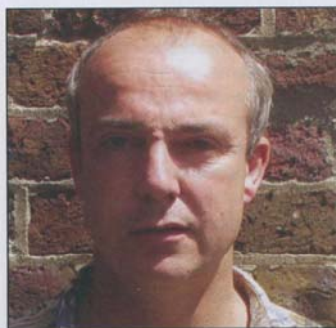


## Brand papers **Special purpose vehicles**

### Get into a smart vehicle



**Special purpose vehicles are a new strategy for brand and business management. Stuart Whitwell explains how they can smarten up your operation**

The myth of marketing as a subset of general business management needs to be exorcised. Marketing is business management. Marketers need to use intangible assets, such as brands, copyrights and patents, to improve how businesses are managed.

A new way to achieve this is with special purpose vehicles. These are legal entities – usually limited companies – set up to house specific assets or liabilities. Traditionally, they were a way to eliminate potential liabilities, such as debt, from a firm's balance sheet. The risk would be owned by the new company.

Special purpose vehicles are now being used for more general business management purposes, especially intellectual property. Trademarks, such as brand names, can be put into them. Copyright of music, books or films can also be transferred into special purpose vehicles, as can patents for drugs, software and industrial designs.



Ralph Lauren: one example of a brand that could benefit from special purpose vehicles

#### The benefits

There are three key benefits of transferring intellectual property to a special purpose vehicle: capital financing; tax savings; and better business management.

- **Capital financing:** Special purpose vehicles are effective structures for securitisation. A brand can be transferred into one and finance raised on the back of the royalty income the brand receives. Finance could be a secured bank loan, which would be at a lower rate than a conventional loan because the brand would act as collateral. Alternatively, the special purpose vehicle could attract finance from other private investors, which would enable both the risks and rewards to be shared.

The key benefit to the brand owner is access to capital at lower interest rates while retaining ownership of the brand. This capital advance could then be invested in the company to support business objectives, such as product launches. For example, Guess, the fashion brand, raised \$75m (£45m) in 2003 by securitising royalty streams from 14 licence agreements.

- **Tax savings:** If the special purpose vehicle is registered in a low-tax jurisdiction, such as the Bahamas, the tax payments are significantly reduced. Polo Ralph Lauren Corporation, for example, could place its Ralph Lauren brand in a special purpose vehicle called Ralph Lauren IP, registered in the Bahamas. Polo Ralph Lauren Corporation, its franchisees and licensees would then pay Ralph Lauren IP for using the brand. As income derived from the Ralph Lauren brand would now go to the Bahamas, Polo Ralph Lauren Corporation would pay less tax.

But the transfer must be carried out at fair value, so if the brand has been grown organically, as with the Ralph

Lauren brand, Ralph Lauren Corporation would incur a substantial capital gains charge. To reduce the charge, the approach is best suited to brands that have recently been acquired or have substantial opportunities to grow.

- **Better management:** A major benefit of putting brands in special purpose vehicles is that they act as a catalyst for improving brand and business management. Understanding the value of the brand being deployed in the market sharpens a management team's focus. Each sector, product, market and territory in the company becomes as financially responsible for generating a return for using the brand as an external franchisee or licensee. It also exposes the contribution of each unit, enabling management to identify relative performances.

The performance of the brand in each area of operation also becomes more visible, making it easier to monitor return on investment.

Putting a brand in a special purpose vehicle enables its health to be monitored without confusion. The brand's isolation can also assist in its sale process. Another benefit is that it exposes the quality of management. Forcing management to pay to use the brand on a fair-market basis makes people immediately accountable.

#### Potential criticisms

Setting up a special purpose vehicle can't be done overnight. It involves lawyers to set up the appropriate structure and accountants to value the intangible assets. The location also needs consideration as the legal and financial implications vary greatly between different jurisdictions. Some critics claim such schemes deprive the country where the intellectual property originates of corporation tax and if it is not done properly, there can

## Special purpose vehicles Brand papers

be potential exposure to transfer pricing issues. But the benefits outweigh the possible difficulties and there are many opportunities in different sectors.

### Opportunities by sector

● **Fashion:** The fashion sector is well placed to have intellectual property housed in special purpose vehicles.

