CHARACTER AND ENTERTAINMENT LICENSING: AN OVERVIEW

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INTRODUCTION

Economic Conditions

Economically speaking, the licensing industry as a whole is trending up, having taken a financial dip following the downturn of the economy, as the economics of licensing tend to reflect the conditions of the marketplace, although there are exceptions. If we take a look at the American licensing industry from 1996 to 2005, we see that the industry peeked in 1999 at US Dollars mark ("USD$") of USD$74,15 billion, having been at the level of USD$72,28 billion in 1996[1]. The very next year it fell to USD$73,75 billion[2].

In 2001, the licensing industry took a significant tumble, and fell to a low of USD$ 70,3 billion[3], its lowest point over this ten year span. Since 2001, the licensing industry has hovered around the USD$70,5 billion and 71,21 billion mark[4].

The question is what caused this meteoric rise in licensing revenue in 1999, and the inability to sustain that growth in 2000? Like most things, there is no simple answer, and no one factor accountable for this financial bubble, in what had, up to this point, been an industry that had witnessed reasonably steady growth. Was the industry just responding to the financial state of the economy, or were there other circumstances at play that were impacting the market.

In analyzing this period, I suggest that the single biggest factor responsible for causing such a large increase in revenue in a one year period was the introduction to the market of the first of Lucas' new installments of his long awaited second three part STAR WARS Trilogy. If ever the licensing industry was offered a "sure thing," this newest STAR WARS film (of his prequel set of films), was such a venture.

Licensees quickly lined up to in hopes of obtaining a license in their product category, many agreeing to pay significant Advances, and pledging lofty Guarantees in order to capture such rights. No one questioned the potential of failure after all, this was *STAR WARS!* When the film broke the actual retail results experienced by many of these companies was quite different then the anticipated outcome. Many licensees produced and distributed more product than they normally would have, but were forced to do so in order to meet the level of their Advances and Guarantees. The consequences of such actions were an overabundance of merchandise in many categories at retail, often causing retailers to markdown such goods early in the product distribution cycle.

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[1] The Licensing Letter, January 2, 2006, Page 1.
[2] Ibid.
[3] Ibid.
[4] Ibid.

The following year 2000, did not have the benefit of booking Advances for new STAR WARS licenses, and its economic difficulties were further compounded by a number of licensees finding it hard to meet their contractual financial commitments due to poor sales, or a markdown of price-points. Thus, STAR WARS income numbers did not meet the forecasted projections, and results helped to drag the overall licensing income numbers down for that year.

In the years since 2000, the US market has only fluctuated by one billion dollars since 2001 till now. From year to year, the growth or loss rate has been reasonably small, giving rise to the belief that such movement is more a reaction to the state of the economy then to the influence of any one property. It is hard to say whether the effects of the STAR WARS licensing program linger in the minds of many, or there has not been a property since to command the same financial impact. Regardless of the answer, general economic conditions, or other factors have been the leading force affecting the state of the licensing industry.

Industry Segments

On a worldwide basis, the entertainment segment continues to hold its lead as the largest financial slice of the licensing pie[5]. However, the corporate licensing category each year gains more ground in the North American market, but in comparison to worldwide numbers, it still clearly ranks in second place behind entertainment.

As the US market has matured in terms of embracing the licensing model as an acceptable form of marketing, many manufacturers have come to view entertainment licensing as either “hit” driven or some cases, especially film licensing, more as of a form of promotional licensing due to the often short term life span many of these titles have had in the market. On the other hand, corporate licensing, known also as brand licensing, allows for long term growth of a licensing program, often promising the licensee an endless opportunity for the development and merchandising of a brand extension based on a well known brand name or corporate symbol. This has generated significant appeal to many manufacturers who have tired of building licensing programs based on character or entertainment properties, often investing significant sums of money in product development and marketing only to find that within a two to three year time span the property no longer has consumer appeal.

With such an obvious distinction between the two, why is corporate licensing still trailing the entertainment category? Perhaps the reason is due in large part to that which was the initial draw to entertainment licensing in the first place – the amount of consumer exposure that entertainment licensing can generate in comparison to all other forms of licensing. No other form of marketing is willing to spend, in such concentrated volume, the amount of money that the film industry does when it opens an “A” title film. No other industry can boost awareness of title or its characters then are the successful entertainment properties. And no other industry has the support or use of as much “star power” as does the entertainment industry. Thus, when a new film breaks there is likely to be significant interest by the licensing community in the property, more than likely it

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[5] Licensing Industry Survey 2005, International Licensing Industry Merchandisers’ Association, Page 4.

will be supported by a (often worldwide) massive marketing campaign, and promoted by well known Hollywood stars. All of these well orchestrated marketing tools provide significant exposure to the consumer, providing licensees with the awareness they need for them to sell-in their products, and then (hopefully) achieve strong retail sell-through.

While corporate and brand properties offer licensees the ability to take advantage of well known and established company images and brands, when the licensee is ready to market its licensed brand extension products, there are few if any integrated star-studded media campaigns to support the licensing effort. The licensee is often left to provide his own marketing effort to gain consumer awareness, and to achieve buyer interest. The media support and consumer awareness factors that accompany most entertainment properties are of immense value in license selection process, and for this reason, entertainment and character licensing will remain a hard category to overtake.

According to the 2005 LIMA Survey, the other licensing categories that were trending up in include Music, with an increase of 4.9%, reaching a Royalty volume of $128 million, the Art category that saw a rise of 2.9%, topping out at Royalties of $175 million, and the Non-Profit group, which gained 4.8%, hitting $43 Million in Royalty earnings for the year.[6] These categories in addition to those of Collegiate Sports, Sports (leagues and individuals), Fashion, and Publishing comprise the major licensing categories in the licensing industry, both in the US market and around the world.

Product Segments

A number of product categories have shown excellent growth while some have lost ground. Whether these changes are due to market trends, new developments in technology, or simply the fickle nature of consumers, it is anyone's guess. According the LIMA 2004 Survey, the 17 product categories were ranked in the following manner:

1. Apparel
2. Toys/Games
3. Videogames
4. Gifts/Novelties
5. Accessories
6. Food/Beverage
7. Home Décor
8. Housewares
9. Health/Beauty
10. Paper Products/School Supplies
11. Publishing
12. Footwear
13. Other
14. Music/Video
15. Sporting Goods
16. Infant Products
17. Promotions[7]

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[6] LIMA Press Release *Royalty Revenue in all licensing Categories increased In 2005*, June 20, 2006
[7] LIMA Survey, Ibid, Page 14

In looking at those product categories that had the largest percentage growth for the year, the list is quite different. The top five product categories increasing their market share for the year included:

1. Housewares / 17.3% Growth
2. Home Décor / 6.7% Growth
3. Promotions / 4.9% Growth
4. Toys/Games / 4.4% Growth
5. Health/Beauty 3.1% Growth[8]

Looking at the overall product spectrum in the time frame of 1998 to 2005, it is interesting to note some of the changes that have occurred in these products category. For example, the Housewares category has more than double in sized in its sale of licensed products, while the Infant Products market has declined by almost half its size during this period. The Music/Video segment has gained roughly 67%, while in the same amount of time, Sporting Goods racks up a 21% loss of market share. And as a final example, Paper Goods/School Supplies almost doubles is sale of licensed merchandise, in this time frame, as the Toys/Games industry saw a decrease in licensed sales of about 14%.[9] Why do same categories enjoy significant gains, and others decrease their sales of licensed goods? There are perhaps many reasons, but it is interesting to note that several of the categories that decreased in sales of licensed products, are categories whose products are targeted to young consumers. Does the drop in recent years of world's birth rate have an effect, and therefore the reason has no correlation to licensing? Or, is it directly related to the issue of licensing, and a lack of successful new properties targeted to this juvenile market?

