*Collaboration and the Knowledge Economy: Issues, Applications, Case Studies*
*Paul Cunningham and Miriam Cunningham (Eds)*
*IOS Press, 2008 Amsterdam*
*ISBN 978–1–58603–924-0*

# Emerging and Conflicting Business Models for Music Content in the Digital Environment

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**Abstract:** As music listening is moving from tangible products to digital services, record labels seem to have difficulties in adjusting their business models to the new reality. This study investigates how Swedish record labels have changed their practices and habits when it comes to marketing, promoting as well as selling music. The 360-degree model - more or less used by all majors - where the label owns or partly owns related rights is one clear tendency. A contrary tendency is split risk cooperation found mainly among the independent record companies and their acts. This is one example of the different practises that can be observed in a market where long-time strategies seem to be hard to draw simply because there is not enough knowledge on how the market will evolve, not even on short-term basis.

## 1. Introduction

Despite the success and booming sales of legal digital downloads (both with and without DRM protection) at iTunes and eMusic, ringtones etcetera, the market for digital music distribution still has a long way to go to cover up for the declining CD-sales observed since all time high sales in 2001 [1].

Plausible explanations for declining sales have been put forward by a number of researchers [2][3][4]. For example the act of listening and purchasing music has faced fierce competition from Internet usage (blogs, Internet-TV, file-sharing), cell-phones, computer games and DVDs. The decreasing diversity in prime time radio-programming (fuelled by big mergers) and the coinciding pattern of concentrating on “low risk” acts by major companies have impoverished the “soundscape” of broadcasted media.

During the latest years a new online ecosystem of companies and stakeholders has emerged with aggregators, distributors, white labels and digital retailers. The value chain for digital distribution of music has somewhat consolidated during the years 2005-2007 and digital sales reached a new global record of 3 billion US$ in 2007. According to most analysing firms and researchers, digital music sales will probably surpass physical sales somewhere around 2011-2013 [5][6].

Therefore, record labels are working hard to try to make use of Internet and mobile networks for marketing and promotion purposes. There are a number of good examples where record labels are active in creating new business models that might have positive effects on future consumption of music. Record labels in the independent sector especially are finding new tools and mechanisms for digital marketing and distribution that is more cost effective and interesting to the consumer.

However these emerging business models sometimes get in conflict with other interests in the music industry. Since the digital landscape is fundamentally different from the physical world, conflicting business models and ideological convictions can be observed throughout the music industry system. Because of these rapid changes, knowledge on how record labels are working in this area is still underdeveloped.

There is a need for new understanding how the record labels themselves are changing their routines and practices and what effects new business models have on their relationship with artists.

## 2. Objectives

The main objectives of this paper are to

- Understand how new technologies are being used by record companies in promotion and marketing and describe concrete differences and similarities between independent and major record companies.
- Understand the relationship between artists and record companies on all levels. How are investments, risks and revenues divided between artists and record companies? Have the forms for cooperation changed over the last 5-10 years? What are the reasons for starting record companies among well-established artists as well as unsigned and unknown artists/bands?
- Identify the challenges for the players in order to find tools for building sustainable and long-term business models.

## 3. Methodology

The main data for this paper has been derived from in depth interviews and detailed forms from nine Swedish record companies and distributors. The size varies from 0-40 employees. The companies are Hybris, Songs I Wish I Had Written, Bonnier Amigo, Playground Music, Lights Out, Sound Pollution, Dead Frog Records, Adrian Recordings and Lionheart International. The comprehensive form consisted of four groups of detailed questions regarding (a) the use of aggregators, distributors and retailers, (b) marketing and promotion, (c) the overall development of the company and finally (d) thoughts and visions about the future.

Due to the complex world of digital distribution and the limited time window, the selection of respondents was limited to the Swedish market. Due to the detailed answers from each and one of the respondents, we unfortunately did not have the liberty to reveal any names in relation to specific responses. In addition to the interviews a thorough investigation of the music industry's policies and structure was performed by attending industry conferences as well as interviewing other stakeholders within the industry.