Such IP could include trademarks, such as brand names and logos, and copyright, including designs such as the Burberry check. It would work for a number of reasons.

1 Revenues are intrinsically linked to the brand – take the logo off a \$100 (£50) Abercrombie & Fitch T-shirt and it becomes virtually worthless.

2 Fashion businesses often have complex businesses models using a combination of owned stores and product lines, franchised stores and licensing products. This suits the simple business structure a special purpose vehicle would enable, geared around the payment of royalties.

3 Fashion businesses are often international and using a special purpose vehicle makes the brand easier to manage.

4 Fashion brands often cross multiple product sectors. Armani, for example, operates its brand in sectors as diverse as hotels, fragrance, clothing, homeware and mobile phones. Calvin Klein successfully raised \$58m (£37.6m) by securitising royalties on perfume brands in 1993. The buyout of fashion brand Bill Blass was financed by bonds backed by the Bill Blass trademark in 1999.

● **Consumer brands:** Other consumer-facing brands have substantial opportunities to securitise their intangible assets to raise finance. Royalty payments from franchisees are regular and secure sources of income. These can therefore be securitised through a special purpose vehicle.

In 2006, Dunkin' Donuts raised \$1.7bn (£0.9bn) by securitising its franchisee payments. Other franchise-based business could do the same, such as Ted Baker, Prontaprint and McDonald's. There has been some activity in securitising spirits brands, such as malt whisky. These brands could be



Calvin Klein: successfully raised \$58m (£37.6m) in 1993 by securitising royalties on its perfume brands

bundled together with the inventory, plant and machinery to raise a considerable amount of finance.

● **Pharmaceutical:** The pharmaceutical industry is highly reliant on patents. Without the appropriate patent protection, the drug is at risk of becoming a generic, wiping billions off its potential value. These patents are ideal for putting in special purpose vehicles as all income is directly derived from them and drugs are sold internationally to multiple partners, business units, distributors and agents. Finance could also be raised on the back of the patents to fund other capital projects, as Yale University did by securitising its patent for HIV drug Zerit, raising \$100m (£50m).

● **Music:** David Bowie is acknowledged as the first artist to raise finance on the back of his intellectual property – the copyright to his songs. In 1997, he needed cash to finance the purchase of some of his songs from his former manager. To fund the acquisition, he securitised 287 of the David Bowie songs he did own, issuing a 10-year bond. He raised \$55m (£34m), foregoing royalty payments from those songs for a decade and 10 years later, ownership reverted back to him. In the meantime, he bought the remaining songs from his former manager and so owned the rights to all his songs.

Since the Bowie Bonds, other musicians have followed suit. James Brown and Iron Maiden both raised \$30m (£18m) in 1999, Rod Stewart raised \$15m (£9m) and Dusty Springfield \$10m (£6m).

● **Publishing:** Literary copyright is also suitable for securitisation and management through special purpose vehicles. It is licensed to publishing houses, film and TV production companies and brand extensions ranging from board games to theme parks.

The estate of Roald Dahl, for example, could put the copyright and trademarks of Dahl's works into a special purpose vehicle. The income from the Charlie and the Chocolate Factory film, DVD sales, books, toys, computer games, ride at Alton Towers and other commercial activities could all be managed in an efficient structure which, if housed in a low tax country, would reduce tax payments. The estate of author John Steinbeck used this approach to raise finance.

● **Film:** Securitisation is becoming popular in the film industry. In 1998, producer Vittorio Cecchi Gori raised \$294m (£178m) in a seven-year bond issue on a library of about 1,200 Italian and international films, including the Italian rights to almost all the James Bond films. Since then, others have included the rights to *Saving Private Ryan* and *American Beauty*, which, together with other Dreamworks SKG films, raised \$540m (£382m) in 2001.

### Conclusion

Any industry that is reliant on intellectual property for revenue is suitable for both management and securitisation through special purpose vehicles. Past examples have included computer games, sports stars and tourist attractions, such as Madame Tussauds. With a firm understanding of the benefits that can be gained by commercialising a company's intellectual property through special purpose vehicles, marketers can begin to move up the management hierarchy and be involved in the restructuring programmes and financial issues that govern the brands they manage. ■

Stuart Whitwell is joint managing director of Intangible Business, the brand valuation consultancy.  
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