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§7.01 CHARACTER AND ENTERTAINMENT LICENSING

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[A] Introduction

The term “*global village*” was first coined by outspoken Canadian born Marshall McLuhan, perhaps one of the best known modern scholars on the influence of media. A technological determinist, McLuhan often credited the electronic media with the ability to exact profound social change.¹ Known as McLuhanisms, terms like “*hot*” and “*cold*” came into vogue in the early 60’s when talking about judging the media. According to McLuhan *hot media* was exclusive, and *cool media* was inclusive. Another McLuhanism is “*the media is the message*,” the idea being that when it came to electronic media, it was not the content that was of greatest significance, but rather the medium itself that would have the greatest impact upon the socio-cultural environment.² It seems that McLuhan’s term “*global village*” drew the most attention then, and is still a phrase that reverberates through the telecommunications industry today. Simply put, McLuhan’s vision of the emerging new technologies would provide the capacity to electronically link the world; a world in which global consciousness would be shaped more by technology than verbalization.³ Yes, the Worldwide Net, and palm size iPhones are indeed proof that McLuhan’s insights were right on target.

But what does a heady discussion of Marshall McLuhan, and terms like hot and cool media and global village have to do with licensing; everything. Licensing is the visual proof of the vision that McLuhan held regarding the potential influence and sway that electronic media would have on the public. What better proof of the power of television or films than to point to their ability to influence significant segments of the consuming public to purchase in mass quantities of various licensed products on a repetitive basis. One need only to look at a television show like Power Rangers and the “craze” it created among young boys to own all things branded with the show’s title or characters to see the proof.

If you doubt that we have become a global village, thanks to licensing, proof of this is very easy to witness. No matter how remote or off the “beaten track” you think you may have wondered, chances are there is always a bit of licensing reality to remind you that indeed you are not quite so far from home as you think. Perhaps it is that Mickey Mouse T-shirt that you spot on some child at play, a Strawberry Short Cake doll being held by some young girl walking by or child clutching his Spiderman action figure that reminds you that the “remote culture you are experiencing has indeed begun the process of overlapping with the very one you left behind. Proof is the proliferation of licensed products comingling with those of native goods not only where you happen to be, but in just about every society across the globe.

As one can point to the influence that media has in upon the consumer, it is also true that media continues to play an important role in licensing. One such role is its continued impact on sales of licensed goods in general, not only in the US, but across the globe; the marketplace is becoming more licensing friendly. Today it is common place to find American brand names for sale in more countries than ever before. Here in America, not only is it easy to spot foreign properties amongst those “made in America,” in some cases foreign properties have had significant impact on the taste, style and development of American product – the influence of Japanese Manga style is just one example. The growth of sales of licensed goods in countries that heretofore have had limited sales of such product is additional proof. China is perhaps the best example of a market that in recent years has more than doubled its sales of licensed products, and has every indication that it will continue to expand that trend as it continues to allow more western properties to be imported.

There is also another trend worth noting that is further evidence that indeed licensing is becoming more popular, the growth of the number of regional tradeshows devoted to licensing. Not long ago the idea

¹ The Museum of Broadcast Communications, Sharon Zechowski

² IBID.

³ IBID.

of hosting a licensing show outside the US was questionable from the standpoint of amassing enough exhibitors or attendees. Today the UK Licensing Show is a well established event, and the Hong Kong Licensing Show is now going into its seventh year, pulling exhibitors and attendees from across Asia. The Japanese Licensing Show is also another example of a licensing show that has become well established, and is a “must attend” event for those in the licensing industry in Japan.

But there are also new shows, either dedicated to licensing, or adding licensing to an existing trade event. India’s long running FRAMES Convention is making a concerted effort to engage the licensing community, bring licensing into this entertainment based convention. Dubai, part of the United Arab Emirates recently hosted its third licensing tradeshow, pulling in exhibitors from many of the surrounding Arab countries, and drawing visitors from over thirty countries. Other countries such as Singapore, Thailand and Korea have held conferences, where seminars on licensing were a significant part of the program.

What this new found interest in licensing indicates is that licensing is a proven marketing method. No longer is there doubt that licensing is an acceptable form of marketing, nor is there any longer challenge to the idea of payment (the royalty) for use of trademark material. It was not so long ago when a licensor had to explain why a royalty was being charged to use of his trademarks. In a relatively few years, the licensing industry has grown from a curious novelty to broad acceptance. Why, the answer is simple, the concept works. To prove this we will look at its growth rate, and those underlying factors that are the reasons why.

