

# The Emerging Music Business Model: Back to the Future?

Alexis Koster, San Diego State University, USA

## ABSTRACT

*For many years, the music industry has consisted of two main components: the concert industry and the recording music industry. Throughout the 80's and 90's, thanks mostly to CD sales, the recording music industry was dominant in terms of revenue and visibility. It reached record US sales in 1999 and 2000 (over \$14.3 billion in 2000, \$13.2 billion of which for CD albums), and between the years 2000 and 2007, the industry has seen a decline of 44% in its sales of physical records. Reluctantly, the recording industry has joined the digital world by signing agreements with a variety of organizations providing music downloading, in particular with Apple and its iTunes downloading service. It earned 1.4 billion dollars from music downloading in 2007 (with another billion from other digital sales such as cellular phone ringtones). Obviously, digital sales have fallen short of compensating the industry for its losses of physical record sales. The concert industry is re-emerging as the potential dominant component of the music industry. In contrast to the recording industry, its revenues have not been affected by illegal Internet downloading. On the contrary, it is making use of the Internet to increase them. Recording artists are taking advantage of the weakening of the recording labels and of the opportunities offered by the Internet to loosen their dependence on the labels. Finally, the once well-defined separation between the concert industry and the recording industry may be disappearing: concert organizers are getting into the recording business and majors are getting into the concert business.*

## INTRODUCTION

A simple image represents music distribution as it had existed for centuries: a performer, singing or playing an instrument, and a hat circulating among the public to collect a few coins. For centuries, many music performers earned a living by receiving money either directly from the public or through a few intermediaries such as concert hall owners. Some, such as Bach and Mozart, were in the employ of a nobleman or a king and paid for playing for their masters and their guests. Beethoven supplemented his income from his concerts and commissioned work by giving piano lessons. The economic condition improved for many music creators and performers in the 19<sup>th</sup> century with the emergence of a middle-class ready to spend money for its entertainment as well as with the enactment of the copyright law, which provided payment of royalties to music composers.

## THE LEGAL ENVIRONMENT OF MUSIC: THE COPYRIGHT LAW

The U.S. Constitution (Article 1, Section 8, Clause 8) stipulates that “The Congress shall have power to promote the progress of science and useful arts by securing for limited time to authors and inventors the exclusive right to their respective writings and discoveries.” Killian and Costello [5] note that “This clause is the foundation upon which the national patent and copyright laws rest, although it uses neither of those terms.” The first U.S. copyright law was enacted in 1790. It took many changes to the copyright law to protect the various forms of music. For example, the statute for copyright of performance took effect in 1889 and the one for mechanical record reproduction in 1909.

The current copyright law in the U.S. is the Copyright Act of 1976 [6]. Many amendments have been enacted since the promulgation of this act. Some resolve ambiguities that became apparent in the 1976 law. Some

adjust it to the 1886 Berne Copyright Convention, which the U.S. ratified in 1988. Some amendments, such as the Digital Millennium Copyright Act of 1998 (DMCA), have started addressing questions related to the use of modern technology.

Because managing and collecting copyright fees is all but impossible for authors, this task is left to music publishers with whom they have historically shared those rights when they were only derived from music sheets [13]. In the USA, music publishers are members of the National Music Publishers' Association, directly or through the representation of publishers associations. They represent the interests of songwriters and music writers. Publishing copyright fees are collected from concert organizers (and, as we will see later, from other forms of music distribution) by three performing rights organizations, namely the American Society of Composers, Authors and Publishers (ASCAP), Broadcast Music Incorporated (BMI), and the Society of European Songwriters, Authors and Composers (SESAC), which authors and publishers join for this purpose. In France, the SACEM has a similar function.

### **THE GROWTH OF THE RECORDING INDUSTRY**

The ability to broadcast music by radio was the first major change brought to the music industry. Although the concert music industry of the time initially saw radio as a competitor that would prevent music listeners to attend concerts, it quickly turned out to be the opposite: by advertising and popularizing music compositions, it actually increased attendance to concerts. For music composers, it added the advantage of earning them copyright royalties collected on their behalf by the performing right organizations. In the U.S., performers do not get royalties for radio broadcasting of their performance (unless they are also the composers). However, they benefit from its advertising effect [9].

