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Best Practices in Negotiating and Structuring Merchandise and Character Licensing Agreements

By Andrew J. Sherman

The use of commonly recognised trademarks, brand names, sports teams, athletes, universities, television and film characters, musicians, and designers to foster the sale of specific products and services is at the heart of today's merchandise and character licensing environment. Manufacturers and distributors of products and services license these words, images, and symbols for products that range from clothing to housewares to toys and posters. Certain brand names and characters withstand the test of time, and others fall prey to fads, consumer shifts and stiff competition.

The trademark and copyright owners of these properties and character images are motivated to license for a variety of reasons. Aside from the obvious desire to earn royalty fees and profits, many manufacturers view this licensing strategy as a form of merchandising to promote the underlying product or service. The licensing of a trademark for application on a line of clothing helps to establish and reinforce brand awareness at the consumer level. For example, when Hurley© licenses a leisure apparel manufacturer to produce a line of Hurley© apparel, the hope is to sell more skateboards, appeal to the lifestyle of its targeted consumers, maintain consumer awareness, and enjoy the royalty income from the sale of the clothing line. Similar strategies have been adopted by manufacturers to revive a mature brand or failing product. In certain instances, the spin-off product that has been licensed was almost as financially successful as the underlying product it was intended to promote.

Brand name owners, celebrities, and academic institutions must be very careful not to grant too many licenses too quickly. The financial rewards of a flow of royalty income from hundreds of different manufacturers can be quite seductive but must be weighed against the possible loss of quality control and dilution of the name, logo, or character. The loyalty of the licensee network is also threatened when too many licenses are granted in closely competing products. Retailers also become cautious when purchasing licensed goods from a licensee if they fear that quality control has suffered or that the popularity of the licensed character, celebrity, or image will be short-lived. Their fears may result in smaller orders and an overall unwillingness to carry inventory, especially in the toy industry, where purchasing decisions are being made by (or at least influenced by) the whims of a five-year-old child who may strongly identify with a character image one week and then turn away to a totally different character image the next week. Manufacturers and licensees have to develop advertising and media campaigns to hold the consumer's attention for an extended period of time. Only then will the retailer be convinced of the potential longevity of the product line. This type of media support requires a balancing of the risks and rewards between licensor and licensee in the character-licensing agreement in the areas of compensation to the licensor, advertising expenditures by the licensee, scope of the exclusivity, and quality control standards and specifications.

In the merchandise licensing community, the name, logo, symbol, or character is typically referred to as the "property," and the specific product or product line (e.g., t-shirts, mugs, posters, etc.) is referred to as the "licensed product." This area of licensing offers opportunities and benefits to both the owners of the properties and the manufacturers of the licensed products. For the owners of the property, brand recognition, goodwill, and royalty income are strengthened and expanded. Manufacturers of licensed products have an opportunity to leverage the goodwill of the property to improve sales of the licensed products. The manufacturer has an opportunity to hit the ground running in the sale of merchandise by gaining access to and use of an already established brand name or character image.

Naturally, each party should conduct due diligence on the other. From the perspective of the property owner, the manufacturer of the licensed product should demonstrate an ability to meet and maintain quality control standards, possess financial stability, and offer an aggressive and well-planned marketing and promotional strategy. From the perspective of the manufacturer of the licensed property, the owner of the property should display a certain level of integrity and commitment to quality, disclose its future plans for the promotion of the property, and be willing to participate and assist in the overall marketing of the licensed products. For example, the unwillingness of a star basketball player to appear for promotional events designed to sell his own specially licensed line of basketball shoes would present a major problem and would likely lead to a premature termination of the licensing relationship.

Top Tips for Successful Brand Licensing:

Choose your partners wisely.

Brand licensing typically requires a closer working relationship between licensor and licensee than does technology or software licensing, to make sure that consistent brand image is maintained in all relevant market segments. Be clear in your articulation and enforcement of brand promise, positioning and brand values. The core of the brand must have values that transcend and add value to products and services in new categories and segments. It must mean something to the consumer and have enough loyalty to carry over into other industries and applications.

Build in checks and balances, both operationally and contractually.

All brand licensing, co-branding, and brand-extension licensing should add to the value of the core brand of the owner/licensor, not dilute or harm that value. Build in quality control provisions, inspection and performance standards, and marketing and usage guidelines to protect the integrity of your brands.

Be proactive in developing new potential applications, market segments, and licensed categories into which your brands could be licensed.

Do not rely solely on your licensees for new ideas or new product development. Licensing is a proactive, not a reactive way to build shareholder value when it is implemented properly. Keep pushing your licensees to produce goods and services bearing your name that will be innovative and product leaders in the segments, not just more of the same under a different name.

Get involved in product design, packaging, product features (materials, shapes, etc.), promotional plans, and other variations of your licensees.

Do not let brand licensing be a part-time commitment of the marketing department of the company. Make sure that proper resources are committed to building a brand licensing department that will review quarterly and annual business plans of licensee, enforce performance milestones and quality control guidelines, and coordinate joint marketing efforts, such as trade shows, promotional campaigns, and sales meetings.

Andrew Sherman is a Partner and Chair of the Corporate Department in the Washington, D.C. office of Seyfarth Shaw with over 900 lawyers worldwide. He is the author of 26 books on business growth, capital formation and the leveraging of intellectual property, including his latest book The Crisis of Disengagement which was published in early 2017. Andrew has appeared as a guest and a commentator on all major television networks across the United States, as well as CNBC's Power Lunch, CNN's Day Watch, CNNfn's For Entrepreneurs Only, USA Network's First Business, and Bloomberg's Small Business Weekly.

He has served as a top-rated Adjunct Professor in the Masters of Business Administration (MBA) programmes at the University of Maryland for 26 years and at Georgetown University for 17 years in both the business and law schools, where he teaches courses on business growth strategy. He has served as General Counsel to the Entrepreneurs' Organization (YEO) since 1987.

In 2014, Andrew was included in the global IAM 300, recognising the world's thought leaders in managing intangible assets. In 2013, he was named by NACD as one of the Top 100 Leaders in Governance. In 2003, Fortune magazine named him one of the Top Ten Minds in Entrepreneurship and in February 2006, Inc. magazine named him one of the all-time champions and supporters of entrepreneurship and business growth.

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