

# Good and Bad Licensing<sup>\*</sup>

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February 13, 2010

PRELIMINARY: PLEASE DO NOT QUOTE

## Abstract

We consider an equilibrium search model of an industry with two types of firms: established manufacturers with scarce R&D opportunities and emerging intellectual property (IP) business models, patent-holding companies (PHCs). The manufacturers invest in R&D and practice their innovations, but PHCs search for opportunities to license their technology/IP. A PHC and a manufacturer can meet either before the manufacturer has come up with an innovation, leading to a technology transfer and an *ex ante* licensing negotiation, or afterwards, leading to an *ex post* licensing negotiation. The latter takes place in the shadow of patent litigation and the manufacturers can use IP to reduce the probability that an infringement holds in the court. We determine the equilibrium mix of manufacturer and PHC types and consider the PHCs' entry incentives and the manufacturers' incentives to invest in IP. The model also generates predictions about licensing fees and industry-level licensing activity.

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<sup>\*</sup>We thank Xavier Carpentier, Pekka Sääskilahti and Juuso Välimäki for useful discussions. This project has received financial support from Nokia.

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