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Royalties as an Alternative Investment

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Royalties are a unique form of investment. Compared to stocks, they provide a stable, fairly low-risk alternative for investors. Instead of owning a share of the company's stock that fluctuates daily, investors are guaranteed a monthly payment based on the company's revenue.

Due to the current state of the economy, many people are looking for new ways to invest their money that are not bound to unpredictable stock market fluctuations. This has led to a rise in the popularity of alternatives to stocks, like royalties. According to the International Confederation of Societies of Authors and Composers, royalty revenues have continued to grow over the past few years in spite of the unstable global economy. In fact, in 2008 more than seven billion euros in royalties were collected worldwide by the 2.5 million artists represented by the group.

A royalty is a monetary compensation paid to the owner of an asset (often an intellectual property). The owner may license the asset to be used by another party, and will be paid a percentage of the net revenues of the asset based on its usage. Royalties can also be used to allow investors in a company to have a percentage ownership of future production or revenues that will be paid at specified intervals like annually, quarterly or monthly.

Royalties are often used as alternative investments in three areas: venture financing, natural gas/oil and entertainment income.

In venture financing, lenders invest in a business in exchange for part ownership of the company, which provides the business owners with funding to further grow their business. In addition, in venture financing the investor normally only makes their money back if the business is acquired or has an initial public offering. However, with royalty-based financing the business owner does not have to share ownership of the company with the investors. Investors instead receive a monthly payout based on the revenue of the company. Royalty-based financing is a hybrid small business loan that combines assets from venture-capital funding and bank loans. The royalty-based financing model has become common among several New England-based investment firms like Royalty Capital Management , BDC Capital and Rockwater Capital.

Owning a natural gas or oil royalty trust is similar to having part-ownership of a natural gas or oil well. Aside from operational costs like staff, management and overhead, most of the profits go to shareholders. In this scenario, the cash flow is tied to the commodities produced by the trust. Because of this, the assets of the business, like large oil reserves, become more valuable in an inflationary environment. Additionally, company's cash flows are protected from inflation. Several natural gas equipment companies offer this investment option like the Natural Gas Services Group, which manufactures natural gas compressors, a necessary piece of equipment for obtaining gas.

This model can also be applied to entertainment royalties, which include royalty streams of music, movie, television, book publishing, etc. Royalties are paid to songwriters, artists, screenwriters and producers by organizations like BMI and ASCAP for music and the Screen Writers Guild for screenplays. Currently, liquidity for the royalty owner is available only by selling their complete works or locking up all future income using the royalties to collateralize a loan. However, through The Royalty Exchange, the owner may sell any percentage of their royalty income at auction to buyers who are looking for a stable income stream. The owner sets the minimum price they will take (the reserve price), so there is no cost or risk for them as the seller. Royalties are paid by the different organizations, like BMI and SWG, into a secure escrow account either quarterly or biannually and then distributed to the buyers where they can track their purchases and revenue through an eTrade like dashboard.

Royalties are a unique form of investment. Compared to stocks, they provide a stable, fairly low-risk alternative for investors. Instead of owning a share of the company's stock that fluctuates daily, investors are guaranteed a monthly payment based on the company's revenue. Business owners also do not have the burden of sharing ownership of the company with their investors. These benefits have made royalties common investments in venture financing, natural gas/oil and entertainment, and could potentially spread to other industries in the future.

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