

Title: Business models in the music industry: in search for the Holy Grail.

In 1998 Shawn Fanning did not realize that he would put into jeopardy an entire industry with a click on his mouse. Since the advent of Napster and the digital revolution it unleashed, the music industry has spent a lot of time, effort and money fighting the Internet, blaming piracy for the decline in CD sales. In the last few years however the industry has been forced to recognize that fighting the rise of the Internet to save the industry is a futile fight. Even if piracy remains a major concern the sole use of litigation will not save the industry.

As more and more companies and artists have been assessing the opportunities the Internet provides, many new business models have emerged and new players have entered the market. In the search for the Holy Grail no clear new model has emerged yet. However we can observe several trends. In this paper I will examine three trends: DIY, 360° and Fan-funding, looking at the problem of value creation, innovation and the viability of the models. Before examining the new models, we briefly review the traditional model.

The traditional model

In this model the value chain can be represented in five stages:

Artist / Record Label / Production / Distribution / Promotion

The artist signs a contract with a label, which then takes care of the production, the distribution and promotion of the record. Some cynics would point out that in the traditional model, unless you are unusually successful, you spend the rest of your career in debt to the label, paying back you advances.

There is a certain amount of truth to this but unless you come from a rich family or your father or mother already work in the music business, most bands do not have the financial resources or marketing clout to make albums and promote them. Signing a contract with a label has traditionally been a major stepping-stone to success. Record labels provide a number of services, the most important being; the discovery of new talent, giving advice to artists on their career and recordings, financing the recordings, promoting and distributing the music. This was the model that grew over the past century without undergoing major changes. Over the past decade however, technological innovation has profoundly transformed each stage in the business of producing and selling music.

Advances in computer technology have reduced drastically the cost of recording an album. As David Byrne has pointed out: “ an album can be made on the same laptop you use to check your email”.¹ The advent of the MP3 format has also reduced manufacturing and distribution costs to near zero. The Internet has radically changed the way in which talent is discovered. Simply having a MySpace page or a video on YouTube, will not by itself guarantee stardom for Bands, but it certainly has become the platform to increase exposure and bring artists to a global audience.

So where do artists stand in this new digital environment? There are many options and models. One option is to completely abandon a record label and do everything yourself. This model came to the head lines in 2007 when Radiohead, after saying good bye to their label EMI, released their seventh album “In rainbows” on their own.

DIY

Radiohead

The album was released on their website as a digital download with a pay-what-you-want model. In the first month the album was downloaded by a about a million fans. Approximately 40% of them paid for the album at average price of 6\$, the band receiving nearly \$3 million. As the band owned the master recording, which in the traditional model the record label usually owns, Radiohead was able to license the album for it to be distributed physically the old –fashioned way. ²

Although, financially the pay what you want model was a success, Radiohead did not use this model for their the latest album “The king of Limbs”. Several reasons could explain why. In 2007, after having separated with EMI, Radiohead had no longer the marketing clout that a major label could offer to promote the album. Offering an album on pay what you want model was quite a radical idea at that time so the group could get a lot of buzz going on social networks as well as in traditional media – and a lot of buzz they did get it. However re-iterating this model for the release of their latest album would certainly not been as effective in generating buzz/

¹ www.wired.com/16-01/

² David Byrne and Thom Yorke on the Real Value of Music.

http://www.wired.com/entertainment/music/magazine/16-01/ff_yorke?currentPage=all

The pay what you want model also showed that fans were willing to pay different prices for an album and depending on the “version “ the album fans are willing to pay more or less. In Rainbows for example, was released in a special physical boxed set, priced at \$80 and sold more than 100 000 copies.³ Although Radiohead has abandoned the pay what you want model they have retained and developed the use of “versioning” or “bundling”. “The King of Limbs” is being sold in four versions. Two digital only versions: an MP3 format sold at €7 and a better quality Wav format for €11. Two “newspaper album” formats, with a lot of extra goodies costing €36 or €39.

Radiohead. The King of Limbs

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Newspaper Album - PRESALE

Radiohead's new record, The King Of Limbs, is presented here as the world's first* Newspaper Album, comprising:

- Two clear 10" vinyl records in a purpose-built record sleeve.
- A compact disc.
- Many large sheets of artwork, 625 tiny pieces of artwork and a full-colour piece of oxo-degradable plastic to hold it all together.
- The Newspaper Album comes with a digital download that is compatible with all good digital media players.
- The Newspaper Album will be shipped from Monday 9th May 2011 you can, however, enjoy the download now.
- Orders placed on or after 21st February 2011 (UK time) will ship from 1st June 2011
- Shipping is included in the prices shown.
- One lucky owner of the digital version of The King Of Limbs, purchased from this website, will receive a signed 2 track, 12" vinyl. Competition closing date 28th March.

