Trade, Service, Persona Marks Get Big Royalties

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Extracting value from intellectual assets; 'affinity licensing' trades on goodwill of intellectual property owner

Every day, the average person is bombarded with more than 1,500 different trade and service marks (INTA 1998). In the U.S. today there are more than 800,000 active, federally registered trademarks (USPTO 1998). Additionally, there are hundreds-of-thousands more active trademarks registered with state governments and an equal number used by businesses without formal registration.

The World Intellectual Property Organization reported there were more than 1,200,000 new trademark registrations worldwide in 1996 alone (WIPO 1998). Approximately 25% of these were in the countries of Japan and China. The five countries with the most trademark registrations in 1996 are shown in Table 1.

NEW TRADEMARK REGISTRATIONS BY COUNTRY - 1996

Country	Resident	Non-Resident	Total
Japan	165,544	12,707	178,251
China	101,178	20,297	121,475
United States	80,874	12,840	93,714
Spain	63,434	17,583	81,017
United Kingdom	29,196	28,274	57,470
All Other Countries	275,240	460,360	735,600
Total	715,466	552,061	1,267,527

Table 1

Table 1 shows that worldwide 56% of all new trademark registrations are given to residents of their respective countries, while non-residents receive a hefty 44%.

IMPORTANCE OF TRADEMARKS AND OTHER INTELLECTUAL PROPERTY TO BUSINESS ENTITIES

For most commercial enterprises their trademarks and other intellectual property are their most valuable financial assets. A review of Security and Exchange Commission (SEC) data for companies that have recognizable trademarks show that the value of the company's tangible property (including trademarks) represents the vast majority of the market value of those businesses.

PUBLIC COMPANY INTANGIBLE PROPERTY VALUE TO TOTAL MARKET VALUE

Company	Percent of IP Value To Market Capitalization
Amazon.com	98%
The GAP	90%
Starbucks	84%
Barnes & Nobles	75%
McDonalds	73%
Disney	68%

Table 2

Given the significant contribution of intellectual property assets to a company's market value as illustrated in Table 2, the ability of a business to fully exploit and extract value from these intellectual assets, such as trademarks, is critical to its overall financial success. Companies that are successful in value exploitation have firmly incorporated an effective management process through which they continuously develop, protect, and extract value from their intellectual property.

Extracting value from intellectual assets is accomplished by using a variety of tools and techniques. Some of the techniques include using trademarks to:

1. Attract and establish key strategic alliances and partnerships.
2. Assist in developing co-branding arrangements.
3. Attract capital and secure loans.
4. Enhance equity participation opportunities.
5. Earn royalty income through licensing and franchising.

While the focus of this article will be primarily on extracting value through licensing and franchising, much of the information and discussion is also relevant to other techniques available to companies for enhancing their market value through intellectual asset exploitation.

AFFINITY LICENSING

The owners of intellectual property assets have learned that there is gold in licensing. Concomitantly, potential licensees are increasingly seeing that they can create instant consumer credibility and consumer demand by developing close associations and affiliations with established brands, celebrity personae and franchised trade names. This type of licensing, which is called

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"Affinity Licensing," makes economic sense to both the licensee and licensor. Affinity licensing is associating one's commercial products and services with another's image and personality. In other words, affinity licensing is trading on the goodwill that the intellectual property owner has established with its clients and customers.

Trademark licensing is the simplest form of affinity licensing. It generally involves two parties, the licensor and licensee. A trademark license permits the licensee to temporarily or permanently rent the trademark's image, personality and goodwill for its own promotional or profit-making purposes. Examples of frequently licensed trademarks include fashion names like Gucci, cartoon characters such as Mickey Mouse, and brand names like Eddie Bauer.

A close cousin to the straight trademark licensing is *celebrity endorsements,* where a celebrity's name, voice, persona or likeness is licensed to a business or lent to a social or political cause. Celebrity endorsements have grown substantially over the last 30 years. It is estimated that today 20% of all television commercials feature a celebrity endorsing the advertised product or service (Agrawal 1995, Sherman 1985).