[1] Economic Conditions

The general economic state of the licensing industry along with the rest of the economy took its lumps this last year, as the marketplace in 2008 was negatively affected by the downturn in both the US and international economies the effects of which caused an almost immediate decline of consumer spending, particularly on non-essential goods. Hardest hit was the all important fourth quarter, which saw many retailers either reduce or cancel orders⁴ The US market posted a loss of \$333 million (5.6%) loss for 2008, with a total of \$5656 million⁵ in estimated in licensing revenue, compared to \$5989 million⁶ for 2007. The worldwide retail sales of licensed merchandise also shrank, falling by 13.9% falling to \$91,547 billion, from the previous year’s total of \$106,335.⁷

Although the economic debacle has been widespread, not all economies have suffered, in fact some have gained ground as markets such as the US, Western Europe and Japan have stumbled. Those that have witnessed increases in retail sales of licensed goods markets include: China (+4.8%), Latin America (+4.3%), Eastern Europe (+2.8%), and Australia / New Zealand (+1.1%), all posting increases over the previous year.

In assessing the American market, it is helpful to provide some perspective by looking back at the past performances of the industry. If we take a look at the American licensing industry from 1998 to 2008, we see that the industry peaked in 2000 at US dollars mark of \$5847 million, having been at the level of \$5452 million in 1998.⁸

In 2001, the licensing industry took a significant tumble, and fell to a low of \$5606 million⁹. It would take the next three years for the industry to regain the financial ground lost, and not until 2005 when licensing revenues hit \$5952¹⁰ did it surpass the level achieved in 2000. The question is what caused this meteoric rise in licensing revenue in 2000, 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 been, up to this point, 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

⁴ LIMA Licensing Industry Survey, 2009, Page 4.

⁵ Ibid.

⁶ Ibid.

⁷ The Licensing Letter, March 2, 2009, Page 3

⁸ LIMA Licensing Survey, 2007, Page 12

⁹ Ibid.

¹⁰ Ibid.

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's new installments of his long-awaited second 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 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 were quite different from 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 mark down such goods early in the product distribution cycle.

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.

There is also a second reason that has to be considered; the state of world affairs. Licensing like any other economic element is subject to the impact of world affairs, certainly those that happen on a grand scale and which effect global markets; the events of September 11, 2001 was such an event. The aftermath of which caused an almost immediate drop in retail sales of all non-essential goods. The licensing industry in many ways is a mirror of the economy's health. In a healthy economy the industry will boom, and in a soft economy the industry suffers due mainly to the fact that a vast percentage of licensed goods are non-essential goods. However, as consumers cut back on purchases of non-essential goods, licensed products continue to prove their edge over generic products when it comes to product selection.

In the years since 2000, the US market has slowly recovered, and in 2006 reached \$6040 million in estimated licensing revenues.¹¹ But once again, as the economy has gone off course the impact on licensing revenue is felt almost immediately. Not only has the industry been impacted by a downturn of retail sales, but by the loss of key retail establishments such as Mervyn's, Linen & Things and Steve & Barry's¹². The retail market will most likely remain "soft" for 2010, but most economists see a slow but steady growth for the US, which means that as the economy rights itself, licensing revenues will also adjust according. The other piece of good news is that not all economies have been hit as hard as the US, and with more licensing revenues coming from offshore than ever before, this may help to offset some loss from domestic income. Who would have thought that we would ever count on Brazil for royalty earnings...As Dylan said, "Time's they are a changing."

[2] Industry Segments

On a worldwide basis, the entertainment segment continues to hold its lead as the largest financial slice of the licensing pie accounting for about 46% (down 4% from 2008) of the estimated revenues. Each year, the corporate licensing category gains more ground in the North American market, but in comparison to worldwide numbers, it still clearly ranks in second place behind entertainment, responsible for an estimated 17% (showing an 8% decrease from 2008) of the total licensing revenues.¹³

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 in some cases, especially film licensing, more as 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

¹¹ Ibid.

¹² LIMA Licensing Survey, 2009, Page 4

¹³ Ibid.

