



## Licensing Agency Compensation: The Inside Story

by - Stephen Reilly  
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One of the needless mysteries of the licensing industry is the topic of agency compensation. Although talented professionals neither gain nor lose anything from disclosing the way they make money, the licensing industry has generally remained silent on this topic. IMC Licensing represents a new generation and a new voice in the licensing industry; we think that clarifying the basic structure and options for licensing agency compensation will serve us and our industry well.

### Why Hire an Agency?

First, let's remind ourselves why a trademark-owner hires an agency to begin with: to gain access to a team of professionals – and a range of focused expertise – that it could not otherwise engage efficiently for itself.

Management guru Peter Drucker once said that outsourcing is not a way to cut costs but “to improve the quality of the people who work for you. You should outsource everything for which there is no career track that could lead into senior management. When you outsource you may actually increase costs, but you also get better effectiveness.”

### How to Pay

How to pay for that effectiveness is a pretty simple matter. An agency has to sell its services for more than it costs to provide them. It can do that in one of three ways: for a fee; for a commission; or for a combination of the two.

Determining the appropriate form of compensation depends, more than anything else, on how the client and agency are prepared to allocate the risk against its likely rewards.

#### *Fee Only*

Simply paying an agreed-upon fee for service is not unusual – consultants, lawyers and accountants are almost always paid this way – but it is unusual in the licensing industry. There are two probable reasons why.

First, if an agency is working for a fee only, they might be incentivized to generate activity and hours, and sometimes nothing more than activity, before moving on to more fee-based work.

Second, we should admit that licensing remains the redheaded stepchild of marketing communications, and rarely gains the budgets of similar fields (public relations, sponsorships or direct marketing, to name a few). Because of this second tier status, few companies have the budget to pay the typically high fees that would be required for an agency to make a profit on a fee only basis.

A fee-based model can work – and has worked for us at IMC Licensing – if the agency is hired as a consultant, and if the client is prepared to pay the agency appropriately for its consulting expertise.

#### *Commission Only*

An agency paid solely on commission assumes all the risk of nonperformance and will make money only if it can generate royalty revenue for its client. Commissions (rather than fees) are typical in any relationship where the agency's job is to maximize revenue for a client, and not just to provide advice or perform easily quantified work. This structure is true for real estate agents, talent agents and investment bankers, among others.



From a client's perspective, this approach may appear to give the agency the maximum incentive to perform. It also gives the agent little capacity to staff the work fully, and may even place the agency's interests in conflict with the client's; the agency may seek to generate deals without regard for the risks they may pose to the client and its brand.



A client who leaves its agency with commission only will have to pay an unusually high commission, which can actually leave the client regretting its decision if the agency does succeed. Such regret may even lead the client to withhold promising opportunities from an agency – pitting the two parties (agency and client) against each other – hardly the team approach sought in effective outsourcing.

At IMC Licensing, we believe that this form of compensation does make sense in certain circumstances: where the client's needs are limited and highly focused and where the opportunity fits directly within the agency's highest area of expertise. For trademark owners with their own internal licensing resources this can be an effective way to utilize agency expertise in specific categories (food, toys, fragrance) to generate deals the client could not gain for itself. The agency faces less expense, and therefore less risk, in generating its reward.

There are several other exceptions to the rule. We have encountered some clients who simply cannot – for institutional or even legal reasons – pay their licensing agency a fee. With those limitations it can still be possible to craft acceptable working terms, if the agency is granted sufficiently broad rights, in categories in which it has experience, and if the agency retains a "super-commission" (as high as 100%) until royalty revenues have reached a specified level, when the commission rate may drop (in stages or all at once) to a more traditional rate.

Under almost all other circumstances, clients should be wary of agencies willing to perform full-service work for nothing. In these circumstances, the agency usually views the client as a "loss leader," and is willing to take on unprofitable work because they think it will lead to other work on better terms from others. This is rarely in the best interests of the client, who often finds that its expectations for service and performance are disappointed by a team that is either understaffed or inexperienced, or both.

#### *Fee and Commission*

The combination of fee and commission is the most common way to pay an agency for launching and managing a client's licensing program. The client invests a relatively small amount, usually limited to the first stage of the relationship, while the agency makes a far bigger investment of resources (people, time and funds) to plan, build and manage the client's licensing program. Such payments are necessary to offset the agency's investment in the typical 18-24 month development cycle before product penetration at retail.

At IMC Licensing, we have found that the payment of a retainer actually increases client engagement in the work at hand. It gives the client some "skin in the game" and forces it to pay attention. A client that pays its agency no money may also pay it no attention, and may fail to give the agent the time and support it requires – simply because the client thinks it will lose nothing for not doing so.

Beyond the development stage (which can easily last up to two years), the agency can look to its commission for compensation – if the client is willing to approve enough high-return opportunities for the agent to pursue. Clients who want a high level of service but who are not willing to grant the agency sufficient opportunities to earn a sufficient return on its work should be prepared to pay the agency a retainer on an ongoing basis.





## Conclusion

Every situation is different, but in general terms, a client can expect to pay agencies along the following lines for each type of relationship:

*Fee Only:* A client prepared to pay a qualified agency a fee only should be prepared to pay rates similar to those for good consultants or – that is, hundreds of dollars per hour or thousands of dollars per day – for all work that anyone employed by the agency performs.

*Commission Only:* A client unwilling to pay any guaranteed compensation, and willing to limit the agency's work appropriately, should be prepared to pay the agency a very high commission, typically in the realm of 50%, on the royalty revenue the agency can earn; how high depends on the specifics of the opportunities to be pursued, the agency's experience with similar opportunities, and the scope of work assigned to the agency.

*Fee and Commission:* Clients who are able to pay a highly qualified and fully staffed agent an early-stage retainer of \$5,000-\$20,000 per month should be prepared to pay the agency an ongoing commission between 25%-40%. The retainer reduces (to some extent) the agency's risk, and so as the retainer goes up the commission percentage might come down; and vice versa.

In licensing as elsewhere in life, you get what you pay for. An agency who accepts less than these rates is probably not the best agency for the job.