The final member of the affinity licensing family is *franchise licensing.* A franchise is a business arrangement whereby the franchisee, for a royalty fee, undertakes to conduct a commercial business using the franchisor's trade name, trademarks, methods and procedures. The International Franchisee Association (INFA) estimates that one-third of all retail sales in the United States are made through franchised units such as McDonalds, Coca-Cola, General Motors and Re-Max.

THE VALUE OF TRADEMARK LICENSING

Corporate trademarks and service marks are generally used in advertising and promoting a company's products and services to its consumers. In the advertising field, these marks are better known as "brand or trade names." They are an everyday part of life in an industrialized society. Some social scientists have posited that this avalanche of images complicates life and therefore harms consumers. In fact, rather than complicating consumer's lives, these marks unquestionably make the consumer's life easier. They do this by giving consumers a shorthand method to identify who is providing, sponsoring or approving the product or service. Imagine if every product was an unnamed generic. Every time a consumer went to the store he or she would, by necessity, have to compare the ingredients on various product labels and ask the clerk about the efficacy of each.

Clearly, it is much easier on the consumer if the consumer has a shorthand method of identifying the products they know and trust. These source identifiers are generally known as trademarks, service marks, trade dress, collective marks and certification marks. These marks can be a word, logo, slogan, package design, color or sound.

Trademark licensors fall generally into five broad categories: corporate, collegiate, institutional, movie and cartoon characters, and fashion. The licensors in each category have different goals, restrictions and objectives in licensing their intellectual property.

Because corporate trademarks and other source identifiers are so valuable, most businesses are unwilling to license them to nonaffiliated entities. However, corporations do frequently license others when expanding into foreign markets and countries and when the marks are used in unrelated areas, such as Cadillac scarves and John Deere cookies. The range of royalties is 1-8% of wholesale revenues colleced.

Colleges and universities have an overriding concern when it comes to licensing their logos, name and trademarks. That is the school's image must not be tarnished by risque licensed products or unscrupulous licensees. A secondary interest is profit maximization, but this is tempered with the knowledge that the chief purchasers of the licensed sweatshirts, pendants and novelties are students and school alumni. Therefore, collegiate licensed products are staid and traditional, and running royalties fall into a narrow range of from 4-7.5% of net revenues.

Institutional licensors such as the Sierra Club, the CPA Society and the local bar associations frequently lend their names to affinity programs with various products and services. As with colleges and universities, their number-one concern is not to tarnish the institution's image. An interesting divergence is that the institutional nonprofit licensors do not seem to have the same profit-maximization constraints as collegiate licensors. The narrow range of royalties is 4-12% of net revenues.

When a trademark owner like Lucasfilms Ltd. and Loony Tunes licenses tie-ins with its trademarks and copyrights it is reaping additional rewards from its already commercially successful motion picture and cartoon properties. In my experience, most trademark licenses are fully negotiable, but some such as film and cartoon characters have fairly rigid royalty rates and licensing agreements on preprinted forms that are generally a "take-it-or-leave-it" proposition. Additionally, licensing agreements for film and cartoon trademarks are usually nonexclusive and restrict the licensee's field of use. Also, they require that all of the licensee's artwork, product designs and advertising be approved by the licensor prior to products being offered for sale. The licensor needs this approval process to assure that its valuable intellectual property will not be harmed by the licensee's use of it. Film and cartoon licensing royalties range from 4-15%.

Fashion and art licensing is a hybrid between traditional trademark licensing and celebrity persona licensing. On one hand the licensee is licensing the designer's styles and fashions, but on the other it is associating itself with the designer's image and reputation. The result is that fashion and art royalties vary greatly based on the artist's involvement and current appeal. Fashion and art licenses range from 2-10%.

THE VALUE AND COST OF CELEBRITY ENDORSEMENTS

The Chicago-based monthly newsletter *IEG Endorsement Insider* estimates that companies in the U.S. spent $800 million to procure all types of celebrities to endorse their products in 1998.

Using a famous face to sell products and services can be quite effective. Celebrities, as a rule, lend instant credibility to the products or services with which they are associated. Further, a famous face or voice attracts viewers and frequently stops channel surfers in their tracks, resulting in higher viewership and greater retention of the marketing message.