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 two to three years 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 because it is more than likely it will be supported by a massive (often worldwide) 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 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 2008 LIMA Survey, out of the top five licensing sectors, only *Collegiate* Licensing experienced an increase with licensing revenues of \$208 million for 2008, representing a growth of 3.6% over the previous year. The remainder of the licensing categories fared less well: *Sports* (leagues and individuals): loss of 9% (\$740 million in licensing revenues); *Fashion*: loss of 4.3% (\$810 million in licensing revenues); *Art*: loss 12% (154 million in licensing revenues); *Publishing*: loss 9.8% (\$37 million in licensing revenues); *Music*: loss 7% (117 million in licensing revenues); *Non-Profit*: loss 9.3% (\$39 million in licensing revenues).¹⁴ These categories: Entertainment/Character, Corporate/Brand, Sports, Fashion, Collegiate, Art, Music, Non-Profit, Publishing, are considered the major licensing categories for the licensing industry

[3] Product Segments

In reviewing the top royalty producing product categories for 2008, while the order of those categories remained consistent from 2007 to 2008, in 2007, every category had experienced an increase in licensing revenue from the prior year. In 2008 the opposite is true; every category experienced a decrease in royalty revenue. According the LIMA 2008 Survey, the 16 product categories were ranked in the following manner:

(CHECK LIST FOR 2008)

1. Apparel
2. Toys/Games
3. Video Games
4. Accessories
5. Gifts/Novelties
6. Food/Beverage
7. Home Décor
8. Housewares

¹⁴ Ibid., Page 5-6

9. Health/Beauty
10. Paper Products/School Supplies
11. Publishing
12. Footwear
13. Music/Video
14. Sporting Goods
15. Infant Products
16. Promotions¹⁵

In looking at those product categories that had the largest percentage loss for the year, the list is quite different. These were the top four product categories that experienced the greatest licensing revenue loss for the year:

1. Home Décor / 9.1% Loss
2. Apparel / 8.2% Loss
3. Gifts & Novelties / 6.7 Loss
4. Housewares / 6.5% Loss¹⁶

Looking at the overall product spectrum in the time frame of 1998 to 2007, it is interesting to note some of the changes that have occurred in these product categories. For example, the Videogames category has steadily increased 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 doubled its sale of licensed merchandise in this time frame as the Toys/Games industry saw a decrease in licensed sales of about 14%.¹⁷ Why do some categories enjoy significant gains, and others decrease their sales of licensed goods? There are perhaps many reasons, but it is interesting to note that in several of the categories that decreased in sales of licensed products the products are targeted to young consumers. Does the drop in recent years of the world's birth rate have an effect, and therefore the reason has no correlation to licensing? Or is the drop directly related to the issue of licensing and a lack of successful new properties targeted to this juvenile market?

[4] Retail Climate

Even when the economy falters, licensing has proved 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 the future hold in store for the entertainment licensing business as a whole? Today's retail climate, which had been hot, took a hard economic dive, and has yet to recover. However, those values that entertainment licensing provides to licensees remain intact: the ability to develop, manufacture, and sell merchandise that has built-in and proven consumer appeal. In the time of a faltering economy, these factors may provide the essential ingredients that will generate a sale. Based on a recent survey, in 2008 the per capita retail sale of licensed merchandise in the US was \$208.60.¹⁸

¹⁵ LIMA Licensing Survey, 2008, Page 14

¹⁶ Ibid.

¹⁷ LIMA Licensing Survey, 2007, page 14

¹⁸ The Licensing Letter, July 7, 2008, Page 3

Father to the modern licensing movement, entertainment licensing has been the catalyst propelling a significant percentage of all product-based licensing to prominence in the retail economy across the globe. In 2008, Entertainment/Character merchandise across all product categories, accounted for approximately \$2605 million in estimated licensing revenues or 46.06% of the total licensing Revenues for the United States and Canada.¹⁹

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 shaping 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 section is titled “Character and Entertainment Licensing,” we will draw no distinction between the two, lumping it all together as simply entertainment licensing. The rationale 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 were something like a puppet or drawn character (frankly they are not fooling anyone), these creatures are the focal point of the property, and the core 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 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 is 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 number two. We will therefore use the toy category as the principal example throughout this chapter.

[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 1920s and early 1930s, 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 principal method by which property owners charge for the use of their property. Kay's answer was to charge the manufacturer (licensee) the going salesman's commission rate of 5%; thus, the royalty as we know it today, was born.

¹⁹ LIMA Licensing Survey, 2008, Page 12

[2] Television the Early Years

There was little change in the world of licensing from the 1930s to the 1970s, 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. Themes like cowboys worked well, for boys – I still have my Hopalong Cassidy watch with the six-gun shooter second hand! – Disney’s Snow White Princess outfits for girls were a natural. And who didn’t send away for a Winky Dink & Me Magic Screen to cover the TV screen in order to help Winky Dink get out of trouble (come to think of it, was that the *real* beginning of interactive TV?), and of course, we all wanted a Spin & Marty T-Shirt – so cool.