Retail Climate

Even when the economy falters, licensing has proven to be an excellent investment for many manufacturers, providing a mainstay for certain of their product lines. Given the built-in awareness that licensing provides for those products, many retailers have continued to support a number of licensed lines even in the face of soft economic conditions, relying on the factor of consumer awareness to maintain product sell-through. What has hurt the licensing industry the most is the reduction of the number of licensed properties that many retailers now carry in comparison to years past. For many of the larger retailers, they are more likely to buy into only the larger licensing programs that offer significant product choice, the potential of third-party advertising dollars, and the possibility of licensor supported retail promotions.

The real question is what does then future hold in store for the entertainment licensing business as a whole? Today's retail climate is beginning to trend up, from an economic slump, the forecast for our industry is looking brighter. Those values that entertainment licensing provides licensees remains intact: the ability to develop, manufacture, and sell merchandise that has built-in and proven consumer appeal.

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[8] Ibid.
[9] Ibid.

Father to the modern licensing movement, entertainment licensing has been the catalyst propelling most forms of product-based licensing to prominence in the retail economy. For the year 2001, the total spectrum of licensed merchandise, across all categories, accounted for (approximately) $70.30 billion dollars of retail sales in the United States and Canada.[10] Of that total, entertainment related product sales were valued at $13.70 billion dollars, or 19% of all licensed products sold[11]

In this chapter we will define what entertainment licensing encompasses. We will also look at the historical rise of entertainment licensing, its importance in today's marketplace both here and abroad, and those factors which are impacting its continued evolution. Stay tuned.

[B] Definition of Character and Entertainment Licensing

Before we can talk about character and entertainment licensing, we should define what it is we are referring to. To simplify things, although this chapter is titled "CHARACTER AND ENTERTAINMENT LICENSING," we will draw no distinction between the two, lumping it all together as simply entertainment licensing. The rational is simple; cute, fuzzy, and cuddly characters are, most often, developed for the purpose of entertaining.

Generally, the distinction between the two areas is this: Character Licensing is applied to those properties that are based on the assemblage of characters. Whether these characters are animated, puppets, or live folk attempting to act as if they something like a puppet or drawn character (frankly they are not fooling anyone), these creatures are the focal point of the property, and upon which all stories are based. This material can be developed in a number of formats, such as theatrical films, television shows, direct to video content, or material for new media including web-programming, phone downloads, etc.

Entertainment Licensing is based on material created as media entertainment in the first instance, and does not focus exclusively, nor center on a specific character or group of characters/figures. It is generally broader in focus, incorporating a range of diverse characters, settings, and/or other elements – meaning, its range is generally broader.

Entertainment licensing includes those properties developed for the purpose of providing its intended audience with material that entertains. Webster's New World Dictionary, Third College Edition, defines entertainment as: "Something that is interesting, diverting, or amusing." Thus, if a property is created for the express purpose of providing entertainment then it belongs in the category of entertainment licensing.

The entertainment licensing category is responsible for a considerable amount of all licensed product sold, and thus responsible for a significant portion of royalty income. Within entertainment licensing, toys and toy-related products are the dominant goods sold, with the video game category coming in as the number two category. We will therefore use the toy category as the principle example throughout this chapter.

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[10] The Licensing Letter, January 7, 2002, Page 1.
[11] Ibid, Page 3.

[C] The Historical Role of Entertainment Licensing

[1] In the Beginning…

There is little dispute that the roots of entertainment licensing lie at the feet of a small mouse – Mickey Mouse that is. The creation of Walt Disney and a breakthrough on a number of levels, Mickey Mouse is also recognized as the father of entertainment licensing. Starting in the very late 1920's – early 30's, this little creature captured the attention and hearts of millions. In addition to providing big screen entertainment, Mickey also found a home on a variety of products, mostly those aimed at the children's market.

Herman "Kay" Kamen, the man responsible for introducing Mickey to the manufacturing world, felt that if the use of Mickey's image created product sales, then Mickey's creator was due fair compensation. But what would constitute fair remuneration for the use of Mickey's image? Kay's response to this question was to set into motion a standard the industry still uses as the principle method by which property owners charge for the use of their property. Kay's answer was to charge the manufacture (licensee) the going salesman's commission rate of five percent; thus the royalty was born.

[2] The 1970's

There was little change in the world of licensing from the 1930's to the 1970's, although many new images from a variety of different properties were marketed on an ever widening array of goods including toys, clothing, books, records, and school supplies. The royalty rates crept up only slightly. Manufacturers relied on the entertainment community to provide both the properties and media exposure. Television remained the chief catalyst for creating interest, both for the consumer and for the manufacturer. Saturday morning cartoons on the three alphabet networks (ABC, CBS, and NBC) were the dominant medium of choice – really the only medium of choice. From time to time, a theatrical film would have a fleeting moment of popularity, although the licensing of feature films remained a tricky business, and of significantly less interest. It is interesting to note that, with the exception of Disney, most Hollywood studios did not even have an in-house licensing department, but relied on outside agents when such need arose.

[3] Television

The 1970's, and the birth of television syndication changed the face of entertainment licensing significantly. As Saturday morning provided only one day a week exposure, the market began to realize that syndicated programming, those shows sold to a cobbled assembly of non-network television stations, could/would afford five times per week exposure, and thus greater impact and market penetration. This was a watershed event for entertainment licensing. It not only provided an opportunity to increase a show's media impact, but it also provided a means for those outside of Hollywood to market their own television properties, and thus create their own television based licensing programs.

Strawberry Shortcake was the first successful property that took advantage of this new trend. Based on an American Greetings card property and in a well-coordinated fashion, the Kenner Toy Company and the other divisions of the General Mills Toy Group, banded together to create both half-hour animation shows and corresponding product lines. This toy company/greeting card company agglomeration acted as both creator and licensor, granting rights to a comprehensive cross section of companies that eventually flooded the market with licensed goods. The initial result was pure success. Audiences watched the animated series, and bought the product. To their credit, both Kenner/General Mills and American Greetings went to great lengths to coordinate the marketing of Strawberry Shortcake, investing significant dollars into retail promotions, and working hard to ensure that each licensee complied with rigid standards concerning product quality and adherence to design guidelines. Many groups followed suit, as toy companies formed partnerships with greeting card companies and other creative entities to use their materials to develop both syndicated television shows and build comprehensive licensing programs.

As with many such good ideas, the Pig Principle set in – if it works, do to death. The marketplace soon found itself glutted with half-hour syndicated shows, and multiple lines of resulting products, as property owner/toy companies quickly became themselves licensors peddling rights to non-toy categories in the same fashion as Hollywood studios and networks. No longer did it seem that the mom and pop toy retailers concerned with the quality and "play factor" of the toys they purchased. Instead, what seemed to matter most was the hope of massive amounts of media, and the promise of large retail campaigns. These were the primary concerns that were now dictating toy purchase decisions. Buyers who only a few years ago were oblivious to television ratings or other such rating tools, were now demanded to know a property's media reach, market share, and time period. Death of this trend could not be far off.