On the flip side, celebrity endorsements can be expensive. They occasionally cost over a million dollars, but most celebrities work on commercials for around $10,000 per day. The celebrity's involvement can run the gambit from a single advertising spot to multi-year multimillion advertising campaigns. With the latter, the celebrity becomes a spokesperson for the business, and in some consumers' minds they are the company. Who can forget Joe DiMaggio and Mr. Coffee? A recently popular form of celebrity endorsement is the infomercial, where for 30 to 60 minutes celebrities such as Fran Tarkington or Jane Seymour pitch the advertised merchandise. For their involvement, infomercial celebrities customarily receive upfront payments and some share of the net profits.

Sports celebrities, in particular, earn substantial monetary rewards for endorsing or sponsoring commercial products or services. *Forbes* magazine reports that in 1997 Michael Jordan earned more from his Nike, MCI, and other endorsements, $47 million, than he did from playing basketball for the Chicago Bulls, $31 million. The *Forbes* list of the 40 highest-paid athletes included seven basketball players, seven boxers, four golfers, three NHL players, three tennis players, three race car drivers and two NFL players. In 1997, these players, boxers and drivers collectively earned $253 million in endorsement royalties and $340 million in salaries and winnings.

A variety of royalty mechanisms are used in licensing sports celebrity personae. Royalties range in structure from one-time flat fees to running royalties based on sales with minimum guarantees. For example, Michael Jordan's contract with Nike includes a large upfront payment and 25 cents per pair of affiliated Nike shoes sold.

Trademarks and celebrity personae have many sources. Some are created, developed and nurtured by businesses to distinguish their products and services from their competitors. Others spring from the artist's brush, computer terminal or motion-picture camera. Still others first appear in cloth and leather on the fashion stage. And some of the most profitable are fought for and earned on courts and playing fields all over the world.

Not all trademarks or celebrity personae are licensed to others; for the ones that are, American businesses and individuals received $5.8 billion in royalties in 1998. The sources of licensable trademarks and talent are broken down in Table 2. This data comes from *The Licensing Letter*, a publication of EPM Communications, Inc. *The Licensing Letter* is an excellent source of information on running royalties and retail sales of licensed merchandise.

RECIPIENTS OF TRADEMARK AND CELEBRITY LICENSING INCOME

Cartoon and Other Characters	22%
Trademarks and Brand Names	22%
Sports Celebrities	16%
Fashion and Apparel	18%
Art and Design	7%
Film and Non-Sports Celebrities	3%
Other (Publishing, Music, etc.)	12%
Total	100%

Table 3

Trademarks and celebrity personae have many uses. For example, the use of celebrity endorsements is an advertising strategy that enhances consumer awareness and acceptance. Moreover, trademarks are an easy way for consumers to identify quality and efficacy. Trademarks and celebrity personae can be emblazoned on fashion apparel, appear on television and radio commercials, and made into plastic toys or games. The data in Table 3 show the uses of trademark and celebrity persona. The data again come from *The Licensing Letter*.

USES OF TRADEMARKS AND CELEBRITY LICENSING BY PRODUCT CATEGORY

Fashion and Apparel	
Clothing	20%
Accessories	9%
Footwear	3%
Entertainment	
Toys and Games	12%
Publishing	6%
Music and Videos	4%
Consumer Products	
Food & Related	9%
Gifts and Novelty Items	9%
Domestics	7%
Health & Beauty	6%
Stationary and Paper	5%
Sporting Goods	3%
Electronics	2%
Other	5%
	100%

Table 4

TRADEMARK AND CELEBRITY PERSONA MARKET ROYALTY RATES

The running royalty rates generated by trademarks, fashion names and celebrities vary greatly. The following are typical bare (no upfront payments) running royalty rates for different sources of trademarks and celebrity endorsements.

A question frequently asked is whether trademark licensing rates changed over time. A good example is the cartoon character Mickey Mouse. Mickey began his licensing career in the 1930s. At that time licensing rates for his character were 5% of the wholesale selling price. This licensing rate increased to 6% in the 1970s, 8-10% in the 1980s and 14% in the 1990s (Siegel 1997). Clearly, Mickey's commercial magnetism and value has increased with time as a result of astute brand and image management by Disney, including extending the loveable character's image into new and profitable areas such as games and videos.