[a] Television: The 1970’s

In the 1970s, the birth of television syndication changed the face of entertainment licensing significantly. Previously, Saturday morning provided only one day a week exposure, but the market began to realize that syndicated programming, those shows sold to a cobbled assembly of non-network television stations, could afford five times per week exposure, and thus greater impact and market penetration. This was a watershed event for entertainment licensing. Not only did this distribution method provided an opportunity to increase a show's media impact, it also provided a means for those outside Hollywood to market their own television properties, and therefore 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; meaning: "if something works over do it." 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 were 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 demanding to know a property's media reach, market share, and time period. Death of this trend could not be far off.

[b] Motion Pictures

A four-letter word changed the film side of entertainment licensing—*JAWS*. In the mid-1970s, 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 resort 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 desirable 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 the film's ending, 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. Retailers 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; followed shortly thereafter by 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. Star Wars promoted this marketing art form to a level it had yet to reach — respectability. Jaws and E.T. were both already retail history, examples of successful licensing programs, and Disney's Mickey Mouse plus a handful of other animated characters were proving to be successful licensing programs that could generate significant sales for longer than a single season. Then comes the enormous positive impact that Star Wars had on both retailers and manufacturers, this 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 viewed, regardless if it came from the cinema screen or the TV screen.

The film was initially represented by the newly established 20th 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 this decision came 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 advertising 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 from what it was back in the 1970s. Many changes have occurred since then, many of which have significantly changed the manner in which the business of entertainment licensing is conducted.

[1] The Property

The entertainment vista is a changing landscape. Tastes change. Popular culture is constantly being bombarded by many influencing factors, some 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 gun-toting Warner Bros. Looney Tunes character Elmer Fudd, who took great pleasure aiming his shotgun at Bugs Bunny. Not an image that mothers 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 number of toy guns that were being sold based on this film. The amount of media this protest received led Congress 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 so chooses.

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 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 1970s a one-year contract was the normal term for most licensing agreements. Today, the average term is between two and 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 Spider-Man video game, removed buildings from the game that resembled the World Trade Center Towers in the wake of September 11. The licensor could not afford to ignore the heightened public sensitivity to the twin tower images. Rather than 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. Yes, Barney does live on, but a mere shadow of his former popularity.

The other issue that plagues some licensing programs is the poor choice of product categories selected for inclusion in the property's licensing program. Those responsible for managing the licensing program must represent the property as it is, and not as they think it should be, and must resist falling prey to what I call the pig principle. Assuming that the licensor has little influence over the property it is charged with representing (agents and 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 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.

Then there is the Pig Principle: if one is good, two is better, three is terrific. The point is that over crowding a licensing program with too much product can have disastrous results; placing too much product that is too similar into the market can kill the license. When the retail shelves become overstuffed with the similar looking merchandise, often the consumer becomes overwhelmed. Rather than inviting a purchase, the reaction is often the opposite; the consumer is turned off, and looks elsewhere for something to buy.

Another dilemma involves 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 overestimate 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 when, 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 (sometimes 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. In 2007 2% of all licensed merchandise was sold via E-Commerce, 2% through Mail-Order, and 1% was sold on TV Shopping channels.²⁰

As a retailing medium, with its limitless capacity for merchandising and endless array of goods, the Internet has demonstrated a growing degree of success even though it has reached nowhere near its full potential. In spite of the aforementioned shrinkage of retail outlets, today's consumer has retail options that were 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 affected 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.

²⁰ The Licensing Letter, March 17, 2008, Page 3

[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 budget, 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 retailers 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 than 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 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 lackluster sales of the more expensive vehicles and playsets. Whether or not the film's anticipated box office 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 manufacturers 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 5% 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 than those products that use licensed properties. Since the 1970s, the royalty percentage has escalated significantly, but recently we have witnessed little movement in the royalty rates, for which the median was 8.7% in 2007.²¹ Over the past six years the median royalty rates for all categories were the following:²²

2002: 8.3%

2003: 8.4%

2004: 9.4%

2005: 8.6%

2006: 8.7%

2007 8.7%

It is interesting to compare the median royalty rates and those average royalty rates within only the

²¹ The Licensing Letter, February 4, 2008, Page 4

²² Ibid.

entertainment/character category. We find a significant difference between the two sets of numbers. The entertainment/character category charges a considerably larger royalty rate than the median average and usually more than any other licensing category with the exception of the music category (average range 8%-14%). Here are the royalty rates for the entertainment/character category for the same six-year period (average range 6%-13%):²³

2002: 10.8%
2003: 11.4%
2004: 11.0%
2005: 11.0%
2006: 11.0%
2007 10.3%

In comparing the two sets of figures over this six-year period, the median royalty average was 8.7%, while the average entertainment royalty average equaled 10.91%. The difference, 2.21% 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 passed on to the consumer, is usually doubled, as the wholesale price of the product is doubled by the retailer from its 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 whether these fundamental financial tools are 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, ensures the licensor a fair minimum payment for use of his property, with the hopes that ensuing royalty payments 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 the long form licensing contract. This sum of money, as with the guarantee, is (usually) recoupable against the payment of future royalties.