[4] Motion Pictures

A four letter word changed the film side of entertainment licensing – *JAWS*. In the mid-1970's, audiences flocked to theaters across the country to watch a very believable shark chew up inhabitants and water toys of a serene New England beach front town. The success of the film generated consumer demand for all things shark, and manufacturers responded with stuffed, mechanical, bendable, and floatable versions of this deadly but somehow lovable shark. To prove that this was not a one-time phenomenon, a cute-in-an-ugly-sort-of-way character named E.T. also caught the public's fancy. Contrary to film's end, E.T. did not go home, he went to retail. Plastic figure E.T., plush E.T., board game E.T., and my personal favorite – clock in the stomach E.T., became all the rage. Retail found themselves in short supply of this space creature, and if you were lucky enough to hold a license, for a period of time, it meant that you were likely to have a very profitable year. Shortly thereafter came the crème de la crème; Star Wars.

Star Wars was not simply a licensing bonanza; it truly changed the face of entertainment licensing, and perhaps licensing in general, as it promoted this marketing art form to level it had never reached – respectability. With success of JAWS and ET already retail history, and the sustaining sales of Mickey Mouse and a handful of other such animated characters, the enormous impact that STAR WARS had on the retail and manufacturing markets was the tipping point for licensing. It proved beyond all doubt the impact that media could have on consumers, and the degree to which their product choices could be influenced by what they watched, be it a film, or television program.

The film was initially represented by the newly established 20^{th} Century Fox Licensing Department. Prior to its release, the film stirred little licensing interest. Presentation after presentation met with little success, until Kenner jumped aboard, and with it a watershed change in the manner in which future entertainment properties would be licensed. The Kenner licensing agreement created a new licensing and merchandising entity, the “Master Toy Licensee.” Kenner demanded, and received, all toy related licensing rights to the film and its sequels. This not only provided the company with a large number of product categories, it also implied that Kenner would be supporting the property with a range of products, a significant marketing commitment, advertising that was likely to include television commercials, and a robust retail promotion program that would ensure retail visibility for its products. To smaller companies, especially those whose products could not afford the luxury of television, print, or co-op ad budgets, Kenner’s marketing commitment helped open retail doors for their Star Wars goods. From that point forward, most entertainment properties have sought a master toy licensee as the first and most integral facet of a coordinated licensing program. Commitment from a significantly large toy manufacturer in the role of master toy licensee all but insures that other companies will follow suit in securing other licensing rights.

[D] Character and Entertainment Licensing: Today’s Trends

Just what is the status of Entertainment Licensing today? The answer is not easy, as the marketplace today is very different then it was back in the 1970's. Many changes have occurred since then, many of which have significantly changed the manor in which the business of entertainment licensing is conducted.

[1] The Property

The entertainment vista is a changing landscape. Tastes change. Popular culture is consistently being bombarded by many influencing factors, some are obvious and some rather subtle. Changing attitudes and interests reflected in the type of entertainment material produced, and sometimes in the manner in which they are marketed, are often shaped in part by the prevailing public viewpoint. This is distilled and reflected back in the types of products that then appear at retail. What may have been an acceptable form of entertainment yesterday might be considered unacceptable now. Examples of this are plentiful even in children’s programming. Take for example the often gun toting Warner Bros. Looney Tunes Characters such as Elmer Fudd who took great pleasure aiming his shot gun at Bugs. Not an image that mother’s really want to their kids to be watching in today’s anti-gun society.

These same influences have impacted certain products and product categories. The second RAMBO film almost single handedly brought about a revolt by parents (let’s be honest here, it really was mothers), who raised a considerable outcry against the sales of toy guns that were being sold based on this film. The amount of media this protest received lead to congress taking steps to legislate stiff regulations restricting the sales of toy guns, a line of product that had, up to this point, been a well established high volume mainstream toy product.

The methods of negotiating licensing agreements have also continued to evolve. At the dawn of modern day licensing, contracts were most often negotiated to include a broad swath of rights. Today, product categories tend to be more narrowly defined, providing the licensee with very specific product rights. Licensing was built on the premise of exclusivity. A manufacturer was willing to pay sums of money in the form of advances and guarantees in order to obtain a sole and exclusive right to become the sole owner of certain rights, which then allowed him to “control” those rights in terms of being the only supplier of such goods to the retail community. This concept provided the manufacturer with considerable leverage with retailers, especially when he held rights to a property and product that was in demand and he represented the only source. Today, most licenses are only available on a non-exclusive basis allowing the licensor the right to freely license multiple companies to hold the same rights if he chooses to do so.

While the financial instruments of the licensing agreement have remained consistent, the manner in which they are used has changed. The advance, that sum of money often paid at the commencement of the licensing agreement remains the same. However, the guarantee, an amount of money that the licensee has pledged to the licensor, regardless of the success or failure of the license in question, has been transformed. Although both the advance and guarantee continue to be recoupable sums, meaning that the royalties paid during the term of the license accrue against monies paid (advance), and monies due and owing (guarantee), many licensors, now demand that guarantees be paid prior to the end of the term of the licensing agreement, often within the first year or 18 months of the agreement. Hardened by having to “chase” licensees for payments of outstanding guarantees at the end of a licensing agreement, the practice of arranging a payment schedule of the outstanding guarantee over the course of the contract, has become commonplace.

On a more positive note, with the development of more sophisticated products, such as video games that require not only a sizable capital investment on the part of the licensee, but development and production lead times that can take up to two years, the average length of a licensing agreement has steadily increased. In the 70’s a one year contract was the normal term for most licensing agreements. Today, the average term is between two to three years, and in some categories, the span of a contract can extend from five to seven years.

In our more “PC” society, there is greater sensitivity by both retailer and manufacturer to consumer attitude. Case in point: Activision, ready for release of its Spiderman video game, removed buildings from the game that resembled the World Trade Center Towers in the wake of September 11th. The licensor could not afford to ignore the heightened public sensitivity to the twin tower images. Rather then risk consumer backlash, the company spent a considerable sum of money to digitally remove the images.

Failure to ignore public opinion or the public's reaction to negative elements of a property can place a licensing program at peril from the onset. An excellent example, in my opinion, of such a failure was the Barney The Dinosaur licensing program. Almost from the onset of this purple character hitting the television airwaves, parents began to bemoan how insipid and uncreative this character was and a backlash to the property began to mount shortly after its debut. Rather than take seriously this growing reaction among adults to their creation, the producers of the property chose to ignore it, and plunged ahead with an ambitious licensing program that soon filled the market with a great deal of purple products. It seems that two year olds, the property's core audience, rarely carry significant amounts of cash when shopping. Market research has shown that this consumer group most often assumes that their stroller pusher will complete any financial transactions on their behalf. Well guess what happened, those stroller pushers, most often adults, decided that they just did not want to buy Barney The Dinosaur. The meteoric rise of the purple beast had a meteoric decline. Bye Barney.

