Media & Content Industry: Music case study

Study for IPTS
Seville, 26 October 2011 Andra Leurdijk & Ottilie Nieuwenhuis
Main questions

1. What are the main economic developments in the music industry?

2. How have digitisation and the internet affected the value network in the music industry?

3. How have the digitisation and the internet affected the competitiveness of the European music industry?
Three main revenue streams

**Song writing**
- Music publishers sign songwriters and license use of songs
- Performing rights
- Performance and distribution of songs
- Public listens, watches and buys

**Live Performances**
- Artist perform live
- Personal managers coordinate careers
- Talent agents book live performances
- Promoters put on live performances
- Venues provide space for live performances
- Public buys tickets for live performances

**Sound recording**
- Artists perform recordings
- Labels sign artists to record
- Producers, engineers and artists make recordings
- Manufacturers reproduce copies of the recordings
- Distributions wholesale copies of recordings
- Retail (online/offline) sell recordings
- Public buys copies of recordings
Eurostat definition of sound recording and music publishing

<table>
<thead>
<tr>
<th>Sound recording</th>
<th>Music publishing</th>
<th>Related activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Production of original (sound) master recordings (tapes, CDs)</td>
<td>• Acquiring and registering copyrights for musical compositions</td>
<td>• Publishing of music and sheet books</td>
</tr>
<tr>
<td>• Sound recording services activities in a studio or elsewhere</td>
<td>• Promoting, authorizing and using these compositions in recordings, radio, television, motion pictures, live performances, print and other media.</td>
<td>Not included:</td>
</tr>
<tr>
<td>• Production of taped (i.e. non-live) radio programming, audio for film, television etc.</td>
<td>• Distributing sound recordings to wholesalers, retailers or directly to the public*</td>
<td>• Reproduction from master copies of music or other sound recordings, see 1820</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• wholesale of recorded audio tapes and disks, see 4649</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Live performances</td>
</tr>
</tbody>
</table>

* Units engaged in these activities may own the copyright or act as administrator of the music copyrights on behalf of the copyright owners.
Characteristics of music industry

- High up-front costs
- Uncertain demand, hit driven
- Strategies of control:
  - Stars, genres
  - Control over value chain
  - Management of copyrights
- Highly concentrated market, dominated by 4 vertically integrated majors, app. 70% of the international market
- Many SME’s

Revenues in 2010

- Universal: €4.449 billion
- Sony Music: €4.240 billion
- Warner Music Group: €2.186 billion
- EMI: €1,792 billion
### Number of firms, employees and labour productivity in EU 27 music industry, 1995-2007

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of firms</td>
<td>4,982</td>
<td>11,833</td>
</tr>
<tr>
<td>Number of employees</td>
<td>15,407</td>
<td>21,023</td>
</tr>
<tr>
<td>Average number of employees per firm</td>
<td>3,09</td>
<td>1,78</td>
</tr>
<tr>
<td>Labour productivity</td>
<td>44,8</td>
<td>67,3</td>
</tr>
</tbody>
</table>

Source: Eurostat

Labour productivity is the amount of goods and services that a worker produces in a given amount of time.
The European music industry
Share of EU members states in total value added of the music publishing industry in EU27 (2007)

Total value added in 2007: 943 million euro

Source: Eurostat
Cost structure of the music industry

Costs for supply chain amount to 38%; for marketing and promotion to 28%

Royalties for composer and artist are significantly smaller: 6 and 12%

Source: Aris & Bughin (2009) based on McKinsey analysis
### Revenue streams in music industry

#### Broader Music Industry Value (in billions US dollars)

<table>
<thead>
<tr>
<th>Service</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Radio advertising revenue</td>
<td>27.9</td>
<td>26.4</td>
</tr>
<tr>
<td>Recorded music retail sales</td>
<td>25.7</td>
<td>23.4</td>
</tr>
<tr>
<td>Live music revenue</td>
<td>19.0</td>
<td>18.1</td>
</tr>
<tr>
<td>Musical instrument sales</td>
<td>14.6</td>
<td>16.6</td>
</tr>
<tr>
<td>Portable digital player sales</td>
<td>16.1</td>
<td>16.1</td>
</tr>
<tr>
<td>Audio home systems</td>
<td>10.1</td>
<td>10.1</td>
</tr>
<tr>
<td>Songwriters</td>
<td>8.8</td>
<td>8.9</td>
</tr>
<tr>
<td>Music TV and music magazines advertising revenue</td>
<td>8.7</td>
<td>8.9</td>
</tr>
<tr>
<td>Music related video games sales</td>
<td>3.5</td>
<td>2.8</td>
</tr>
<tr>
<td>Performance right market</td>
<td>1.6</td>
<td>1.8</td>
</tr>
</tbody>
</table>

Source: IFPI RIN (2011)

1940-1950: Television changed radio format, increasing reliance on music and news.

1960s: Music Tapes – Hometaping led to declining LP sales.

1980s: Music Tapes – Hometaping led to declining LP sales.