*perhaps

Newspaper Album + MP3 PRICE €36.00

Newspaper Album + WAV PRICE €39.00

PRE ORDER



Digital only

Radiohead's new record, The King Of Limbs, is presented here with a choice of two digital formats:

- MP3 version is a 320K constant bit rate file.
- WAV version is a full CD quality uncompressed digital audio file.
- One lucky owner of the digital version of The King Of Limbs, purchased from this website, will receive a signed 2 track, 12" vinyl. Competition closing date 28th March.

MP3 PRICE €7.00

WAV PRICE €11.00

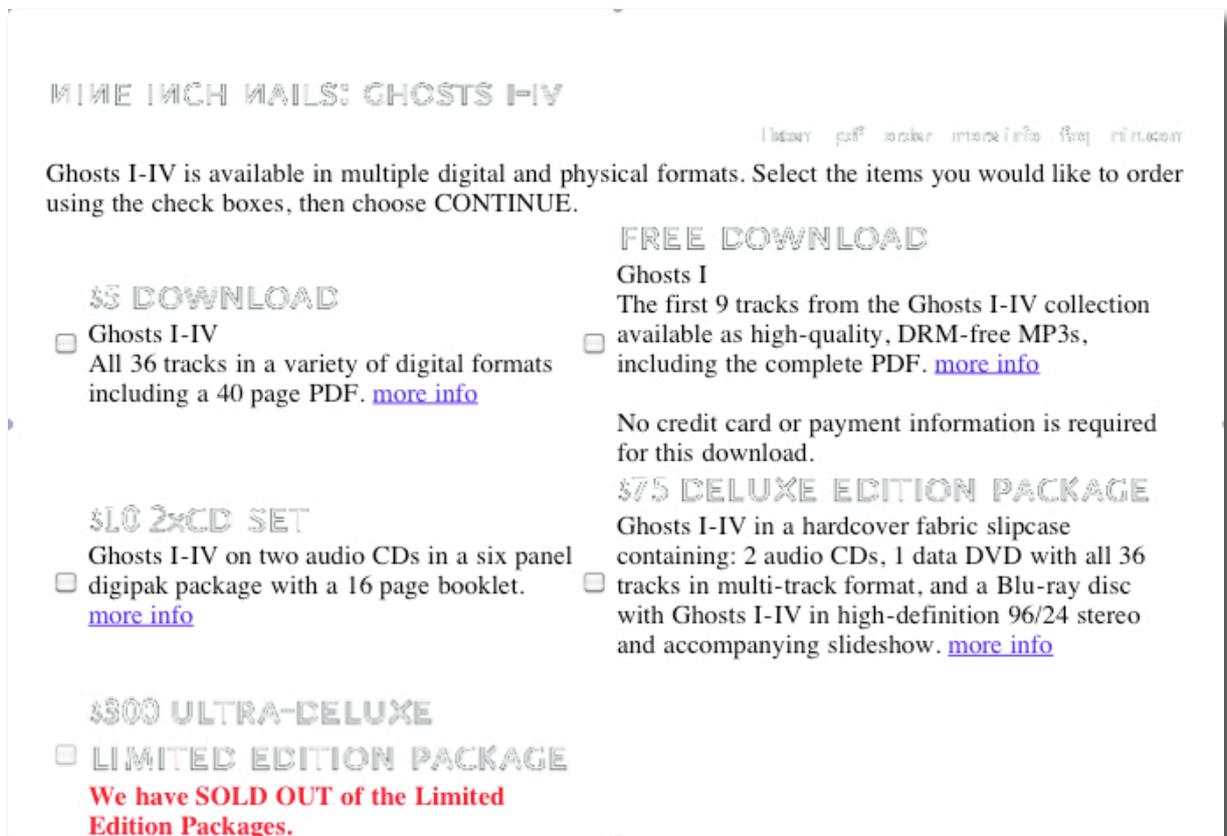
ORDER

Radiohead are here playing into trend, which is notably offering consumers a range of products with different values and prices depending on the options chosen. This model has grown recently and the options go from giving your music for free to selling a deluxe edition CD for \$300. Trent Razner, the front man behind the band Nine Inch Nails has been a key player the development of this model.

³ <http://www.nme.com/news/radiohead/40444>

Nine Inch Nails

Just like Radiohead, NIN, left their label and released the album Ghosts I-IV by themselves in 2008 on their website. There were 36 tracks on the album. There were numerous options for fans to obtain the music.