What is a reasonable guarantee? In my opinion, shared by many others, 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, and 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, sort of adding 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 other costs, such as product development, marketing, and advertising.

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 competitive in the market. In categories where the retail price point is of paramount importance, an

²³ Ibid.

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. Licensors must also be mindful that as licensees are often placed in the position having to negotiate price points with retailers in order to capture a sale. The royalty is a fixed cost and cannot be reduced, therefore the higher the royalty the more difficult it becomes to reduce product costs to meet a retailer's demands.

The level of royalty percentage demanded by licensors can adversely affect sales performance of the licensed articles; 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 versus Corporate/Brand Licensing

Reality is there are potentially more opportunities to market established brand names and trademarks than there are popular movies, television shows, cartoon characters, and lovable 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. A corporate/brand licensing program based on an a well established mark has the feasibility to remain a viable, compared with entertainment licenses that usually have a predictable shelf life of two to five years. So why does Corporate/Brand licensing trail Entertainment licensing?

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 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 or 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 for legal protection of their trademarks—companies who might otherwise remain outside 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 United States, but on a global basis. Outside the US and to a lesser extent Western Europe, corporate/brand licensing still remains a distant second to entertainment licensing. Why, it requires companies who are confident in the inherent marketing stability and soundness of the licensing process to build a base of potential licensees in various categories in order to fabricate a suitable foundation of for the growth of corporate/brand licensing.

Even with its predictable short shelf life, Entertainment licensing has one significant advantage over every other form of licensing, including corporate/brand licensing. That advantage is the amount of media exposure that can be generated by a film or television show. No other form of licensing can match the potential of creating as much consumer awareness in such a brief span of time as the opening of a new film or the debut of a new television series. Even with its risks, perhaps this single factor – much like the appeal of a multimillion dollar lottery pot with its impossible odds to win still draws huge ticket sales – an entertainment property has proven sales appeal.

[F] Character and Entertainment Licensing in the International Market

Not even the splash and glitter of designer licensing can surpass the universal appeal of entertainment licensed products. Although in recent years some studies show that corporate/brand licensing may have made significant inroads in the US marketplace, in the international marketplace entertainment licensing unquestionably reigns supreme.

Historically, Hollywood has played to a world stage. Its films and television shows have an audience that spans the globe. Walk into 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 2008, the worldwide retail sales of licensed merchandise stood at \$91,547,000.²⁴ Of that total, \$32,467,000 was generated outside the United States.²⁵

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 1980s it seemed that licensing was a one-way avenue, America exporting its entertainment materials to the remainder of the world, without any interest to develop licensing programs of foreign created entertainment content. As our society has become in many ways a more global community, 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; US property owners only pitching them to represent materials in their markets. Nowadays, such conversations often an equal mix of both parties trading rights of representation. 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 United States and it becomes very apparent that the influences of Eastern culture, in this case the Japanese Manga comic style, has had a significant effect in altering the taste of the comic reader market, producing some of the hottest selling comics books in that market.

So just what is the state of worldwide licensing? Using retail sales of licensed merchandise as the yardstick, in 2008, the worldwide sales of licensed merchandise fell by 13.9% from the previous year figure of \$106,335,000.²⁶ It was not economic doom and gloom for everyone. With an increase of 4.8% in the growth of product sales over the prior year, China experienced the largest expansion of licensed product sales than any other territory.²⁷ Other markets that also saw growth in the retail sales of licensed merchandise included both Latin America (4.3%) and Australia/New Zealand (1.1%).²⁸ The following are the 2005 worldwide retail sales of licensed merchandise by geographic region:²⁹

(B) Billions / (M) Millions			
Territory	Retail Sales	% of Change	% of Total
US/Canada	\$59,080 (B)	-14.0%	64.5%
Western Europe	\$20,500 (B)	-16.0%	22.4%
Japan	\$6,150 (B)	-18.5%	6.7%
Aust/NZ	\$1,795 (B)	1.1%	2.0%
China	\$1,520 (B)	4.8%	1.7%
Latin Am	\$1,095 (M)	4.3%	1.2%
Southeast Asia	\$715 (M)	-3.4%	0.8%
Eastern Europe	\$329 (M)	2.8%	0.4%
Other	\$363 (M)	3.7%	0.4%

²⁴ The Licensing Letter, March 2, 2009, Page 3.