The other issue which plagues some licensing programs is the poor choice of which products categories are selected for inclusion in the property's licensing program. The entity charged with the responsibility for managing the licensing program of property must represent the property as it is, and not as they think it should be. Assuming that the licensor has little influence over the property it is charged with representing (agents and/or licensing departments for the most part do not have script approval), then care must be demonstrated to direct all licensing efforts toward those categories of goods best suited to the property. The attempt to force fit a property to a product does not work. Whether it is for reasons of monetary greed, to placate a licensee, or some other reason, time and again, we often see results of such efforts in the retailer's markdown bin left begging to be purchased at some ridiculous price reduction.

Another dilemma is those licenses that mimic or imitate successful properties. Often a popular license will spawn copies, most of which fall well short of the original, and help to generate an over-proliferation of the trend. Being second or third in the marketplace with a similar concept is very tricky. Frequently, both licensor and licensee of these kind-of-a-likes will over-estimate the public's interest, and find that the market has lost interest just about the time their goods are hitting the shelves. This results in lost sales, markdowns, and an opportunity for the retail to bash the licensing industry with yet another failed property, when in fact the original licensing concept was quite successful.

There are also those times, acting with the best intentions or at the demand of the property owner (you can also read that as studio), licensed products are thrust onto the retail shelves before there is any real consumer awareness or interest of the property. The axiom that retailers have a short attention span is all too true. Merchandise that fails to attract sales is often swiftly moved to the markdown table, a sure sign to the consumer that the license is dead or dying. To mitigate this, it is wise to allow the property time to achieve some level of awareness in the mind of the consumer *before* it appears on retail shelves. There is only one opportunity to be new and fresh, and those properties that move too quickly into the market may find that there is little or no consumer interest in their property, and thus little or no motivation to purchase the resulting licensed merchandise. From then on it is a battle to remain in place until sales pick up. Given that many products require a year (sometime more) to reach the market, it is advisable to plan the retail launch of products to coincide with that point in time when the property is likely to have the muscle to help licensed goods achieve a strong sell-through.

[2] The Retailer

Over the last two decades, the face of retail has changed dramatically. At one time the market was dotted with a larger variety of different retailers: department stores devoted significant footage to toys, games, and the like; there was a meaningful number of mid-tier retailers whose price points fell in between the high-end department store and the mass market; and a reasonably wide variety of mass marketers existed that peddled to the broadest consumer base. Today, department stores, for the most part, are out of the toy business. We have witnessed shrinkage in the number of these institutions through acquisitions and closings. The number of surviving mid-tier retailers has significantly dwindled – lest anyone try to find a Wards store in any mall, for example. The mass-market branch is unquestionably dominated by the holy three: Wal-Mart, Kmart, and Target. Earlier industry leaders such as E. J. Korvetts have long ago fallen by the wayside.

However, new systems for retailing goods have sprung up including television sales in the form of dedicated channels such as Home Shopping Network; an increase in catalog sales resulting from an even wider assortment of specialty and general interest catalogs; and certainly the Internet, as a retailing medium, with its limitless capacity for merchandising and endless array of goods, has demonstrated a growing degree of success even though it has nowhere near reached its full potential. In spite of the aforementioned shrinkage of retail outlets, today's consumer has retail options unavailable just a few short years ago.

It is important to note that the marketplace has no shortage of retail stores; it is ownership that has coalesced resulting in the concentration of decision making into fewer hands. The selection of those licensed properties that will receive retail support is being effected by this trend, as the sheer number of persons making the buying decisions is shrinking to a mere handful of people. In the past, product choice was often left to the department buyer. Today, more often it is the corporate hierarchy that is dictating which licensed products are permitted retail exposure. This has resulted in an increased importance for the licensor to market their properties not only to the manufacturer, but to the retailer as well.

With the major chains selecting fewer licensed properties to support, establishment of viable retail relationships has grown in importance. The unquestioning goal of the licensor and licensee partnership is acquisition of retail shelf space. With greater competition to achieve this end, and fewer decision makers controlling this precious space, retail relationships have become an essential factor in achieving success.

[3] The Manufacturer

In the "good old days" a nice sales piece, a few good pictures, maybe a short video reel, and possibly a handful of story lines was about all that was required to pitch a property to the intended licensee. With the evolution of the syndicated program, it became mandatory to provide a list of market clearances and viewership numbers. Today, if it is a film, the size of the film's budge, the magnitude of its advertising budget, the number of opening screens, a list of the promotional partners, and the promise or hint of a feature sequel or television series are needed for a successful sales pitch. If the license is a television show, then the question of audience share and reach are equally as important as is the question of next season's renewal forecast, in order to make a successful presentation. For both film and television there is also the big question of the interest and support the licensor has established or intends to generate within the retail community. Studios have established separate departments whose sole job is to keep leading retails advised of new releases in hopes that such information will help make it easier for licensees to achieve a sell-in of their goods.

Like retail, the manufacturing market has also shrunk. Today, there are only two top tier toy companies in the market, each having purchased a number of their rivals. No longer is the licensor able to pit competing toy companies head to head in order to generate bidding wars for property rights. Although some exceptions still exist, such as the mega-property that retains certain negotiating muscle, manufacturers today are usually in a better position to dictate licensing terms then just a few short years ago. A bargaining chip that licensors have gained however is one mentioned earlier, the now pervasive use of non-exclusive contracts. Faced with the reality that they no longer hold total exclusivity of their rights as they once did, licensees often see this threat of non-exclusivity as a form of control which can be exerted by the licensor.

Another factor that has placed a crimp in the garnering of manufacturer's interests in entertainment licenses has been the failure of the "sure-thing" property. If there was ever a license that one could hang the word "sure-thing" on, it was the first installment of the second STAR WARS Trilogy. Sold for high financial terms, and widely anticipated by consumers, licensees and retailers, this it-cannot-miss-property did exactly that, it failed to deliver forecasted results. As an example, a benchmark product, T-shirts, went on sale at half-price just two weeks after the film's release. Hasbro witnessed strong opening sales of their action figures, but lack-luster sales of the more expensive vehicles and playsets. Whether or not the film's anticipated boxoffice receipts could have ever met the benchmark set by the movie's pre-opening hype is not the issue. The failure of STAR WARS to deliver the promised sell-through of its licensed goods left in its wake a more jaded group of manufactures who no longer believed that any license could be counted on as a "sure thing."

[4] The Deal

The other big issue is the deal itself. In the beginning, Disney said there would be a five percent royalty, and all was good. Over the years the royalty load (that royalty percentage charged licensees by the licensors) is in fact a cost passed on to consumers, and is most often reflected in the retail price of the product. It is one reason that generic products usually cost less then those products that use licensed brand names. Since the 70's, the royalty percentage has escalated significantly, but recently we have witnessed little movement in the royalty rates, which for 2005, the median was 8.6%[12]. Over the past six years the median royalty for all categories were the following:

2000: 8.5%
2001: 8.4%
2002: 8.3%
2003: 8.4%
2004: 9.4%
2005: 8.6%[13]

What is interesting to compare are the median royalty rates and those average royalty rates within only the entertainment/character category. What we find is that there is a significant difference between the two sets of numbers. The entertainment/character category charges a considerably larger royalty rate than the median average, and on average more any other licensing category with the exception of the music category[14]. Below are the royalty rates for the entertainment/character category for the same six year period:

2000: 10.4%
2001: 11.0%
2002: 10.8%
2003: 11.4%
2004: 11.0%
2005: 11.0%[15]

In comparing the two sets of figures over this six year period, the median royalty average was 8.6%, while over this same period, the average entertainment royalty average equaled 10.93%. The difference, 2.33% may not seem so significant, but one must take into consideration, that in most cases the cost of the royalty is included in the wholesale price of the product. Therefore, when the item is priced for retail purchase, the cost of the royalty, which is then past on to the consumer is usually doubled, as the wholesale price of the product is doubled by the retailer from it wholesale base price.