NINE INCH NAILS: GHOSTS I-IV

Ghosts I-IV is available in multiple digital and physical formats. Select the items you would like to order using the check boxes, then choose CONTINUE.

\$5 DOWNLOAD

Ghosts I-IV
All 36 tracks in a variety of digital formats including a 40 page PDF. [more info](#)

\$10 2xCD SET

Ghosts I-IV on two audio CDs in a six panel digipak package with a 16 page booklet. [more info](#)

\$75 DELUXE EDITION PACKAGE

Ghosts I-IV in a hardcover fabric slipcase containing: 2 audio CDs, 1 data DVD with all 36 tracks in multi-track format, and a Blu-ray disc with Ghosts I-IV in high-definition 96/24 stereo and accompanying slideshow. [more info](#)

\$300 ULTRA-DELUXE

LIMITED EDITION PACKAGE
We have SOLD OUT of the Limited Edition Packages.

FREE DOWNLOAD

Ghosts I
The first 9 tracks from the Ghosts I-IV collection available as high-quality, DRM-free MP3s, including the complete PDF. [more info](#)

No credit card or payment information is required for this download.

The first 9 tracks out of the 36 were free to download. For \$5 you could get the whole album plus a 40pages pdf file. For \$10, you got 2 CD set plus a 16 page booklet. For \$75 you got a deluxe edition package including all of the above plus a DVD, Blu-ray disc and a nice booklet. For \$300 you got the ultra deluxe limited edition package, which was limited to 2500 copies and all signed by Trent Reznor himself.

In less than 30 hours the \$300 packages sold out making a gross profit of \$750 000 and if you include all of the other options the total amount earned after the first week was \$1.6 million.⁴ What was so surprising about the NIN model was that the band was making a lot of money while giving their music for free.

Just a couple of months after the release of Ghosts I-IV, NIN released their next album, The Slip. This time, the entire was available to download for free but fans were also given the option of buying the album in different physical formats, CD/DVD or vinyl with lots of extra goodies.

⁴ Masnik, Mike. <http://www.techdirt.com/articles/20091119/1634117011.shtml>

The Slip and Ghosts 1-IV were both released under a Creative Commons license, which means that fans could share the songs legally online. NIN even encourages fans to do this. As it is clearly stated on their download site:

we encourage you to

remix it

share it with your friends,

post it on your blog,

play it on your podcast,

give it to strangers,

etc.'

Trent Razner has certainly understood that giving music for free opens up new opportunities to reach a bigger audience. Giving music for free has real economic value. Mike Maznik has formulated this concept as: $\text{Connect with Fans (CwF) + Reason to Buy (RtB) = The Business Model}$. Since fighting piracy is a hopeless battle, instead of treating fans as criminals, you have to connect with them and give them a reason to buy. It is essential to build and develop your fan-base. Offering free MP3 downloads is an essential marketing tool to give reasons to buy: be it deluxe DVD editions, merchandising, T-shirts or concert tickets. It was no surprise that on the same day The Slip was released, Trent Razner announced the next NIN tour. So when you downloaded the album you also learned about the tour and the tickets for the concerts were sold quickly.

Income from live concerts has also become an important source of revenue for artists and in many cases can generate far more income than CD sales. Table 1 lists the gross income from touring for the top ten income earners in music for 2002. As we can see from the table, income from touring highly exceeds income from recordings. For example Paul McCartney received around \$65 million from live concerts while only receiving \$2.2 million through recordings. The Rolling stones pocketed more than 39 million from concerts while earning less than 1 million in record sales.

Table 1: Estimated Pre-Tax Gross Income by Source for Top Ten Artists Who Toured in 2002 (Millions in U.S. Dollars)

Rank	Artist	Live Concerts	Recordings	Publishing	Total Income
1	Paul McCartney	64.9	2.2	2.2	72.1
2	The Rolling Stones	39.6	0.9	2.2	44
3	Dave Matthews Band	27.9	0	2.5	31.3
4	Celine Dion	22.4	3.1	0.9	31.1
5	Eminem	5.5	10.4	3.8	28.9
6	Cher	26.2	0.5	0	26.7
7	Bruce Springsteen	17.9	2.2	4.5	24.8
8	Jay-Z	0.7	12.7	0.7	22.7
9	Ozzy Osbourne	3.8	0.2	0.5	22.5
10	Elton John	20.2	0.9	1.3	22.4

Source : Marie Connolly & Alan B Kruegar, Rockonomics: The Economics of Popular Music. Bureau of Econ. Research, Working Paper No 11282, 2005.

Concert-ticket sales have become the music industries fastest growing source of revenue. Worldwide concert revenues increased from \$16.6 billion in 2006 to \$22.2 billion in 2010.⁵

As the live music industry is far from being in crisis, it has given rise to a new model: the 360° deal.