²⁵ Ibid.

²⁶ Ibid.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.

[1] Europe

What are the differences that separate the United States and Europe in terms of how the business of licensing, specifically entertainment licensing, is being conducted? Surprisingly, more and more there are fewer and fewer differences separating these markets. The same general categories prevail in Europe and in the United States. Although the corporate/brand licensing industry has by no means 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 see 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 dominant form of licensing in the European marketplace. Driven by the same forces that do so in the States—media—this market has long since shrugged off the death-like grip that so many governments held over television distribution, and there has been a greater choice of programming available to consumers. Accompanying this influx of entertainment properties into the European market has been an expansion of the number of entertainment properties reaching the consumer. Also, the introduction of satellite programming has had a positive impact on licensing, as it too provides 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 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 Europe, as there is in the United States, 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 United States 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 market 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, however; with \$108 billion in sales at stake, there are still plenty of consumer dollars worth fighting for.

[new] Retail Sales of Licensed Merchandise vs. Per Capita Sales of Licensed Products

There is value in analyzing global licensing from a different perspective; comparing the retail sales of licensed goods of the top 20 markets against these same markets regarding their annual consumer per capita expenditure made on the purchase of licensed goods. The results clearly point out how important such factors as: media penetration, per capita wealth, availability of disposable income, ratio of urban to rural population, retail infrastructure, literacy, and a common language play in the general success or failure of licensing to thrive in any given market.³⁰

³⁰ The Licensing Letter, July 7, 2008, Page 1

It should come as no great surprise that the US tops the list of retail sales of licensed merchandise and also the per capita retail sales of licensed merchandise (\$206.80).³¹ When evaluating the factors why the US holds the number one position on both lists, the following are of key importance: a large segment of the population has access to a moderate level of disposable income; retail has evolved into a highly sophisticated environment that services both the urban and rural markets; easy access to mass distribution of a wide variety of media; a reasonably high level of literacy and a population speaking a common language; all the ingredients necessary to support the licensing dynamic.

In the number two slot, as the second most proliferant territory in the sales of licensed goods (6,150 Billion), Japan falls to number nine in per capita retail sales of licensed merchandise (\$59.12). Germany, in similar fashion, is the seventh highest market in sales of licensed merchandise (\$3,70 Billion), but drops to 13th place on the per capita retail sales list. As a last example, China tied with Spain as the ninth leading marketing in the sales of licensed goods, drops off the top 20 markets list to number 32, when it comes to the issue of per capita retail sales of licensed products.³²

The seemingly disparate relationship between the retail sales of licensed merchandise and the per capita retail sales of licensed products as outlined above is due in large part to the issues delineated at the beginning of this section; the status of various internal factors within a market that will either promote or inhibit the growth of licensing. Using China as the example, although its economy is growing at an amazing pace, a significant percentage of its vast population does not have much if any disposable income, lives in rural areas, has limited access to media, nor availability to retail outlets that provide an extensive selection of consumer goods. Such conditions clearly constrain the growth of any form of licensing. As per capita figures take into account all such influencing factors, it becomes easy to understand why there is such a discrepancy between the two these two pieces of data.

[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, with one notable exception; I am 100% confident that change will occur. Change within the licensing industry on both the domestic and international levels will continue, not only because change is inevitable, but also because of a growing number of new factors that are (or will likely soon be) influencing the marketplace. Without placing any significance to the order of importance, I offer the following as examples of pending changes certain to have considerable influence on the entertainment licensing industry.

[1] Globalization

We have already seen, and are likely to continue witnessing a wave of foreign-born entertainment properties infiltrate 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 – label this the xenophobic view.

True, a number of international properties have been developed outside the United States and have made 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 Morphin Power Rangers, and of course Harry Potter to see what influence foreign properties have had on the US market.

Whilst it is true that a portion, significant or otherwise, of earnings from these properties may leave the United States, nonetheless, these “foreign objects” do generate considerable dollars for US companies. Those who benefit from such imports are the licensors who are engaged as agents to represent the property

³¹ Ibid., Page 3

³² Ibid.

on behalf of its international owners; licensees who purchase the various licensing rights; and of course the retailers who sell such licensed goods.

The globalization of licensing is a positive step forward for the industry for the following reasons: provides US licensors and licensees with additional territories in which they can vend their properties and products; furnishes the broadcast media with expanded markets for program sales; offers local manufacturers the rights to obtain sublicensing or local licensing rights; and supplies local retailers with a wider assortment of merchandise. With the evolution of the international market comes an expansion of the avenues of distribution of US-based licensed properties, and as a consequence, an increase of earnings to the licensor.

