Lessons from Royalty Negotiations: Fool Me Once, Shame on Me
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Negotiating royalties is challenging under the best of circumstances. Below I outline several real-world examples of successes, near-failures, and collapsed deals. Not surprisingly, in the failed and nearly failed deals, emotions and personal objectives rather than business economics drove the negotiations.

Example 1: David versus Goliath

Several innovators (we'll call them the Davids) from a corporate giant (Goliath) formed a start-up company and attempted to negotiate a license deal to acquire the rights to the technology that they developed while at Goliath. Goliath had no use and no intentions to use the technology.

The Davids asked Fuentek to assist them in their negotiations. During our initial call with the Davids, they indicated that they planned to offer Goliath a whopping 60% royalty rate. "Why so high?!" we asked. The Davids were paralyzed with fear that Goliath would shut them out. Without the technology, they had no business.

We pointed out that at a 60% royalty rate, they wouldn't have a business, either. "Run the numbers," we recommended. After doing some financial analysis, the Davids realized that we were right. To be successful, they had to not only get a license, but do so at a more reasonable rate. We were able to help them negotiate a license that started out at 5% and ramped to 10% over time. Working from a position of strength—based on the merits of their business plan rather than a position of fear—the Davids were able to negotiate successfully.

The deal was a huge win for both parties involved. The Davids successfully built their company and sold it a few years later in a multi-million-dollar sale.

Lesson Learned: Put fear and emotions aside and examine the economics of the deal.

Example #2: Sometimes a Bird in the Hand Really Is Worth Two in the Bush

Now let's consider a deal that on the surface appeared to be a "give away." A Fuentek client was approached by a company for a single-use, internal-use-only technology license. We estimated the value of the technology to the prospect at $100K in cost savings. But the prospect had offered only about $10K for the license.

On the surface, this seemed like a poor offer that fell well short of the true value of the technology. However, the innovation was a method for improved manufacturing, and any infringement would be virtually impossible to detect. The licensor believed that if they rejected the offer, the prospect would use the technology anyway, and the licensor would have great difficulty enforcing their patent.

Based on this logic and our royalty negotiation discussions, the client decided to take what they could get, and accepted the offer as is.

Lesson Learned: When evaluating a deal, always question what the outcome would be if you don't go through with the deal. Sometimes withdrawing from the deal may be more expensive than taking a low offer.

Example #3: Blinded by Greed

Now it's time to talk about economic realities. The licensing manager from a Fortune 100 company called Fuentek to tout a deal that he had just signed. Several internal innovators had formed a start-up and licensed their technology—and the licensing manager was thrilled to have negotiated an up-front payment of $1 million, payable in three installments over the first year.

This scenario was quite similar to one faced by our Davids as they attempted to negotiate with a Goliath. But this time around, Goliath had won the first round of negotiations.

Although we hated to burst the licensing manager's bubble, we predicted that the innovators would be back to renegotiate the license before the second installment was due. "Cash is king in a start-up," we said. Such an up-front payment created a heavy burden that would drain the start-up's coffers. The liability also would prevent the start-up from getting additional funding from other investors.

The licensing manager brushed our comments aside and insisted the deal was a good one.

History told otherwise when the innovators returned several months later with a request to renegotiate the deal. Fortunately for everyone involved, this time around the Goliath involved was more reasonable, and we helped the group develop a win-win deal.

Lesson Learned: Look at all of the implications of a deal—both for the licensor and licensee. To be successful, a deal has to make good business sense for both parties. A good deal is one that works for everyone.

If you would like to discuss the concepts presented here in further detail, please contact Fuentek at info@fuentek.com or 919-249-0327.