1990s: CD – Replacement of LP collections led to a new revenue stream.
New value chain music industry

Andra Leurdijk

Music industry - a case study

Creation

Production, Editing

Marketing, Promotion

Distribution

Consumption

Physical players:
- Music labels
- Physical retailers
- Artist
- Media (Radio, A&R)

Digital players:
- Music labels
- Device Manufacturers
- Telco's
- Pure Web Players
- New Labels
- Concert Promotion Companies
- Consumers
- Artists

Traditional Players

New Players
Creation / production

✓ Recording, mixing, mastering, editing and producing is no longer attached to time and space, easier to produce

✓ Artists can have more direct contact with audiences/fans and have access to alternative funding options, such as crowdfunding

✓ Less dependent on intermediaries?

Surroundings of the Nilento recording studio in Sweden
Development in global consumer sales for physical and digital recorded music (2005 – 2015*)

*Figures for 2011-2015 are expected sales for recorded music.

Source: PWC and Wilkofsky Gruen Associates, 2010
### Change in physical and digital sales

<table>
<thead>
<tr>
<th>Country</th>
<th>Physical Sales Change</th>
<th>Digital Sales Change</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>-684.6</td>
<td>245.7</td>
<td>-438.9</td>
</tr>
<tr>
<td>Germany</td>
<td>-288.1</td>
<td>104</td>
<td>-184.1</td>
</tr>
<tr>
<td>France</td>
<td>-484.9</td>
<td>70.5</td>
<td>-414.4</td>
</tr>
<tr>
<td>Spain</td>
<td>-208.4</td>
<td>18.5</td>
<td>-189.9</td>
</tr>
<tr>
<td>Italy</td>
<td>-205.6</td>
<td>11</td>
<td>-194.6</td>
</tr>
<tr>
<td>Netherlands</td>
<td>-55.8</td>
<td>12.4</td>
<td>-43.4</td>
</tr>
<tr>
<td>Switzerland</td>
<td>-83.3</td>
<td>18.3</td>
<td>-65</td>
</tr>
<tr>
<td>Belgium</td>
<td>-44.5</td>
<td>3.5</td>
<td>-41</td>
</tr>
</tbody>
</table>

#### Chart: Change in US Million dollars

- Y-axis: Change in US Million dollars
- X-axis: Countries

#### Table:

<table>
<thead>
<tr>
<th>Change in US Million dollars</th>
<th>United Kingdom</th>
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<th>France</th>
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</tbody>
</table>
Piracy or consumer dissatisfaction?

Piracy

OR

Consumer dissatisfaction?

Protest against verdict of Pirate Bay in Sweden, 18 april 2009
Sharing vs. buying

For every 5 files shared...

...1 song is bought.

For every 15 to 20 downloads, one track less is sold.

Downloaders also go to more concerts and buy more merchandise (TNO, 2009).

Source: Rob and Waldfogel (2004)
Music industry response to file sharing

- Filing law suits against P2P services, closing down Napster (2003)
- Then licensing of music to online music providers (Apple iTunes store in 2003)

Source: Apple Inc/European Audiovisual Observatory
<table>
<thead>
<tr>
<th>Business models</th>
<th>Services</th>
<th>Options for users</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single song downloads</td>
<td><img src="amazon.png" alt="Amazon" /> <img src="spotify.png" alt="Spotify" /></td>
<td>Users download and buy single songs at fixed price per song.</td>
</tr>
<tr>
<td>Membership</td>
<td><img src="emusic.png" alt="Emusic" /></td>
<td>Users pay for limited download quota per month or other fixed period.</td>
</tr>
<tr>
<td>Membership ‘all-you-can-eat’</td>
<td><img src="melon.png" alt="Melon" /> <img src="spotify.png" alt="Spotify" /> <img src="rhapsody.png" alt="Rhapsody" /></td>
<td>Unlimited access to catalogue. Users get temporary license to listen to music.</td>
</tr>
<tr>
<td>Ad based model</td>
<td><img src="pandora.png" alt="Pandora" /> <img src="cs.png" alt="CS" /></td>
<td>Music is streamed, users are unable to make own playlist (but do have ways to personalize by liking or disliking played songs.</td>
</tr>
<tr>
<td>Bundling</td>
<td><img src="cubomusica.png" alt="Cubomusica" /> <img src="fastweb_music.png" alt="Fastweb Music" /> <img src="tdplay.png" alt="TDPlay" /></td>
<td>Access to music catalogue in combination with other media products, such as mobile phones, iPods or in combination with mobile subscriptions</td>
</tr>
<tr>
<td>Cloud Services</td>
<td><img src="amazon.png" alt="Amazon" /> <img src="clouddrive.png" alt="CloudDrive" /> <img src="7digital.png" alt="7Digital" /></td>
<td>Users can download music and store this in a personal box ‘in the cloud’</td>
</tr>
</tbody>
</table>
Company case: Spotify (Sweden, 2006)

- Streaming service and online music store
- Available in 8 EU countries & US, 300 employees
- Freemium and subscription model
  (Jun 2011: 3.13 million free user, 1.54 million paying subscribers)
- Facebook account needed to sign up