In less than two decades, we have witnessed the expeditious growth of international licensing. Back then there were only a handful of countries that supported the retailing of US-born properties. Now, we are witnessing the establishment of China as an important market, which in only a few short years has grown to an almost \$2 billion market. Can India be far behind? Even smaller markets are witnessing the spread of licensing. In 2007 Eastern Europe, as previously noted, had a 39.1% growth in sales of retail licensed merchandise, at the same time as the top two markets, the United States and United Kingdom, lost sales. In this age of new technology that enables the delivery of affordable programming to a broader audience than ever before, entertainment that is likely to stimulate the sales of licensed merchandise, it is reasonable to conclude that territories such as Southeast Asia and Central America are also likely to see an expansion of licensing in their markets.

These are the real benefits of the globalization of licensing, the boundary less 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. The downside is only that it increases the level of competition, as added to the property pool are a greater number of licenses to vie for the attention of licensees, retailers and consumers. 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 failure to consider the panoptic view of the issue: how will globalization ultimately be of significant benefit to the growth of the licensing industry as a whole?

[2] New Media

The emergence of new media, including the Internet, 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 that properties are finding it more difficult to establish a sizable fan base, the cornerstone of any licensing program.

Back in the "good old days" of the '70s and '80s, with a commitment of a 26 half-hour animated television series (the average cost of which was then about \$13 million for the package), the support of a syndicator, and a master toy licensee locked up, you stood an excellent chance of creating a successful licensed property. Aided by selection of the right toy company (at one point there were at least ten to choose from), 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 needed for a 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 third or fourth quarter of the second year of the show's programming.

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 (lest 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 well executed concept.

What brought this all to a halt were the rising costs of media production and the growing reluctance of toy companies to continue to invest in developing both the media and the associated toy products. The major toy companies found that the numbers were becoming too large a risk: over \$13 million to fund 26 episodes of animation plus the necessary toy product development dollars (depending on the property the cost for molds alone could run as high as \$2-3 million), in addition to packaging, marketing, retail, and advertising costs. It was quickly becoming apparent that working under such budgets, failure could bring a company to the edge of bankruptcy. Due to the rise in the number of new properties developed under this formula it heightened the competition for viewers and increased the risk factor.

By the beginning of the 1990s, the formula of toy company/supported and media/developed properties had all but died out; in its place, the major television networks started to fund their own development. They began to introduce live action programming in addition to animation product as concepts upon which to build licensing properties ("Save By The Bell" is perhaps the best example). This period also marked the rise of the "boy bands," and a big surge in the music scene, as the basis for licensed properties, most of which were targeted to the tween/teen market. Later in the decade we 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 came from the Public Broadcasting (PBS) sector. Although for many years PBS already 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 springboard to initiate a licensing program. Programming on PBS could/can be achieved via: local station, regional sector station or group, or by direct support from the national network itself. In this fashion, championed by the local PBS 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 as an effective platform for generating the requisite media exposure imperative for establishing a licensing program.

When talking about new media and its relationship to licensing, the obvious question is what importance and role does the Internet play? Until recently the Internet has been used primarily only as a sales device for the promotion and sales of licensed products. The question is can the Internet, which provides both quantitative and qualitative exposure and influence, act as a viable conduit for building a base of awareness and support sufficient to inaugurate or sustain a licensing program? To date, this has yet to really happen to any significant degree. There is no clear 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 their television, film or publishing exposure.

Although Internet sites have proved beneficial for supplying supplemental information and as reinforcement to a property's primary form of distribution, thus far, due perhaps to clutter, insufficient means or methods of communicating site addresses, or consumer reluctance to use this medium as an entertainment platform, the Internet still remains an relatively ineffective primary source as a launch site for licensing programs. The increasing popularity of the webisode format, short form programming often lasting only several minutes, specifically produced for Internet distribution is gaining in popularity, and may prove to be a successful format for developing programming for this medium, and to opening the door to using the Internet as the means to inaugurate licensing properties.

[3] Rising Cost

When entertainment licensing consisted mostly of label slapping, the placement of a property's name or character images on existing product with little expenditure to transform pre-existing product into something new, the cost of entry into licensing was far less costly. Today, as example, the average cost to develop a video game title – even those in the budget game category – are well into the six figures. For creation of an "A" title game, which could take up to two years to produce, development costs can easily above the ten million dollar mark.

As licensors have demanded, and rightly so, 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, and 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.

