Larry and Barry Wondering Why Royalties Are Not Already The Standard Way Of Financing Companies

Arthur Lipper

Larry: I don't get it.

Barry: What is your current unsolved mystery?

Larry: We know that royalties are the better way of financing businesses. We get the money for a negotiated percentage of our revenues and get to keep all of the ownership of our company.

Barry: Yes, and no one tells us how much to pay ourselves or what kind of cars the company should lease for our use or if we should buy a competitor and how much stock or cash we use.

Larry: Yeah, and no one tries to change our policies about the payment of commissions to those who help us make sales, or fusses when we decide to do some research which will not add to profits for another few years.

Barry: Yes and if we want we can always exercise our redemption right and buy back the royalty.

Larry: That's if we hadn't already bought some of the outstanding royalties as a result of our making offers to those royalty holders wanting a quick profit and liquidity.

Barry: So what's wrong, what are we missing, as it seems this is the way any business owner truly believing in the likely significant increase in future value of his business should want to go.

Larry: Maybe they are afraid to project annual revenues.

Barry: Why should that be a problem, as the company doesn't have to guarantee that they will be successful in achieving the projected revenues? It all depends on the deal negotiated.

Larry: But it is true that if the company takes more of the risk by assuring minimum levels of royalty payments, irrespective of revenue growth, a lower royalty rate can be agreed upon.

Barry: Yes, and they even have a deal where if we project revenues very conservatively and exceed the projected levels for an agreed number of years the royalty rate is decreased for future years. It's like what really happens in a negotiation between knowledgeable parties and it's called REXScaledRoyalties.com.

Larry: Sure and there is also a penalty if we come up short in the revenues projected for a number of years.

Barry: Their REXdebt-shareRoyalties.com sure makes it attractive to both the investors and business owners as after the debt is repaid the royalty rate is so very low. This is the deal structure they suggested for us.

Larry: Their loan rate was only about 20% to 30% higher than the bank charges its best credit-wise customers and the banks had no interest in doing a term loan with us. Their 2% going to 1% of revenues after the repayment really works very well for both of us.

Barry: It must be some fears that prompts business owners to sell stock in their companies at a valuation which they will regret if the company does as well as they tell the investors will be the case.

Larry: And that is where the problems start, as all the investors want is reported profits at a level justifying the price they paid for their shares, even if that means we are paying more in taxes than if we took a longer term view and spent current profit-reducing money to make future money.

Barry: It is such a logical approach that I can't figure out why all business owners wouldn't use royalties to grow their business on a non-equity dilutive basis and without the legal and internal political problems which result when the inevitable conflicts arise between the investors and we, the major shareholders.

Larry: So the only other fear can be that of projecting revenues, and that shouldn't be a problem for honest business owners as the structure of the deal can accommodate the dependence on projected revenues.

Barry: It is probably the investment bankers and lawyers who are reluctant to do something new to them, especially when the present structures are profitable and familiar for and to them.

Larry: Perhaps their Royalty Issuer Assured Return approach is best as then the focus of the investor would be on getting the minimum return regardless of the projected revenues being achieved.

Barry: Yes, I liked the REX-RIAR.com approach as then we would be able to negotiate the lowest level royalty rate since we are picking up the risk, instead of the investor.

Larry: Then all we have to do is make the investor comfortable that we will stay in business to pay the negotiated minimum quarterly royalties, with the growth of the projected revenues being gravy.

Barry: It is also true that some investors will not be satisfied with just our assurance as to the minimum payments. If this becomes a problem we should be able to pay someone a fee to get an endorsement or third party guarantee for all or some part of the risk.

Larry: That's funny as what could happen is the person guaranteeing the payment of the minimum royalties would likely just decide to do the deal themselves.

Barry: That's called an elegant problem and we should only be so lucky.