## 4. Findings

### *4.1 Distributors, aggregators, retailers and e-tailers*

The interviews with the respondents confirmed the picture of a slightly complex world of middleman's and varying definitions of the titles above among respondents.

a) Distributor – Historically a distributor is a company that distributes physical goods, e.g. CDs to the sales channels. The sizes of the distributors in terms of turnover vary a lot. All major record companies have always had their own companies for distribution and the gap between these and all others is usually big. Due to the massive workload of finding, recording, producing and promoting acts a distributor can relieve some of the administrative pressure for especially small record companies. For example it is not unusual that smaller record companies use majors as distributors.

b) White Label – A B2B company that has developed a technical platform for sales of digital music. Usually the White Label clears all the rights with the different rights holders

and the customer, e.g. a physical store or brand, uses the platform to create a customized online store. 24-7 Entertainment is the largest European White Label. Other examples are Inprodicon and OD2 (owned by Nokia).
c) Aggregator – Typically a company whose main business model is to aggregate digital content from distributors (or directly from record companies). The aggregator provides the content for retailers/e-tailers in other words a distributor of adapted digital content. The border between distributors and aggregators is somewhat fluent but the aggregators main task is to act as a promoter and “push” the digitized music in as many channels as possible. Examples on such Aggregators are The Orchard, Phonofile, CD Baby and IODA Alliance.
d) Retailer/e-tailer – A company selling digital products to consumers. In this context, digital downloads such as digital audio files, music videos or mobile ringtones are being sold. Usually an online shop makes use of a White Label solution, but he largest online music shop, iTunes, is a stand-alone solution.


*Figure 1: A common sales chain for digital music.*

Record companies can, depending on the product, sell their digital content directly to a consumer. However the most common solution for a record company is to use a distributor (or go directly to an aggregator) in order to minimize the administration and maximize the availability of their products at on-line services. A key issue is namely the huge number of available retailers for music of variable size on different markets, read countries. [7]

Almost all retailers have their own format for metadata, technology for uploading and desired file format. Every song is supposed to appear as different kind of products; ringtone, audio and video. Furthermore, when it comes to downloads for cell phones, the content also needs to be adapted for each model, a process made either by the aggregator or the retailer. On top of that, the major cell phone operators in each country have their own solutions for selling digital content.

The study points out a diverse picture where bigger record companies and distributors try to manage the contacts directly with retailers whereas smaller companies need to use distributors and aggregators. In order to cover the markets in Sweden, Norway, Denmark and Finland with digital downloads via Internet and cell phones, the biggest respondent uses no less than twelve business parties, despite the limited size of the total markets.

The problem is that every middleman of course demands a share in order to cover investment costs [8]. Some respondents claim that e.g. mobile ringtones is a loss in terms of money due to the high billing fees. Video downloads are better, but the earlier mentioned adaption to various cell phone models is costly.

All respondents claim that information they get from digital sales is reliable in most cases. But the level of detail and formats varies a lot, making it sometimes hard to get a compiled image how sales of e.g. a certain single is related to market activities.

One issue addressed by many respondents is the slow handling by some retailers. For example iTunes can take 10 weeks before a tune is available for purchase. It seems like some retailers have different priority lists depending on the customer. A second explanation might be the overall low profitability in this part of the market making it hard to find a balance between staff and pressure for uploads. This type of delays makes it hard for smaller record companies to synchronize sales releases of CDs and downloads.

As even major record labels have started experiment with DRM-free music, the markets acceptance for direct sales through retailers has widened. Some artists have for example started selling mp3s directly to fans. One example is the Swedish retailer Klicktrack who delivers a Do-It-Yourself platform that makes it possible for artists or labels to sell music directly through their own webpage or through a centralized digital store.

Most of the respondents estimate that the time spent on digital sales is 5-15 percent. When asked how much of the sales is digital downloads, the answers was 2-15 percent. Only one respondent replied that they had a digital/physical ratio of 50/50 and 40/60 respectively and that the digital part would soon surpass the physical ditto.

### *4.2 Marketing and promotion*

Most of the respondents still uses “traditional” marketing channels such as TV, radio and ads in printed newspapers, preferably music magazines either directly or indirectly via composite adds by their distributors/retailers. Other respondents (the smallest) question the real effectiveness of using printed media.

