IMC LICENSING

It pays to do your homework when licensing your brand
by Bruce Bridges, Vice President, Licensing

As a leading brand licensing agency, IMC Licensing talks to dozens of leading brand licensors every year about their work. We are always surprised how many companies have developed substantial licensing relationships without having thoroughly reviewed their options in advance. Too many big companies have ended up in licensing deals only because a manufacturer came to them and presented an opportunity that seemed like a good idea. This reactive approach sometimes works out, but taking a more proactive and disciplined approach is the only professional way to approach new partnerships and build a successful and long-term licensing program.

No brand should sign licensing deals before it has established its own strategic plan for licensing - a topic for another article. Once the licensing strategy is set, however, another challenging phase of work begins: Finding ideal partners in targeted categories which is not easy. Numerous market factors, including the recent trend of retailer and manufacturer consolidation, make for a more challenging process by reducing the number of suitable partners. As a result, thorough due diligence is necessary to identify the best possible partner for the brand's licensing opportunity.

The level of due diligence and safeguards put in place will vary based on the risk level and scope of the proposed licensed products.

Top 10 Key Areas for Due Diligence

This "Top 10" approach to licensee selection due diligence initially appears a little daunting. However, the more homework that is performed in advance, the more resources and headaches saved down the road.

1. *Licensee Background.* Determining brand fit is certainly the first go/no go decision point – does this deal fit the brand's strategy and image? A manufacturer's licensing experience is important but not absolutely required. However, the licensee's philosophy and vision need to be fully understood to ensure the parties are compatible. Examining the category's competitive landscape is also important to understand who the key players are and which brands they license.

2. *Potential Conflicts.* Having the potential licensee complete a licensing application will provide good background as well as help raise any potential issues. Internal communications are crucial to ensure that a potential license

will not violate any internal policies or cannibalize the brand's core product. Potential cannibalization is sometimes tricky as it may be a valid concern or just a perceived threat.

3. *Financial.* Utilizing the standard financial tools, such as running a D&B report and researching SEC filings can provide a certain level of assurance that the potential partner will be able to perform financially. Tools to help mitigate risks in this area will be discussed later.

4. *Sales, Marketing & Distribution.* Strength in key channels of distribution is important to the success of the program. Does the licensee have strong retailer relationships in these channels already or are they planning on using your brand to open these doors? Sales organizations can take many forms including direct sales, the use of distributors or brokers, or some combination of both. If the brand is amenable, potential cross-promotional opportunities may provide another tool to promote the brand's core products alongside the licensed products giving the brand more leverage with retailers.

5. *Manufacturing Capability.* Much manufacturing is performed overseas so the brand needs to determine if this is an issue for the organization or not. The use of third party manufacturers is common in licensing – and as a result, it is important to ensure that manufacturing capabilities are documented in the license agreement and a manufacturer's agreement is required and in place.

6. *Social Accountability.* Is the licensee's Code of Conduct acceptable and consistent with the brand's position? This Code of Conduct will examine practices related to child labor, health and safety, harassment or abuse, compensation and benefits, and environmental compliance. These codes help to ensure that the rights of workers in factories manufacturing the licensed products are respected. Periodic Social Compliance Audits will help ensure that socially acceptable working conditions are maintained on an on-going basis.

7. *Reference Checking.* Checking references can be an illuminating experience when narrowing down the field or making the final decision. Talking to retailers will give insights into the reliability of the licensee and the quality level of their product. Existing licensors are also an excellent source of information – both in what they say and what they don't. If necessary, bank and supplier reference may help alleviate certain concerns.

9. *Business Terms.* Whether motivated by income generation or not, knowledge of prevalent business terms in licensing agreement is key to getting the best deal for the brand. Will the licensee have an exclusive agreement? What royalty rate is fair? What about advances and guarantees? All of these terms are negotiable and should be viewed holistically as they all are interrelated. The royalty rate will be based on a number of factors including strength of the brand and the particular product category. Advances and guarantees are usually a factor of the licensee's projections. Guarantees should not be used as a way to exploit the licensee, but as a tool to keep them motivated giving them the proverbial "skin in the game."

10. *Mitigating Risk.* A number of tools are available to help a brand mitigate the risks in licensing their brand:
    - Customized Quality Exhibit: Aside from the standard quality language in the licensing agreement, this can identify specific standards that the licensed product should be tested against.
    - Insurance Limits: Required insurance limits can be increased to deal with riskier categories like food or children's products.
    - Standby Letters of Credit or Guarantee Escrow: This can be utilized in extreme cases where financial concerns exist.

Now that the homework has been done and the agreement has been signed – the real work begins. Focus now shifts from due diligence to execution related to education of the licensee, product development, quality control, and licensee compliance.

This valuable exercise highlights why any brand licensor should be very deliberate about putting its valuable asset in the hands of a licensing partner. Having this discipline up front will help protect this valuable asset. Implementing tools for mitigating risk can also add another layer of protection. All in all, good partners are hard to find, but certainly worth the effort.

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