Franchising as a business form contributes greatly to the American economy. As of 1998, there were more than 550,000 franchising outlets in the United States employing more than 7 million people. These outlets sell retail and wholesale goods and services generating over $800 billion in annual sales. Today, franchising sales make up a third of the America's retail trade. Franchising sales increased from 28% of retail sales in 1975 to 34% in 1990 (Trutko 1993). The forecast is for U.S. franchised retail sales to reach 50% in the early 21st century (Franchise Architect 1997).

Franchising systems can be broadly classified into two types —"Product/Trade Name" and "Business Format." Product/trade name franchising is a relationship between supplier and the dealer in which the dealer agrees to distribute a particular manufacturer's products within a specified territory. Your local General Motors and Ford dealerships are examples of product/-trade name franchising, as are many Exxon service stations and Coca-Cola soft drink distributors.

Product/trade name franchising systems do not generally have royalty payments associated with them. Rather all of the franchisors' profits are embedded in the wholesale product price charged to the franchisee.

Business format franchising is a business arrangement whereby the franchisor conveys to the franchisee an entire system for conducting business. This system includes products, services, trade name logo and other trademarks, advertising concepts, and policy and procedures manuals. Examples of business format franchising are McDonalds, Marriott Hotels, Ace Hardware, and Roto-Rooter.

There were 2,177 franchisors in 1994 in the United States with 542,000 operating units (U.S. Department of Commerce 1994). The U.S. Small Business Administration estimates that each year between 200 and 300 companies seek to meet consumer demand by franchising their products and services for the first time (Shane 1997). The U.S. Federal Trade Commission estimates that in January 1999 there were 3,500 franchisors in the United States (FTC 1999), and according to the International Franchise Association, a new franchise unit is opened every eight minutes every business day.

U.S. franchisors have expanded aggressively abroad in the last 10 years as the globalization of the world economy has taken place. In 1994 the Commerce Department reported 374 U.S. franchisors operated 35,000 franchised units abroad. Today, about 20% of American franchisors have international franchised units. McDonald's alone as of February 1999 has restaurants located in 115 countries and serves over 40 million hungry customers each and every day.

The average cost of a business format franchise in the U.S. varies greatly. A new franchisee of a McDonald's restaurant can expect to pay an initial fee of $300,000 (for a 20-year franchise), while a Snap-On Tools franchisee will pay only $4,000. The average initial franchise fee is about $20,000. Along with franchise fees most franchisors require the franchisee to invest heavily in inventory, fixed assets and working capital. Some examples of average initial investments are Holiday Inn ($3 to $5 million), Uniglobe Travel and Subway Sandwiches ($150,000), and Merry Maids ($30,000). The average initial investment required is around $175,000, but the full range is $500,000 to $6 million. Most franchisors permit some or all of this investment to be borrowed from others.

Business format franchising ordinarily has running royalties that range from 4-8%, with the full range being from 1-15% of revenues. Franchise royalties usually include an "advertising fee" component and a "royalty rate" component. The average advertising fee is 1-3% of gross revenues, while the average royalty rate component is 3-6%.

TYPICAL TRADEMARK AND CELEBRITY BARE RUNNING ROYALTY RATES

	Average	Narrow Range	Broad Range
Cartoon and Other Characters	8%	4 to 15%	2 to 40%
Trademarks — Corporate	5%	1 to 8%	1 to 15%
— Collegiate	6%	4 to 7.5%	3 to 10%
— Institutional	7%	4 to 12%	2 to 15%
Sports Celebrities	4%	1 to 9%	1 to 15%
Sports Teams	9%	6 to 12%	5 to 15%
Fashion and Apparel	7%	2 to 10%	1 to 15%
Art and Design	7%	2 to 12%	2 to 15%
Film	10%	6 to 15%	5 to 40%
Overall	6 to 10%	2 to 12%	1 to 40%

Table 5

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