignore this situation, conceding that licensing agreements may be used to serve small foreign markets. From the perspective of internalization theory, the costs of internalization may overcome the benefits in small markets, but this conclusion does not lead automatically to the choice of licensing, but often to not enter these markets, due to the risk of dissipating the firm's competitive advantage by creating a future international competitor.

- *Speed of Diffusion of Innovations*

Changes in the speed of diffusion of innovations also challenge the theoretical perspectives examined, and, more specifically, the IPLC model and internalization theory. Bartlett and Ghoshal (1998, p.14) claim that the high cost of innovation combined to the increased speed of diffusion triggered by globalization have "encouraged companies to transfer new technology voluntarily", with licensing becoming "an important source of funding" and cross-licensing "a means to fill technology gaps". This change, induced by globalization, invalidates the conclusions one can draw from the IPLC model, which remains still applicable to only a few situations. As to internalization theory, although its assumptions and rationale remain solid, these changes reduced the scope of its application to managerial decisions.

- *Mode Packages*

The simultaneous use of two or more modes of entry and operation in a given foreign market also challenges the application of existing theoretical perspectives to international decision making. Contractor (1985) was among the first to suggest that exporting, licensing, and foreign direct investment could be combined. Benito, Petersen, & Welch (2009, p.1460) indicated that although researchers often look at modes as "discrete alternatives", firms often use mode packages, with a "dominant mode within the package", and changes in modes ("some minor and subtle, others major and tantamount") and in the relative importance of each mode may happen over time. For example, a firm may license its intellectual property to a joint-venture with a local partner, thus combining a contractual and an equity entry mode. The use of more than one mode may be a source of additional revenue, increased control, or a means of reducing risk (Benito, Petersen, & Welch, 2011). However, to this point mode packages using international licensing have been insufficiently theorized and empirically studied.

6. Suggestions for Future Research on Licensing

International licensing is often used by firms to enter foreign markets, and it is sometimes the only available entry mode. In spite of this, the extant literature has largely ignored this critical decision; the main theoretical perspectives consider licensing as an alternative and less attractive entry mode. It is our contention, however, that changes in globalization have turned international licensing into a more viable and interesting alternative to many firms, especially SMEs and those operating in high-technology, creative, and service industries, or in small or protected foreign markets.

More theoretical developments and empirical research are needed to improve our understanding of international licensing. We suggest therefore the following lines of inquiry in order to reexamine the role licensing in the IB literature:

- First of all, definitions of international licensing need to be updated to include the new role of licensing, and its growing use by new breeds of firms that proliferate in the new global environment. When presenting definitions and conceptualizations, authors should clarify whether their definitions refer to licensing as a broad international strategy, an entry mode in foreign markets, or simply an operational approach to doing business abroad.
- Second, there is a need for new theoretical perspectives when examining international licensing. Two promising theoretical perspectives that have been increasingly used by IB scholars are institutional theory and the resource-based view (RBV). While the RBV provides a strong conceptual framework to understand firm resources and capabilities, institutional theory offers a broad view of how the firm's external environment – both the country of origin and the foreign market – influence internationalization decisions. In addition, industrial economics may also provide some insights on how firms in different industries may use licensing. The combination of these perspectives may provide new avenues for the understanding of how firms use international licensing as a strategic decision in their internationalization process.
- Third, longitudinal (process) studies could contribute to the understanding of how firms combine licensing to other entry modes, either simultaneously in different markets, or in the same market but in different time periods. To study the use of mixed entry modes would be a relevant contribution to the understanding of the location and timing of international resource allocation. Empirical research on international new ventures suggest these firms effectually adopt different non-equity market entry modes, responding to unforeseen opportunities or to network relationships (Jones, Coviello, & Tang, 2011; Knight & Liesch, 2016). Emerging market firms may also make more use of mode packages that include licensing than traditional multinational enterprises from developed countries, since the first often suffer of resource scarcity.
- Fourth, research could look at both inward and outward licensing activities and the relationship between them. Do firms that use licensing as an entry mode in foreign markets (outward licensing) have had previous experience with inward license agreements? In this case, what types of learning with inward licensing seem important to stimulate the adoption of licensing in a firm's international expansion? Furthermore, once a firm uses international licensing and acquires experiential knowledge, what changes, if any, are introduced in the firm's international strategy?
- Fifth, in line with the RBV, researchers could investigate what types of organizational capabilities are required to successfully use international licensing. It is conceivable that not every firm is equally capable of managing licensing agreements effectively. Therefore, the nature of the organizational capabilities that allow a firm to use licensing to achieve higher performance needs to be examined and tested. What types of firms seem to be more capable of mastering licensing agreements?

- Sixth, the role of industry in the adoption of international licensing is a major area of research to improve our understanding of the phenomenon. Which industries offer the best conditions to the adoption of international licensing? To what extent industry structure favors or not the use of international licensing? What is the relationship between international licensing and industry characteristics such as the speed of diffusion of innovations, the degree of maturity, and the technology level of the industry? Moreover, the value system of the industry may interfere in the use of international licensing.
- Seventh, similarities and differences between the home and the host country environments may influence international licensing decisions. To examine this issue, institutional theory can provide an alternative theoretical framework to internalization theory, using the constructs of regulative distance, cognitive distance and cultural distance (Scott, 2001; Tung & Verbeke, 2010). Furthermore, firm size, age and international experience may moderate the impact of distance on licensing decisions.
- Eight, one could speculate on the relationship between state control and the use of licensing. There is some evidence that state-controlled firms are more ready to accept risk in their international expansion than other firms (Knutsen, Rygh, & Hveem, 2011), due to relationships between national governments, as well as the existence of bilateral or multilateral agreements. To what extent state control influences the choice of international licensing is still open to research.
- Finally, the link between licensing and international performance needs to be thoroughly examined.

Summing up, there are several research opportunities on international licensing, an issue that has remained relatively unexplored both theoretically and empirically in the IB literature. We argue that there is a need to better understand this issue, and present several potential avenues for future research.

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