Banner ads give better statistic feedback of the overall success for a campaign than printed ditto according to the respondents. A number of other on-line channels also seem to become more important. Since some respondents refer to printed newspapers as something that the younger generation does not read, the interest has turned to the Medias where they think they can meet this audience of growing importance.

Almost all respondents refer above all to MySpace as an important channel of making artists and groups searchable, known and render possibility to listen to their music. The majority of the MySpace sites related to the respondents are maintained and updated by the artists themselves. Sites like YouTube and MySpace are considered as natural channels for promoting videos and recruiting new fans. Official statistics of shows/plays on these and a number of other websites such as Facebook are used to value popularity of artists and releases. In fact some respondents actively plant genuine music files on P2P networks as a part of their marketing strategy and follow the number of downloads. This is the opposite approach of the bigger respondents that share the overall opinion of the majors.

The above-mentioned statistics and, more important, sales and airplay charts are used in contacts with music journalists in order to encourage medial coverage such as interviews or reviews. In the same way, exposure in media is used as arguments in promoting music for both physical and on-line stores. Unfortunately the correlation between observed interest and purchases is not always that good which is frustrating according to some respondents.

So-called street teams are those who talk well and spread the word about a certain group or artist on forums or blogs. It is not unusual that these unofficial on-line street teams are supplied with unique mp3s in order to encourage continued coverage and fuel the traffic to these blogs, forums and communities.

Some respondents stress the importance of building relationships to bloggers, which occasionally also happen to be journalists writing for printed Medias. Search engines for blogs are used daily in order to follow up what is written about a certain act.

When asked how much time that is spent on on-line marketing (both for downloads and physical goods) versus ads in “traditional” medias (print, TV, radio) the answers varied from 5/95 to 50/50. The biggest respondent in terms of employees and turnover had the biggest displacement towards “traditional” medias. But for the second biggest, the division was nearly even. It seems like more niche companies tend to focus on on-line marketing.

It is not expensive (but rather time-consuming) to make music available for digital downloads. In fact, it has never been so inexpensive to produce recordings of high technical quality and make them globally available for digital downloads. At the same time, marketing music with the aim of reaching a broad audience has never been more difficult and expensive.

### 4.3 *The overall development of the companies*

The number of signed artists has remained the same or declined according to the respondents and no one reports increasing sales of physical units. Nevertheless physical sales is considered as an important source of income for many years to come.

Digital downloads have remained the same or increased, but not boosted as expected which is a huge disappointment so far. The time-consuming handling of metadata, uploads and contracts is still a limitation and according to some respondents makes digital sales not even profitable. All respondents have adopted new digital platforms but some feel that the major companies have chosen a price model that does not work [9].

The music industry is moving extremely fast and small companies are finding niches, the only way to be profitable as a small player on the market. Short ways between idea and action, flexibility, creativity and focus on digital sales have been the common recipe to adapt to the changing prerequisites. Some respondents are digitalizing their back catalogues in order to make them available for downloads.

When asked about the future of the company, one respondent answered that it is a positive trend that an increasing number of artists want to go independent and thereby take control and make decisions in a world where one need to be flexible. The same respondent believes in developing split-risk-models where both parties get an equal share of a success.

One respondent believes that they will develop from being a pure record company to become a composite music company acting as a publishing house, record company and working with management. This trend is also obvious among majors.

### 4.4 *Visions and thoughts about the future for the music industry*

One of the biggest respondents hopes that the majors will be become ever fewer and bigger. Smaller companies will benefit from this development through growing market shares on an overall declining market. The future will namely be more global yet more niche.

A global meta-standard among all rights-holders for distribution of all kind of digital media files is crucial in order to cut administration costs, middlemen and shorten unreasonable lean times. An extension of this would be the dream scenario of a common global database for distribution of digital content. The metadata standard DDEX (Digital Data Exchange) has been developed by the music industry and computer industry. Active members of the consortium are Apple, Microsoft, Real Networks, all the major record labels as well as Ascap, MCPS-PRS and other collecting societies. Apple has already implemented the standard in iTunes but aggregators and other players in the digital ecosystem have not fully embraced the standard [10]. One explanation might be necessary yet expensive adaptions of existing business platforms to the standard.

