5 Ways to Evaluate a Company as a Potential Licensee

June 13, 2014, Categories: Licensing by Kim Steadman

In the wise words of Dr. Seuss, "Step with care and great tact. And remember that Life's a Great Balancing Act."

Finding that balance in licensing partnerships does take a great amount of care and tact, but with the right plan you can move mountains – or at least your bottom line! But, if you chose the wrong partner — especially in a high risk category — it could be devastating to your brand.

Taking an educated risk, however, can be very worthwhile for all involved. For example, in 2008 IMC brought its client, Remington, a well-known and established brand, together with TrailSteaks, a provider of premium jerky and smoked meats based in Chattanooga, TN. TrailSteaks made a great product albeit with limited distribution. IMC performed a full due diligence on TrailSteaks–including touring its 3rd party manufacturer, and performing background checks on the company and its executives. We got creative in securing the guarantees and giving sales thresholds for the first year to insure success. The result is a successful program that's still in stores today including expansion into Canada!

Still, entrusting your brand to another company is always risky business, and brand owners and agencies may become overexcited by the deal's dollar signs. To protect your brand, it's vital to carefully evaluate the deal itself, as well as the potential partner's ability to make the deal a success for all involved.

Here are five ways to weigh the experience and capabilities of a potential licensing partner:

1. Longevity and Size – The number of years a company is in business will allow you to evaluate how it has weathered the changing economy as well as any negative publicity – like a recall, for example.You'll want to know that if something goes wrong, it will not close shop and leave you holding the bag. Since all agreements take a considerable amount of resources to manage, you need assurance that it will at least meet the guaranteed minimum payments to secure your ROI.

Smaller companies are more likely to walk away from a contract if it doesn't go well. Negotiating and managing a contract along with product development will cost valuable resources internally along with your licensing agency (if you have one). For this reason, conducting a thorough due diligence on startup companies is a must. A startup company can be defined one that's less than five years old.

That being said, working with startups can be very fruitful — especially if its executives previously had experience with another well-known reputable company where they demonstrated success.

2. Financial Stability and Strength – Does the potential Licensee have the means to develop, market and service a licensed program? If it is a public company, you can analyze its financials to evaluate viability. If it's private, more than likely that information won't be provided to you. Instead, ask for a range of current annual sales and if it has been experiencing growth or decline over the years. Again, you just want assurance that it has the financial stability and strength to build a successful licensing program.This includes weighing the potential licensee in conjunction with the product category. For example, if the product category is low risk, then you can take a little more risk on the company. On the other hand, if you're entering a high risk category, your potential partner must be highly reputable, financially strong, and have a sound track record with high quality products.

Finally, a strong, stable company should have a highly rated insurance provider, and because your company will be named as an additional insured on the policy you'll want to make sure you're fully covered. You should require your potential licensee to carry an ample amount of insurance with no lower than an "A" rated insurance company.

3. Experience with Product Quality – First, evaluate existing products. Check online consumer reviews and comments related to its products. Ecommerce sites like Amazon and Walmart.com provide an abundance of information about what's going right – and wrong – about a company's products.But don't stop there – You should also review its manufacturing information. Does it manufacture in-house or use a third party? Ask for information on the manufacturing facilities including if it holds any certifications and if it has had any recent audits by another well-known CPG firm and/or national retailer. You may even want to audit its facilities on your own or hire a reputable third party to do so. You don't need to conduct an audit before the Agreement is signed, but it's wise to include that "facilities must be in compliance before product is manufactured" as part of your approval process.

Speaking of wrong… Ask up front for disclosure of any negative publicity like recalls and do online research to confirm what you've been told. Product recalls do happen, but it's how a company reacts that really tells the tale. A healthy company will learn from recalls, implementing stringent quality standards and developing a policies that protect customers and the company itself. Potential Licensees are typically straightforward with this information and will provide what you need to evaluate the partnership and the product. If it's not, that could be a red flag!

4. Company Reputation – We've talked a little about reputation related to products, however, what about the company overall? Conduct online research about the company — along with its officers — and watch for red flags like lawsuits or problems with other licenses. If there are, most companies are willing to provide an explanation and how it was rectified.Ask for recommendations from at least three sources such as other Licensors and Retailers. Call each of the references and ask them very brief questions regarding:

- The longevity of their business together
- Satisfaction with the quality of its products
- Its ability to ship on time
- Its compliance with the terms of their agreement
- Any further information they'd like to provide that may be helpful to you

When making the calls, you do not need to disclose what type of business you plan to conduct. It's enough to say, "our company is considering doing business with [said company] and we are conducting due diligence."

5. Strong Distribution and Sales Capabilities – Retailers like doing business with vendors that are already selling to them. You will have more success if your potential licensee has products in key retailers that would potentially carry your licensed product.Further, find out how it conducts sales to retailers. Is it through brokers, internal or both? Most of the time, companies use internal resources for national accounts and brokers for regional and smaller accounts. Understanding how things happen "on the ground" will further inform whether your deal is the deal for this potential partner.