Advances and guarantees have always been an integral component of the licensing deal structure. A necessary ingredient, rights have a value, and consideration has always been measured by the size of these financial instruments. The question today is are these fundamental financial tools being misused by licensors?

The guarantee essentially serves two main purposes. The first is to ascribe a fair market value for the use of the licensed property during the term of the agreement. This sum of money, most often recoupable against royalty payments, insures the licensor a fair minimum payment for use of his property, with the hopes that ensuing royalty payments

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[12] The Licensing Letter, Volume XXX, N0. 3, 2006, Page 4.
[13] Ibid.
[14] Ibid.
[15] Ibid.

over the life of the contract will exceed the guarantee. This money (usually) must be paid in full by no later than the end date of the licensing agreement. The second function of the guarantee is to provide the licensor with a minimum amount of financial compensation for having agreed to take those rights, now in the possession of the licensee, off the market.

The advance is simply a portion of the guarantee, payment of which is often required on signing of the licensing agreement, or on signing of a deal memo – a short form agreement that may be used prior to signing of a long form licensing contract. This sum of money, as with the guarantee, is (usually) recoupable against the payment of future royalties.

The question is what is a reasonable guarantee? In my opinion, shared by many others, is that the combination of the advance and guarantee should reflect a reasonable assessment of the potential royalty earnings over the life span of the contracted term. But for some reason some licensors have lost sight of this concept, as the in many cases the guarantee has become some number that resembles more licensor wish fulfillment than a realistic appraisal of projected royalty earnings. Too often in recent years licensors have attempted to delegate the financial risk of the license to the licensee, demanding guarantees that nearly equal the total (estimated) royalty earnings the license is expected to generate during the term of the agreement. Under such stiff financial conditions, a licensee's failure to reach these projected sales goals has resulted in significant losses to the licensee; not only from failure to achieve profit from product sales, but also payment to the licensor of unearned royalties, a sort of insult to injury to the manufacturer.

In most licensing agreements, it is generally accepted that advances and guarantees are, for the most part, recoupable against the royalties due the licensor. Guarantee commitments that exceed royalty earnings therefore represent an additional loss to the licensee above and beyond the losses suffered from insufficient sales, and those other cost such as product development, marketing, advertising, etc.

The royalty percentage level must also be judiciously considered. The royalty is the most important element of any licensing agreement, as this is the amount of money per unit the licensor will earn. There are however, limits to the level of royalty percentage that any product can bear, and still make it affordable and/or competitive in the market. In categories where the retail price point is of paramount importance, an increase of even a mere percentage point can have a significant impact on retail sales. It is vital to remember that the royalty load is passed on to the consumer, and is reflected in the product's retail price, as was noted above.

The level of royalty percentage demanded by licensors can adversely affect sales performance of the licensed articles; as such increases can cause adverse consumer reaction. Simply put, the consumer may choose a lower priced item in the same product category, resulting in lower sales performance. Thus, the net effect of increasing royalty rates may, in reality, have a contradictory effect. The actual results may cause a reduction in sales, and therefore lower the overall royalty yield to the licensor.

[E] Character and Entertainment Licensing vs. Corporate Licensing

1998 was a significant year for many things, including the licensing industry, which in the US market saw entertainment licensing taking second place in terms of the gross retail sales of products. That year, retail sales of trademark and brand licensed merchandise accounted for 24% of the total $71,150 billion dollar licensed products retail market, in comparison to the 21% share of entertainment goods sold[16]. In 1997, these two categories had tied at 22% each.[17] In years prior to 1997, entertainment licensing held a clear first position in terms of retail sales of licensed products. Since that time, the gulf has widened between these two dominate categories. Today, trademark and brand licensing accounts for nearly 25% of the market, and Entertainment Licensing stands at 19% of all licensed products sold at retail[18].

There are many differing opinions as to why corporate licensing has surpassed entertainment licensing. In this author's opinion, it is due in part to the rising popularity of licensing overall, not the decreased interest in entertainment properties. Furthermore, one need only count the number of viable, well-known corporate brands available compared to that of popular licensable entertainment properties to realize that there is simply more opportunities to market established brand names and trademarks then there are popular movies, television shows, cartoon characters, or loveable creatures. Also noteworthy is that there is not the inherent short-term risk to licensing brands and trademarks that so often accompanies the licensing of entertainment properties. It is also true that the proven retail success of entertainment licensing has given rise to other licensing categories, such as art, health, beauty, and non-profit, that heretofore has not practiced this form of marketing to any great extent. The net effect of this is to cause greater competition for the consumer's dollars.

The heightened awareness of corporations as to the value of their brands and trademarks is testimony to the impact that licensing is having on the market place. Companies who previously placed little importance on their corporate marks, in terms of consumer interest vis-à-vis licensing, are now turning to the merchandising of their logos and trademarks, developing licensed products and brand extensions. Licensing success stories from such industry giants such as Coca-Cola, General Motors, and Harley Davidson, have brought the message home; there is marketing power in a well known and widely accepted brand name and trademark. Not only is there monetary benefit to be derived, but of equal of greater importance is the value of brand exposure to the consumer.

Corporations have, thanks in part to the legal profession, become painfully aware that failure to use their trademarks and brand names may place their trademarks in jeopardy. Thus, some companies for no other reason than the need of legal protection of their trademarks, companies who might otherwise remain outside of the licensing arena, have initiated licensing programs. Whatever the reason, one cannot dismiss the growth of the brand and trademark license category not only in the US, but on a global basis.

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[16] The Licensing Letter, January 4, 1999, Page 3.
[17] Ibid, January 5, 1998, Page 5.
[18] Ibid, January 7, 2002, Page 3.

[F] Character and Entertainment Licensing in the European and World Market

Other than designer labels, perhaps the most universal licensing category is that of entertainment licensed products. Although in recent years some studies show that corporate or brand licensing may have surpassed entertainment licensing in terms of total royalty income in the US, throughout the international marketplace, entertainment licensing unquestionably reins supreme.

Historically, Hollywood has played to a world stage. Its films and television shows have an audience that spans the globe. Walk into to almost any toy store on the planet, and most likely you will find products bearing the likeness of Mickey, Barbie, and a host of other American properties. In 2004, the worldwide retail sales of licensed merchandise stood at $107,335,000,000[19]. $36,835,000,000 of that of that income was earned outside the US[20].

Each international market is different. Customs, taste, and interest vary significantly. What is successful in one area of the world may not be so elsewhere. Until the 1980's it seemed that licensing was a one-way avenue, America exporting its entertainment materials to the remainder of the world. But like so many other things, this too is changing. Today, we are importing a variety of entertainment properties and styles from Europe, Japan, Australia and other markets. Dialog with international licensing agents is no longer one sided, with us pitching them to represent our materials in their markets. Nowadays, they are often seeking our aid in representing their properties here in the United States. As economic borders are being breached, our collective entertainment taste are also undergoing change, creating a greater acceptance of that which is not made in America. Just visit a local comic book store in any market in the US and it becomes very apparent that the influences of Eastern culture, in this case Japanese, has had a significant effect in altering the taste of what are now the hottest selling comics today.