One of the biggest respondents believe that smaller independents will face a hard time where they will have to choose between bankruptcy or to put their material in the back catalogue of a bigger distributor of digital content. The same respondent think that only a handful of distributors with good local connection can be profitable on a market of the size of Sweden’s nine million inhabitants.

Companies with an old back catalogue should be able to receive economical support from the government in order to manage musical cultural heritage as in e.g. Denmark, according to one respondent. One cannot lean on the forces of the market when it comes to maintaining cultural diversity in a global market that is shrinking.

The technological change is considered positive but the biggest respondents are irritated on the slow level of determination showed by politics. The standpoint of politicians and legal authorities against illegal file sharing must be clear. A little bit dejected, one respondent describes Sweden as a world-leader in illegal file sharing activities and that digital downloads therefore are hard to sell.

Perhaps the biggest challenge is to win the upcoming generation. “It is not that young people have stopped buying CDs. They have not even begun.” This is a significant quote from one of the respondents. These upcoming consumers have little or no affection to physical music artefacts compared to former generation’s CDs and LPs.

It took a long time before digital downloads got widely accepted by majors. Now we are facing the next challenge according to the respondents, namely the lukewarm interest for streaming services by majors. Despite the high level of control and low risk of piracy, majors have not wholehearted embraced services like Pandora and Last.fm.

But in the spring of 2008 some steps have been taken from major labels to license their catalogues to new forms of services [11]. Flat fee, bundled or ad based services like Spotify, Nokia Comes With Music and Qtrax are in advanced stage of planning with the major labels that might lead to a shift in business models during the coming years.

Flat-rate services will be the norm of the future according to many of the respondents. Unlimited file sharing bundled with broadband connections is mentioned as one solution for future income. In the spring of 2008, STIM, the Swedish Performing Rights Society together with some other Swedish music organisations, somewhat unexpectedly, opened the door for cooperation with ISPs concerning monitored but unlimited music downloads for private use [12]. Even though the division model and the technology behind are not clear, this is an interesting step. Completely unthinkable only a few years ago.

A fee of 5 or 10 € on the monthly broadband connection or the TV-license would be an appropriate level for such service according to the respondents in this study. A problem might be the logical somersault: on one hand illegalize file sharing and on the other hand collect fees because of file sharing activities. Nevertheless illegal file sharing is limiting the willingness to invest in new systems and business models in the music industry according to the study.

Another interesting example of Flat-rat services is anywhere.fm where the user uploads his/her music to a web service that can be streamed from any web-browser. Combine this usability with the range of songs in iTunes, add a low monthly fee to get free access to streaming/downloads and make it available through cell phones (where the operator already today uses a flat-rate for data traffic). Majors and indies regardless of size will have the same opportunities and it appeals to the upcoming strictly mobile generation. This is the kind of services that will reshape the landscape of music consumption according to the respondents.

## 5. Conclusions

An obvious proof for a non-matured digital market observed in these studies is the vast different approaches that the record companies have chosen in order to sell their products. Practices differ as each record label is trying to find their own way of getting revenues from digital distribution. Surprisingly no regular communication seemed to take place between the companies, accept for between two of the smallest companies.

One has to bear in mind that the typical record label entrepreneur often has a history of getting it done “by themselves”, not relying on anyone else to run their business. The Swedish music industry has in some senses become institutionalized during the second half of the 20$^{th}$ century leading to groups of companies having more business relations than others [13]. In the light of the latest year’s technological development, one could argue that these “islands” are making it harder for new knowledge and business practices to spread within the music industry system, leaving each and everyone of them alone in their struggle.

But the interest for information from diverse channels such as activities on file-sharing networks, social networks, UGC-services and web radio is higher than ever among all players on all levels in the industry. Business models are more and more based on feedback information from online music usage, i.e. the amount of plays on MySpace, YouTube, Last.fm, iLike, iMeem, MySpace.TV etcetera and record labels are often making decisions based on these sources rather then airplays and record sales.

As a result of these findings a platform that automatically gathers and analyzes usage data from different music services has been developed by Musiclink, the company funding this study. The platform is now being used by all the respondents as well as additional companies in a new research project partly funded by The Swedish Governmental Agency for Innovation Systems. As a further result of this study a spinoff company, named TrendMaze, was started in May 2008. The business model is to be a provider of Business Intelligence focused on online usage of music.