The main technology that has fashioned the music recording industry is the recording of music on long playing vinyl records (introduced in 1949 by Columbia Records) and on compact disks (CDs, introduced in 1982). By 2000, the recording music industry was a \$14-billion business in the U.S. (92% from CD sales) and its worldwide revenues topped \$38 billion. By then, most of the smaller recording labels had been acquired by five majors, which together shared about 85% of the U.S. market: EMI, BMG, Sony, Universal Music, and Warner Music (BMG was recently acquired by Sony).

### **TRADITIONAL BUSINESS MODEL: BETWEEN THE CONCERT INDUSTRY AND THE RECORDING INDUSTRY**

The Recording Association Industry of America who regroups most labels, including the majors, provides the various figures about the recording industry on its website [17]. It is harder to get equivalent figures about the concert industry. For the year 2000, Connolly and Krueger [4] indicate sales of almost \$1.4 billion for concerts of rock artists listed in the Rolling Stone Encyclopedia, which represents about 75% of all concert revenues according to those authors. Therefore in 2000, a rather imprecise ballpark figure of concert revenues would be about \$1.9 billion. This is much less than recorded music sales for the same year.

Although a measure of the success of music performers is usually presented by the media as the number of CD units they sold and as their rankings on billboard charts, most revenues for performers are derived from concerts, and the difference between the two sources of revenues is quite large. For example, the top-ranked rock performer in 2002, Paul McCartney, received \$64.9 million from live concerts, \$2.2 million from recording sales, and also \$2.2 million from copyright royalties; 31 out of the 35 top-ranked artists had more revenues from concerts than from recordings [4].

The reason for the relatively low revenues derived from recording stems from the way labels structure the recording contracts with the performing artists [13]: they typically provide an advance to the recording artists for a given CD, but before the artist can start earning royalties for the sale of each CD unit, there is "recoupment", that is the label subtracts many types of expenses. Moreover losses from previous CDs are applied to new CDs. Finally,

little known artists who sign with labels have contract clauses that are less favorable than the ones received by better known artists (for example, smaller royalties per track, required commitment to more recordings, and so on).

In spite of the apparent separation between concerts and recordings in the traditional music business model, there exists some synergy between concerts revenues and recording sales: artists who sell many recordings usually get larger audiences at concerts and the tickets are sold at higher prices. Conversely, an artist's successful concert tours increase CD sales for that artist.

### **END OF THE MUSIC CD?**

Yearly sales of CDs in the U.S. since 2001 show accelerating declines, starting with 2.3% between 2000 and 2001, reaching 10.9% between 2005 and 2006, and 20.5% between 2006 and 2007, and totaling 44% between 2000 and 2007 [17]. The year 2004 showed a slight increase of 1.9%, attributed to the deterrent effect of well-advertised heavy fines levied against users of illegal file-sharing. Figures abroad are fairly similar. Should this trend continue, this would certainly be the end of the CD. Actually, the "end of the CD" has now been announced many times: a recent Google search found more than 40,000 websites with this phrase in it. We can think of a few cases where the CD makes more sense than digital files, for example classical music and jazz. For these types of music, the higher quality provided by the CD is critical. But sales of classical music and jazz together account for only 4.9% of all CD sales.

There are other signs of the expected demise of the CD. The once successful retailers of CDs, Tower Records and the Wherehouse, have gone out of business. Amazon is replacing shipments of physical CDs by digital downloads [18]. Apple's iTunes sales of digital files has now surpassed Walmart sales of music CDs and has become the industry retail leader [15].

### **END OF THE RECORDING MUSIC INDUSTRY AS A MAJOR MUSIC INDUSTRY COMPONENT?**

For years, the majors tried to delay the growth of digital music sales in various ways, such as refusing to license large parts of their catalogs to download services and imposing conditions, such as Digital Right Management (DRM), limiting the duration of availability of music files or the number of permitted copies [11]. One by one, the various limitations are being lifted. It seems that each day, digital music stores announce new agreements with the labels to distribute music over the Internet: various ways of streamlining music, often free; various types of downloading, by subscription or for a fee, sometimes as low as 30c per track, or even free, with or without DRM; deals with commercial websites, such as iTunes, as well as social websites, such as Imeem and MySpace; and sharing of advertising revenues.