So just what is the state of worldwide licensing? Using retail sales of licensed merchandise as the yardstick, in 2005, the overall worldwide sales of licensed merchandise rose by one percent to $108.4 billion[21]. The market which experienced the largest gain in percentage growth was China, with an increase of 12.5% over the prior year[22]. The Russian market experienced growth, due in part perhaps to its economic boost from a the increase in the world's oil prices, but markets such as Japan and Australia where essential flat for the year.[23]. The following are the 2005 Worldwide Retail Sales of Licensed Merchandise by Geographic Region:

[19] Ibid, March 20, 2006, Page 3.
[20] Ibid.
[21] The Licensing Letter, March 20, 2006, Page 1.
[22] Ibid, Page3.
[23] Ibid, Page 1.

Territory	Retail Sales	% Of Change	% Of Total
US/Canada	$71,200 B	1.0%	65.7%
Western Europe	$24,725 B	0.9%	22.8%
Japan	$ 7,625 B	-1.0%	7.0%
Aust/NZ	$ 1,700 B	-1.4%	1.6%
China	$ 1,125 B	12.5%	1.0%
Latin Am	$ 870 M	2.4%	0.8%
Southeast Asia	$ 700 M	2.5%	0.6%
Eastern Europe	$ 170 M	9.7%	0.2%
Other	$ 250 M	11.1%	0.2%[24]

[1] Europe

Overall, the European market witnessed an increase of less than one percent in the increase of licensed merchandise during 2005. The softest markets in terms of sales were both German and France, with sales reported as "flat" in Spain. The strongest market proved to the UK, which experienced a significant pickup in consumer spending late in the year. Germany was greatly aided by playing host to the world Cup tournament which began to reap some benefits from that event as 2005 drew to a close. In Central and Eastern Europe, business enjoyed a robust seven percent gain, greatly aided by the fact that now eight countries in that region have joined the European Union[25].

The question is what are the differences that separate the US and Europe in terms of how the business of licensing, specifically entertainment licensing, is being conducted? Surprising more and more there is less and less differences separating these markets. The same general categories prevail in Europe as they do in the US. Although by no means has the corporate/brand licensing industry matured to the level of the US market, it is certainly increasing in size on steady basis. Whether it is the importation of American brands such as Jeep, Harley Davidson, or Hummer, these brands have established penetration throughout the European marketplace. There are however some uniquely European brands that are taking hold, and it is quite likely that one day in the near future we will some of these corporate brand names migrating to the American market.

Certainly, entertainment and character licensing of both home grown brands, and American imports are the dominate form of licensing in the European marketplace. Driven by the same forces that do so in the states – media – as this market has long since shrugged off the death-like grip that so many governments held over television distribution, there has been a greater choice of programming available to consumers. Accompanying this influx of entertainment properties into European market has been an expansion of the number of entertainment properties reaching the consumer. Also the introduction of satellite programming has also had a positive impact on licensing, as it too has provide a platform for launching licensing programs.

On the retail side, similar to the American market, there has been growth of retail chains that are of significant aid to the marketing of licensing programs in general. As

[24] Ibid, Page 3.

[25] Ibid, Pages 1 & 3.

multi-store chains increase in both size and number across the European landscape, the ability to launch broad marketing campaigns and sizable promotions in support of licensed properties provide an important form of marketing support, which only a few years ago, did not really exist.

The largest problem that the European market faces is one similar to that of the US market; the market is maturing, making significant growth all but impossible. Although there is a strong and viable consumer base in the Europe, as there is in the US, each of these markets will find it increasingly more difficult to achieve all but small percentage gains from year to year. Perhaps a single property may have a momentary impact on the financial health of the market, such as STAR WARS did in the US in 1999-2000, but such growth will most likely prove to be unsustainable, and numbers will likely return to what they had been. As previously, discussed, the American has experienced almost no growth in the sales of licensed merchandise, for a number of years, moving at most one percentage point up from the previous year. The licensing picture is far from dark, with 108 billion dollars of sales, at stake, there is still plenty of consumer dollars worth fighting for.

[G] Predicting the Future of Character and Entertainment Licensing

Lacking the astrological connections of Nostradamus, I undertake future predictions concerning the fate of entertainment licensing with great reluctance. Of one thing I am certain, change within the licensing industry, both domestically and internationally, will continue to occur. Not only because change is inevitable, but due to a number of factors that are influencing the marketplace.

There are a growing number of marketing and licensing trends that are, or will have, substantial impact on entertainment licensing. Without regard to significance of importance, I offer the following list as some of those circumstances that will and/or are having a considerable influence on the entertainment licensing industry.

[1] Globalization

We have already, and are likely to continue to witness, a wave of foreign-born entertainment properties infiltrate into our domestic market. The net effect of this "foreign invasion" is a loss of revenue to US-based licensors. Simply put, if the underlying property is not "made in America," then the bulk of royalty income will flow out of the US market. This is indeed the myopic view.

True, there are a number of international properties that have been developed outside the US, and are making inroads into mainstream American culture: properties that have landed plum television slots and movie deals; been developed as video games; or invaded through literature. One need only mention titles such as Pokemon, Mighty Morphine Power Rangers, and of course Harry Potter to see what influence foreign born titles today are having on the US market.

Whilst it is true that a portion, significant or otherwise, of earnings from these properties may leave the US, nonetheless, these "foreign objects" do generate considerable dollars for US companies; for those licensors who are engaged as agents to represent the property on behalf of its international owners. Monies are also generated for those licensees who purchase licensing rights, and of course the retailers who sell the licensed goods.

The globalization of licensing can also be studied from the effect it is providing US licensors and licensees with expanded markets for their properties and products; providing the broadcast media with a broader market to for its program sales, local manufacturers to purchase sub or local licensing rights, and those local retailers who will direct order merchandise from US licensee. As the international market continues to grow, so to will those avenues continue to expand for the distribution of US based licensed properties.

In less than two decades, we have witnessed the expeditious expansion of the international licensing marketplace. Back then there were only a handful of countries that supported the retailing of US born properties. Now, we are beginning to see the awakening of China, which in only several years has already grown to an almost two billion dollar market. Can India be far behind? We have also seen smaller markets such as Eastern Europe sustain a 9.7% growth in 2005, as markets such as the US, Japan and the UK struggle to gain a mere one percent growth. While its market share is still small, with eight counties in this marketplace now members of the European Union, it is likely that such growth will continue. In this age of new media, and affordable technology, there is an even greater ability to reach a broader audience then ever before with programming that is likely to stimulate the sales of licensed merchandise. Thus, countries as Southeast Asia and Central America are also likely see an expansion of retail sales of licensed products in their markets.

These are the real benefits of the globalization of licensing, the boundless use of the world's populace as the marketplace for licensing. The benefits to our industry are staggering in terms of the impact on growth. Yes, there is a downside – mainly from increased competition from the international market in terms of those properties that will compete for royalty dollars against US bred licenses – but competition has always been the cornerstone of the American marketing system, whether it is domestic or foreign born. Fear of this trend is irrational, and born out of a disregard to consider the panoptic view of the issue: how will globalization ultimately be of significant benefit to the growth of the entire licensing industry.