All companies in the study claim that their own activities on file-sharing networks are important, but they refer to different approaches. In fact, some smaller indies actively share their music on file sharing networks and state that this is a vital and effective instrument of their marketing. The tendency among bigger indies is that e.g. spoofing (publishing corrupted files on P2P networks) is an important tool in protecting their assets. In other words, a view similar to major record companies.

The study also shows that the cooperation between record companies and artists in terms of risk-taking, financing of recording and marketing is perhaps the biggest difference compared to earlier years. Because of declining CD-sales the so called 360-degree model has gained large attraction during the latest years where the record labels either owns or share a part of the rights to all relating products, merchandising, tour production, publishing, synchronization (the practice of getting music into movies, TV-shows, commercials), digital distribution etcetera. A second way of cooperating is to share risks, e.g. letting the artist finance or partly finance some part of the production process.

The 360-degree model is probably one reason why some previously signed artists have decided to start their own record companies in order to gain control over rights. For others starting a new record company is the only way to get published.

The straggling approaches draw a diverse picture of a market where long-time strategies seem to be hard to draw simply because there is not enough knowledge on how the market will evolve, not even on short-term basis. This together with mental models and beliefs about how the music business is supposed to work makes it hard for some record labels to adjust to the Internet economy and new consumer behaviour [14]. On the other hand, our study shows that there is a tremendous creativity going on among smaller record labels. New alliances are forming within the industry and some of the respondents are even working together with some of the larger file sharing networks. This is creating somewhat a clash between the larger labels and these new initiatives [15].

In the past national airplays was a vital instrument in establishing a new record on the market and thereby more or less guarantee good record sales. Today not even established record companies can rely solely on airplays. Therefore some of the respondents primarily refer to airplays as sources for royalty income (especially Swedish public service radio with its higher kick-back rate compared to commercial ditto). However the study shows that for some specific genres the commercial radio still is the most important shopping window.

The study has six major conclusions:

- Practices among record labels differs widely when it comes to marketing and promotion online. Majors and somewhat bigger companies emphasize the importance of traditional channels whereas smaller, often very specialized, companies rely on online marketing.
- Approaches to file sharing networks differs depending on how large the record label is. Some of the small labels share their music for free on file sharing networks.
- The relation to the artist has in large changed to the 360-degree model where the label owns or partly owns related rights (major companies) or split-risk solutions (smaller companies).

- Bigger record companies try to cut digital middle hands by working directly with retailers whereas smaller companies need to use aggregators.
- Flat-rate services, e.g. different kind of streaming services or free-music-download through ISPs, was nearly unthinkable only a few years ago. Today collecting societies, record labels and ISPs conduct serious discussions about the future.
- Information from free online music usages is becoming increasingly important to understand the changing wishes of the customers. Business models based on compiling complex information from various on-line sources will find customers on all levels and size of the music industry.

The overall link between these conclusions is declining revenues and a changing market for music that has not yet consolidated.

### *5.1 The future of the music industry*

As the music industry is moving from a product based industry to service based [16] practices, business models are changing drastically. For some record labels digital sales contribute to nearly 50% of the total revenues and the music industry system is no longer homogenous. Telecommunications companies like Ericsson, TeliaSonera, Telenor, France Telecom, 3, Nokia and Samsung are all important parts of the new music ecosystem having an increasing role in the new music distribution system.

During the latest years revenues from performance and private copy levies have increased for every year while revenues from sales of copies have decreased. Between the years 2000 and 2004 revenues increased with 30% for collecting societies in USA, UK and Sweden [14]. At the same time revenues from physical sales decreased with about the same amount. In other words a dramatic shift of sources of income.

It is possible that the music industry is moving from per unit revenues to more flat rate based revenues divided by functions similar to the models collecting societies have used for decades. In such reality there is a large need for getting reliable data on usage of music from music services. TrendMaze is focusing on this area as a result of what has been found in this study.

### *5.2 Future research*

This study has been focused on Swedish record labels. The interviews have revealed that the situation is mainly the same for all record labels in Europe. However, to fully understand the complex landscape for digital music distribution on a European scale further research is needed in countries like United Kingdom, Germany, France and Italy.

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