Will digital music sales alone permit the recording music industry to survive as a major element of the music industry? This seems unlikely. The ratio of the digital sales to the total sales of the recording industry has grown from 9% in 2005 to 23% in 2007. As impressive as this relative growth seems, it is taking place in a fast shrinking environment and is compensating only partly for the industry losses. Two features of the digital market are important factors. First, it is estimated that the ratio of illegal download to legal download is 20 to 1 [8]. The assertion that illegal downloading is not the main cause of the recording industry losses [12] has now been discredited [10, 14]. Second, in 2007, 20 singles were legally downloaded for each album [17], representing only a 2 to 1 ratio in terms of revenues. In comparison, in 2000, the recording industry revenues from CD singles were less than 1% of the revenues from CD albums.

As discussed in a previous section, the recording industry, primarily the majors, used to have a position of strength in their contracts with performing artists. The Internet now provides alternatives to the artists. This is illustrated by the recent dealings of the British rock group Radiohead [3]. At the end of 2007, the group did not renew its contract with EMI. Instead it started offering its new album, "In Rainbows", on its website for downloading. The price was whatever the buyer wanted, for a limited time. The experiment has been a financial success for the rock group, with about 1 million downloads, which brought to the rock group about \$3 million.

This experiment is not all bad for the labels. In its aftermath, the sales of the CD itself, released by a small independent label newly started, was number one on the billboard chart in the U.S. EMI is taking advantage of this success to release a CD of former Radiohead hits in June 2008. Edgar Bronfman, the current CEO of the major Warner Music, sees a silver lining to this experiment. In particular, the Warner Music group has formed a joint venture with the rock group to distribute the album *In Rainbows* on the Internet [2].

## **THE MUSIC INDUSTRY: BACK TO THE FUTURE**

The analysis presented in this paper so far indicates that the relative importance of the concert industry has been increasing in the music industry because the recording industry share has been steadily decreasing for the past seven years. Will the concert industry grow on its own? What is and will be the effect of music downloading on concerts? As discussed previously, Connolly and Krueger [4], who provide U.S. rock concert figures through 2003 show a peak of \$1.4 billion (translated as \$1.9 billion for all types of concerts) for 2000, with a decline to \$1.2 billion in 2003. The loss of revenues for rock concerts between 2000 and 2003 has several possible reasons. One of them derives indirectly from illegal downloading. Concert ticket prices used to be kept relatively low by performers to increase attendance and, as a consequence, boost CD sales. As illegal downloading has cut their revenues from CD sales, performers have increased concert ticket prices. As a result of this increase in ticket prices, concert attendance and revenues have been decreasing. Connolly and Krueger call this the Bowie effect.

At this point, it seems hard to gauge the full effect of internet downloading, illegal or legal, on concert revenues. One trend is to get concerts “wired” to increase their audience as well as advertise. Small gigs and large concerts are getting webcast live [16]. Revenues come from advertising. The major concert promoters, more particularly Live Nation, are all active in webcasting as well as in TV broadcasting.

Finally, the music industry has reached a point where its two main components, the concert industry and the recording industry, may be fusing together. Live Nation, one of the major concert promoters, has started its own label. It has signed Madonna, of whom Live Nation was already the concert promoter [1]. In fact, we are speaking of an entity, Artist Nation, which is more than a recording label. Artists who sign with Artist Nation are partners. Artist Nation manages the partners’ various music rights as well as insures them global distribution and marketing. More recently, rapper Jay\_Z has signed with Live Nation in another deal that encompasses much more activities than tour promotion and music recording [7]. Recording labels are not waiting quietly either. They started to move into the concert business a few years ago and continue to do so, buying concert halls and concert producing companies [19].

## **CONCLUSION**

After almost ten years of turmoil, some trends appear in the music industry as a whole, but we do not yet see very specific business models: 1) continuous steep declines of CD sales, partly compensated by increasing digital sales; 2) a profusion of different models for digital music revenues; 3) aggressive moves of concert promoters into the recording business and the webcasting of concerts; 4) moves of labels into the concert business.; 5) and possibly the fusion of the two main components of the music industry.

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**NOTES**