[2] New Media

The emergence of new media, including the Internet, and cable and satellite television has provided the market with additional ways to launch new properties. However, as the dominance of the established networks diminishes, so too does the market share for any single program; greater program choice is delivering smaller audiences. The net effect of this trend on licensing is a greater difficulty in establishing a sizable fan base for a single show/property, the cornerstone of any licensing program.

Back in the "good old days" of the 1970's and '80's, with a commitment of a 26 half-hour animated television series (the average cost of which was about 13 million dollars for the package), with the support of a syndicator, and a master toy licensee locked up, you stood an excellent chance of creating a successful licensed property. The right toy company support (at one point there were at least ten major toy companies), and that all important television slot locked in for at least a half season – 13 episodes – the ability to attract other licensees in a variety of other product categories was reasonably easy. All you really need for good chance at success was the exposure of the property via its syndicated slot (or perhaps a Saturday morning network time period), and the master toy company's television commercial campaign, which would usually start in the fourth quarter of the second year of the show's airing.

Such hits as "Strawberry Shortcake," "CareBears," "Transformers," "My Little Pony," "Gem," and "Teenage Mutant Ninja Turtles," were the beneficiaries of this type of formula. However, there were notable flops, (least we forget "The Get Along Gang"), which only reinforced the rule that at the root of a successful licensed property there still had to be a good idea well executed. What brought this all to a halt were the rising cost of media production, and the reluctance of toy companies to continue to invest in both the cost of developing both the media and associated toy products. The major toy companies found that the numbers were becoming too large a risk: 13 plus million to fund 26 episodes of animation; the necessary toy product development dollars (depending on the property the cost for molds alone could be as high as 2-3 million); in addition to packaging, marketing, retail, and advertising costs. What was quickly becoming apparent was that working under these budget numbers, failure could bring a company to the edge of bankruptcy. There was also the additional factor of a growing competition for viewers, as the number of new properties developed under this formula had greatly expanded, increasing the risk factor by a significantly margin.

By the beginning of the 1990's this formula of toy company supported media developed properties had all but died out, in its place, the major television networks began to fund their own development, this time attempting to use live action programming in addition to animation as concepts upon which to build licensing properties. This period also marked the rise of the "boy bands," and a big surge in the music scene, as the basis for licensed properties aimed at the tween/teen market. Later on in the decade we would also saw the rise in importance of the video game market as a basis for licensing, with several video game properties creating massive licensing programs even before they found their way on to television as half-hour animation shows.

The other media impact on licensing during this period was the growing importance of PBS, the Public Broadcasting network. Although for many years PBS had had an influence on licensing with its popular children's show, Sesame Street, it is during this period that PBS rooted itself as an important spring broad to initiate a licensing program. Programming on PBS can be achieved through either a local station, regional area station group, or by the national network itself. In this fashion, championed by the Connecticut station, the program "Barney The Dinosaur" found a home on PBS, and grew to become a multi-billion dollar retail hit. Since then, many other programs have followed suit and PBS is well established an effective platform for generating the requisite media exposure imperative for establishing a licensing program.

When talking about New Media, the obvious question is what importance does the Internet play? Can the Internet, as it is used today, provide both quantitative and qualitative exposure and influence, and thus act as a viable conduit for building a base of awareness and support, sufficient to either inaugurate or sustain a licensing program? To date, this has yet to really happen to any significant degree. There is no evidence that any licensed property has been able to establish the necessary constituency by solely relying on its Internet exposure to achieve meaningful or sustaining retail sales. Indeed we have witnessed the development of certain fads and sell-through of trend merchandise, but nothing that can compare with properties that have been marketed via television.

Although Internet sites have proved beneficial for supplying supplemental information and as reinforcement to its primary media, thus far, due perhaps to clutter, insufficient means or methods of communicating site addresses, or consumer reluctance to use this medium, the Internet still remains an ineffective primary source as a launch platform for licensing. Looking forward, this may change, but for now, and the immediate future, the Internet cannot be considered as a primary media outlet as it relates to propelling a property to the forefront of public awareness sufficient for the establishment of a licensing program.

[3] Rising Cost

When entertainment licensing consisted mostly of label slapping, the placement of licensed image(s) and/or the property's title on existing product, the cost of entry into the licensing arena was quite manageable. Today, for example, the average cost to develop a video game title starts in the seven figures, and for creation of an "A" title game development costs can run as high as 10 to 15 million dollars.

As licensor's have, and rightly so, demanded that products bear a more faithful representation of their properties, product development costs have sharply escalated. This not only places greater financial burden on the licensee, it also increases risk. The net effect is a greater reluctance by licensees to acquire licenses that cannot demonstrate: an existing consumer fan base; have or maintain reasonable media exposure; and provide considerable retail support.

The rising costs associated with licensing are not only confined to those relating to the development and marketing of licensed product, it is also true of the licensing deal itself. The level of advances, guarantees, and royalty rates have decidedly crept up over the years to sometimes unrealistic proportions, but more about that under "Deal Terms."

As the cost of licensing continues to escalate, now more than ever, it is mandatory that licensees demand of licensors all pertinent information that will afford them the best advantage in making a decision as to whether or not a particular license fits their needs. Today, it is not enough to merely ask for audience demographics, share and time slot if it is a television show, what needs to be ascertained is the likelihood of the show's survival for the season, and if not, what guarantee or recourse do you have if the show is cancelled prior to completing its first season's run. If the property is a theatrical film, is there a boxoffice number that the film has to reach that locks in the guarantee? If not attained, is the guarantee nullified? Does the same hold true for a video game if sell-through figures do not materialize? Looking for some insurance against a property's failure to perform should be standard questions asked during negotiations. Whether or not you are able to achieve such concessions should not dissuade you from making the attempt.

When the stakes have escalated to the level they are today: development of an action figure line runs upwards of several million dollars to create molds and packaging; marketing of even a simple t-shirt can cost many thousands in inventory, marketing costs, and sales commissions; and contribution to retailer's ad funds, and a variety of "other" retailer charges are being dumped on manufacturers, licensees *must* demand more information from the licensor. The purpose of this is to ascertain the highest possible comfort factor *before* committing to licensing terms. Conversely, it is the obligation of the licensor to do all he can to work diligently with each licensee to ensure that they have access to the best material available for the development of licensed goods. Licensees need to be made aware of the other companies hold licensing rights to the property in an attempt to build cross marketing opportunities. In order to insure that products reach the market on time, licensors needs to treat the issue of product approval as a primary obligation that must be processed in a timely and efficient manner. Steps such as these will help to mitigate the pain of higher costs, and help achieve a better success rate for all parties.

[4] The Retailer

The retailer is continuing to expanding its role in licensing, and no longer are the key retail chains content to play a subordinate or passive role in the licensing equation. Retailers understand the importance of their shelf space. As gatekeepers to the consumer they are demanding greater participation, such as retail exclusivity, and even outright ownership of certain merchandising rights. In this new expanded role, the retailers are placing greater demands on the manufacturer, some of which are having a significant impact on the way licensing is being conducted. As example, key retailers are demanding that unsold merchandise be accepted for return. Not the usual method of sale, as most merchandise is sold on a one way basis. Many manufactures, faced with the prospect of possible returns, are asking licensors for return clauses or higher allowances in their licensing agreements to account for merchandise that is returned from retailers.