Rising costs of licensing are not only confined to the development and marketing segments of the licensing equation, but to the rights fees charged to acquire such property rights. The level of advances, guarantees, and royalty rates charged 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 viewer demographics, audience share and program time slot. If the property is a television show; what needs to be ascertained is the likelihood of the show's survival for the full first season. If questionable, or uncertain, then what guarantee or recourse do you, as the licensee have if the show is cancelled early. If the property is a theatrical film, is there a box office number that the film has to reach that locks in the guarantee? If that figure is 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 such concessions are achievable should not dissuade any licensee from the pursuit of such grants.

Licensees *must* demand more information from the licensor when the stakes have escalated to the levels they are now: development of an action figure line runs upwards of several million dollars in design, mold, and packaging costs; marketing of even a simple *T*-shirt can run into the thousands when inventory, marketing costs, and sales commissions are factored in; and contribution to retailer's advertising funds, and a variety of "other" retailer charges are being dumped on manufacturers as the retailer continues to acquire more control.

The purpose of all this information gathering 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 that hold licensing rights to the property in an attempt to build cross-marketing opportunities. In order to ensure 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 to 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 fully understand the importance of their shelf space. As gatekeepers to the consumer they are demanding greater participation; retail exclusivity and even outright ownership of certain merchandising rights are a few examples of ways the retailer is participating in the licensing process. 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. For example, key retailers are demanding that unsold merchandise be accepted for return. This is not the usual method of sale, as most merchandise is sold on a one-way basis. Many manufacturers, 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 may be returned.

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. The problem is, in most standard licensing agreements as now written, a licensee cannot 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 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 certain properties. Although this practice has historic roots going 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 successful include housewares, toys, clothing, and even certain holiday products.

Counterpoint to the increasing stranglehold that retail has been placing on the 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 Internet storefronts pop up offer a wide variety of merchandise, much of it being licensed goods. From T-shirts to toys, just about any type of item is available online if you look hard enough.

Perhaps the one segment of the market that has benefited most from this new e-tail trend is the category of collector goods. Often relegated to local hobby or comic stores, tucked away in a corner of some "trend" retailer, or crowded on an over-stuffed shelf of the few remaining mom and pop shops left, 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 core collector genre such as Sci-Fi, horror, action or comic, and thus fail or refuse to stock such merchandise. Internet stores also provide an almost infinite amount of shelf space, affording manufacturers the ability to present complete lines, replete with detailed information about each item offered; a highly important factor in appealing to buyers who will spend considerable sums of money to purchase such products, with price points that often start at \$150.00 and quickly climb much higher.

As consumers grow more accustomed to purchasing merchandise online, less fearful of transacting purchases over the Internet, and buying items which they have yet to feel, touch or smell, this form 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 increase if the product is sold by the licensee to the consumer on a direct sales basis. Under the terms of traditional sales, the licensee is selling his licensed goods to the retailer on a wholesale basis which is then the price used as the basis for calculating the royalties due the licensor. Under ideal circumstances, if the licensee sells the same item on a direct basis via his own Internet shop -- by passing the retailer or distributor -- selling directly to the consumer at the full retail price point, then the licensor should be paid a royalty based on the retail and not the wholesale price point. Therefore, an item sold on a directly bases could generate a royalty twice the amount than if it were sold as by the same manufacture to a retailer on a wholesale basis.

[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 bidding wars over licensing rights that can escalate 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 overzealous sales forecasts as the determining factors in establishing advance and guarantee parameters.

Today, there is a backlash from manufacturers, and licensors are to blame. Advances and guarantees do serve a purpose, and they are a very necessary ingredient of any licensing contract. As rights owners, we are trading tangible rights in exchange for financial consideration. As products bearing the licensed images are sold, it triggers a royalty to the rights owners, which is usually expressed as a royalty. This is a fair trade: rights for monetary consideration. Each party is or will receive something of value; the licensee obtain's the use of protected rights in order build product or develop a service that is intended to achieve profit. The licensor is paid a fixed dollar amount or a percent of the revenue generated from the sales of goods that bear his legally protected materials.

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; the development of product, packaging, and the associated costs of retailing and marketing the licensed goods.

In order for any property to achieve the position that enough companies are convinced that it has either the creativity, awareness, or appeal to generate substantial consumer sales, it is reasonable to conclude that the licensor to was required to make the investment of imagination, time, hard work and dollars. This is the licensors' investment—it is real, and cannot be, nor should it be, attenuated. Thus, in any fair transaction there must be the exchange of consideration. Ergo the creation of the advance, that initial payment made to