<table>
<thead>
<tr>
<th>Subscription model</th>
<th>Price / Month</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free</td>
<td>0</td>
<td>Online ad-supported desktop version</td>
</tr>
<tr>
<td>Unlimited</td>
<td>4.99</td>
<td>Online ad-free desktop version</td>
</tr>
<tr>
<td>Premium</td>
<td>9.99</td>
<td>Premium service, mobile and offline</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Price / 10 tracks</th>
<th>Price / 15 tracks</th>
<th>Price / 40 tracks</th>
<th>Price / 100 tracks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>€9.99</td>
<td>€12.99</td>
<td>€30.00</td>
</tr>
<tr>
<td>Price per track</td>
<td>€1.00</td>
<td>€0.87</td>
<td>€0.75</td>
</tr>
</tbody>
</table>
Company case: Spotify

After the introduction of the Spotify-Facebook partnership (September 2011), the number of users grew with one million new users a month.

- Revenues from £11.32 million in 2009 to £63.17 million in 2010 (458% increase)
- More revenues from subscriptions than from advertisers
- The company is not yet profitable
Consumer surplus?

✓ Consumers can now listen anywhere and anytime to their favourite music, adjusted to a personal profile.

✓ Consumers have a much more active role in sharing, uploading, commenting and remixing music.

✓ But also: lock-in effects? Less diversity?
### SWOT 1

<table>
<thead>
<tr>
<th>Value network</th>
<th>Strengths</th>
<th>Weaknesses</th>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
</table>
| Production    | • Large variety of national artists and vibrant popular music cultures | • Music industry leans towards strong promotion of big stars | • Talent scouting and talent development remains a professional skill needed by many musicians in order to succeed in the market  
  • Lower costs for production tools, enable SMEs to enter the market and for artists to manage (more parts of) music production themselves  
  • Production can be located anywhere, nearness to music centers in London, New York less necessary | • Uncertainty about level of investments in music production  
  • Greater reliance on hits and stars |
## SWOT 2

<table>
<thead>
<tr>
<th>Value network</th>
<th>Strengths</th>
<th>Weaknesses</th>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregation &amp; distribution</td>
<td>• One of the successful new online distributors located in Europe</td>
<td>• Few national artists are sold outside their country of origin</td>
<td>• Establishing links between online music service providers and social networks, mobile phone operators and device manufacturers for promotion and distribution of music</td>
<td>• Legacy distribution models through record companies and retail increasingly under pressure</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• More options for less well known artists to reach (niche) audiences</td>
<td>• Continuing unauthorised downloading</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Stronger interaction and ties between artists, labels and audience</td>
<td>• Music retail shops closing down</td>
</tr>
<tr>
<td>Value network</td>
<td>Strengths</td>
<td>Weaknesses</td>
<td>Opportunities</td>
<td>Threats</td>
</tr>
<tr>
<td>--------------</td>
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<td>---------------</td>
<td>---------</td>
</tr>
<tr>
<td>Business models</td>
<td>• A lot of experimentation with new business models</td>
<td>• Music industry slow to respond to digital innovations and the changes in business models this requires</td>
<td>• Increasing willingness to pay for digital music • Contextual services, offering extra features, are a USP for music providers • Development of revenue sharing deals or license contracts which are beneficial for artists, record companies and online music providers alike • Involvement of users in (creation and) promotion and distribution of music • new talent scouting &amp; financing models</td>
<td>• Decrease in overall revenues for music industry • Lowering market barriers may be to the detriment of Europe’s competitiveness in a global market</td>
</tr>
</tbody>
</table>
For Discussion

- More comprehensive overview of revenue streams necessary to get full picture. How?

- Market power of new players (in pricing etc.) & relation with legacy music industry

- Will investment in original music production suffer?

- Does European music industry have greater or lesser opportunities in digital music market?
Digital performance rights in the US rose 60 percent in 2010 to $249 million (PWC, 2011).

Source: IFPI RIN (2011)
Retailers

✓ The decline in physical sales has led to the closure of many specialized physical retail stores
Positive effects of filesharing

1. Consumers surplus, because access to large amount of music
2. Wider platform for artists

Leading to a raise of interest in live performances.

Source: OECD (2010), WAN (2010)
Impact of digitization

✓ Decline of physical music since the late nineties
✓ Music consumption shifted to online
✓ Traditional business models are disrupted
✓ Overall decline of revenues

But also:
✓ Cheaper and easier availability of digital music on different devices for consumers
✓ More possibilities for artists to produce and distribute their music, independent of intermediaries
The music industry

- Subscription services
- Television/movies
- Wholesale distributors
- Music stores
- Supermarkets
- Radio
- Digital (e.g. iTunes)
- Physical (e.g. Amazon)
- Online stores
- Subscription services
- Videoplatforms
- Television/movies
- Online blogs/personal websites
- Social networks
- Content creators (musicians, composers, studio engineers, songwriters)
- Music publishers and record companies
- Concert promoters
- CD manufacturers
- Wholesale distributors
- Hardware provider
- Concert promotors
- Music publishers and record companies
- Online stores
- Subscription services
- Videoplatforms
- Television/movies
- Radio
- Live performances
- Retail
- Music stores
- Supermarkets
- October 26, 2011

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Music industry - a case study