In some cases retailers, rather than returning unsold merchandise, will demand aggressive markdowns off the original wholesale price. This affords the retailer the opportunity of pricing unsold merchandise at deep discount prices without making them, the retailer, the only party to take the financial hit. In turn, the manufacturer then wants the right to readjust the wholesale price used as the basis to account royalty payments to the licensor. The net effect is that the royalty levels are decreasing even though there might be an increase in the quantity of goods being sold at retail. Problem is, in most standard licensing agreements as now written, a licensee can not reduce the base price of the licensed item below a certain percentage base (price point) without the permission of the licensor. Lacking such approval, the licensee could be forced to absorb the full impact of such markdowns imposed on him by the retailer. The original intent of this prohibition in most all licensing agreements is to forestall the "dumping" of the licensed article by the licensee; pricing the item so inexpensively that retailers can purchase the product and retail it at a significant discount to the consumer. To do so can conceivably devalue both the product and the property in the mind of the consumer, with potentially severe consequences to the perceived popularity of the property.

There is also a movement by some retailers to acquire licensing rights of certain product categories of some properties. Although this practice has historic roots that go back many years, (Sesame Street clothing has been a direct retail license for many years), we have witnessed a significant explosion in this trend. The more popular categories in which this practice has proved success include: housewares, toys, clothing, and even certain holiday products.

The counter point to the strangle hold that retail has been placing on marketplace is the growth of direct sales. With the advent of the Internet, for the first time it is now possible to generate immediate, universal, and affordable offers for all types of merchandise directly to the consumer. We have seen countless storefronts pop up on the Internet that sell a wide variety of merchandise, much of it being licensed goods. From t-shirts to toys, there is just about any type of item available online if you look in the right place.

Perhaps the one segment of the market that has benefited from this new e-tail trend the most is the category of collector goods. Often relegated to mom and pop type store, hobby stores, comic shops, or tucked away in corner of some "trend" store, the collector category has found the Internet to be a real boom to their industry. No longer is this type of merchandise subject to the whim of the retail buyer, who may or may not be in the forefront of current trend, or a fan of that particular subject matter being offered, and thus refuses to stock the merchandise. The Internet affords these manufactures the ability to provide not only complete lines, but also detailed information about each item offered, in addition to testimonials from contented collectors who have purchased such merchandise, and are pleased with the quality and authenticity of the product; a very important and necessary aspect for selling this type of product.

As consumers grow more accustomed to purchasing merchandise online, less fearful of transacting credit card purchases over the net, and buying items which they have yet to touch, feel, or smell, this from of retailing will continue to escalate. Over the past five years, online retailing has shown steady growth, with no signs of this trend tapering off. For licensors, it offers a potential bonanza, as most agreements are, or should be written, that royalties paid to the licensor track with the price at which the product is sold by the licensee. Thus, if the licensee sells the product at a wholesale cost, the royalty is paid on the wholesale price. If, in fact, the licensee is selling the same item direct to the consumer, at the full retail price point, then the licensor should be paid a royalty on the full retail cost. Therefore, the same item sold directly to the consumer (not through a retailer) would/should generate a royalty payment that could be twice the amount than if it were sold as a wholesale item to a retailer.

[5] Deal Terms

A great number of licensees believe that they no longer should or must assume a disproportionate share of the risk in undertaking a license. Faced with rising costs, a more difficult retail climate, and a greater uncertainty of which licenses will achieve sell-through success, many manufacturers are no longer willing to commit to excessive advances and guarantees. With licensing rights bidding wars that can goose advances and guarantees into the stratosphere, and sure-thing licenses failing to deliver promised financial returns, the licensees feel warranted in demanding reduced terms. No longer willing to bank large advance payments or commit to substantial guarantees, the prevailing attitude seems to be that royalties must be earned through actual product sales, rather than from over zealous sales forecasts used as the determining factor to establish advance and guarantee parameters.

Today, there is a backlash from manufactures, and licensors are to blame. Advances and guarantees do serve a purpose, and they are a very necessary ingredient of any licensing agreement. As rights owners, we are trading tangible rights in exchange for financial consideration, which is usually expressed as royalties. This is a fair trade – rights for monetary consideration – each party receiving something of equity. Both parties have, or will have to make, an investment in order to obtain profit. The licensor has already made his investment – he has built a property which the licensee believes has value. The licensee, upon obtaining the license, is now obliged to make his investment; it is in the form of the development of product, packaging, and the associated costs of retailing of the licensed goods.

In order for that property to have achieved that status, it took imagination, hard work and investment of time and dollars. This is the licensors' investment – it is real, and cannot nor should be attenuated. Thus, in any fair bargain there must be an exchange of reasonably equal consideration, therefore the need for some payment for the right to acquire the use of the property.

Concerning the purpose of a guarantee, the licensee obtains a set of rights for a fixed period of time, regardless of whether or not he chooses to make full and complete use of those rights in exchange for the agreed upon financial commitment. Once again, the only compensation the licensor receives is a financial one. Thus, the guarantee provides the licensor with some assurance that a certain amount of income will be paid for having taken these rights off the market for the term of the licensed period.

The real question is, as it has always been, what is fair compensation for those rights that the licensee is acquiring? Be assured, that a reasonable level of the advance and/or guarantee is not some budget number that the licensor needs to achieve for his quarterly or yearly balance sheet, or some "ideal" dollar amount that would satisfy a producer or superior. Advances and guarantees must reflect realistic sales projections, which in some measure are representative of the popularity of the property, the sales appeal of the product in question, and the current economic conditions of the marketplace.

If you are negotiating for rights to a popular property, but in a product category that has limited appeal, then the numbers should reflect both facts. The same is true if the general economic conditions of the market are soft, and overall retail sales are down. These factors must be taken into consideration, in order to reach terms that are both fair and realistic to both parties of the agreement. To do otherwise is to create a lopsided deal that will prove either difficult to enforce, or be assured that you are likely to face future negotiations with the same licensee.

Too often licensing agreements are negotiated in the *heat of the moment*, with little thought to the fact that there will be future properties and opportunities. It is this "in the moment" negotiation that can lead licensors to push for unrealistic terms; advances and guarantees, the level of which meet the need of the licensors' current budgetary demands (or over zealous sales and/or royalty forecasting), which are not based on realistic sales projections or current market trends. These are negotiating traps that the unwitting licensee may fall prey to, or the greedy licensee can overlook as he is blinded by his thirst for this opportunity of the moment.

In licensing, the financial payoff is the royalty; that dollar amount per item sold that a licensee pays to the licensor. In the perfect licensing agreement, the final royalty figures should well exceed both the advance and guarantee, rendering these financial instruments unessential.

In case, ignorance or greed, we the licensors should be held to a higher standard. If we are the shepherds of the licensing deal, we bear a greater responsibility for its outcome. As such it is up to us to insure that the terms of such deals reflect realistic goals. No, we should not give away our hard earned equity, but nor should we advantage ourselves of terms we know to be unrealistic. There are only a finite number of licensees operating in any one product category. As such we need to care and nurture each of these important assets, insuring that they remain players today, tomorrow, and for the future.

Taking into consideration all the above, I continue to envision a robust future for entertainment licensing. Human nature dictates a need for escape, and what better form than through entertainment and with it, a desire to own its trappings in the form of licensed merchandise...Thanks Mickey, and my best to Walt.

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