360° deal

The 360° deal is an alternative to the traditional recording contract where record labels receive a percentage of all of the artists earnings instead of just record sales. These include revenue from merchandising, ring-tones, and concert tours. In exchange for receiving a proportion of all revenue streams from an artist, the label commits itself to provide greater support to the artist on a long-term basis, including a higher upfront, as well as funds promotion and touring.

The 360° model has been gaining momentum since it emerged in the early 2000s when Robbie Williams signed a record breaking \$157 million deal with EMI. Edgar Bronfman, CEO of Warner Music Group announced in 2008 that all new artists would be signed under 360° deals and that about a third of their artists were already under those contracts. Traditional record labels are not the only businesses using the model. New actors have entered the market

⁵ <http://www.grabstats.com/statmain.asp?StatID=70>

such as the concert tour promoter Live Nation. In 2007, Madonna was the first major artist to sign a 360° deal with Live Nation. The deal was worth \$120 million dollars giving Live Nation an all-encompassing stake in the music and music-related businesses of Madonna including albums, touring, merchandising, Web site, film projects and sponsorship agreements. Other artists joined the Live Nation bandwagon, including the rapper Jay-Z, who signed a deal worth \$150 million. The singer Shakira left Sony BMG to join Live Nation for contract worth \$70.

The growth of 360° deals has not gone without provoking a certain amount of controversy. Some analysts would question the profitability of the massive advances Live Nation has paid. After all, why would concert tour promoter working in a growing and profitable market ever want to enter a declining recording business? After the announcement of the Madonna deal the value of Live Nation stock did drop significantly. The fall in prices could surely be explained by a combination of many variables. Executives at Live Nation attributed the decline to a problem of “timing of large tours”. However the drop in the stock price also suggests that investors were dubious as to the profitability of such contracts.⁶ The fact that Madonna’s label, Warner did not match Live Nations offer also casts a doubt about the financial viability of such a deal.

Like many innovations the 360° model was born in a period of turmoil. Due to the dramatic decline in record sales over the past decade, traditional record labels have desperately been searching new remedies to stay alive. In the search for the holy grail however some see 360° as just a new cash cow for labels who are desperately seeking to maintain their profit margins by tapping into the money that bands earn from playing shows and selling merchandise. Labels defend 360° deals as a justification for investing more time and money in the career of an artist without worrying about recouping investments from album sales. After all, the argument goes, labels take the risk in developing artists, so why shouldn’t they get a bigger share of the pie when an artist succeeds?

One of the problems in the traditional model is the fact that the success rate is very low. Only a small fraction of artists developed will be commercially successful. Estimates of the success ratio vary between one in five and one in ten.⁷ Even though that one record can usually make enough money to cover the losses of the others, it does show that investing in new talent is risky business. Discovering new talent is the lifeblood of record companies and the digital age has certainly changed how talent is discovered.

⁶ Karubian. Sara. www-bcf.usc.edu/~idjlaw/PDF/18-2/18-2%20Karubian.pdf. p.425.

⁷ Investing in Music. IFPI

There are numerous examples of success stories fostered by the Internet. One of the most talked about and well documented is the British rock band, the Arctic Monkeys. In France, the rapper Kamini became an overnight success after shooting a video, with just a total budget of 100€, and putting it online on YouTube and it's French equivalents WAT.tv and Dailymotion.com. Although the Internet has become an incredible promotional tool it has become a victim of its own success.

The number of bands using the web has increased tremendously. MySpace alone had more than 2.5 million hip-hop and 1.8 million rock acts registered in 2009. Quantity of course does not mean quality. In this vast arena of potential talent, how can A&R teams spot the next jewel in the crown, and reduce the investment risks incurred in developing new talent? One option is the use of fan-funded sites.

Fan funding

Fan-funding or crowd funding is based on the theory of the “wisdom of the crowd”, where the collective opinion of a group of individuals is considered to be better than the opinion of a few experts. In the music industry it consists of asking your fans help to raise funds for a new project, an album or a tour for example. Although the model is not new it is gaining steam. More and more fundraising websites have been popping up. Although there are a lot of similarities between the business models used there are also differences. Here are some examples.

Sellaband

Sellaband was created in 2006 and is based in Amsterdam and Munich. Like many other fund raising websites, individuals interested in supporting an artist buy “parts” in the project. An artist sets a fund raising goal and once that goal is reached, those who have invested in the project get rewarded. Depending on how much an individual invests, the rewards can vary between receiving a free download of the album, to exclusive CDs, having lunch with the band, and even a cut in the revenues from future sales. Sellaband generates income by taking 15% of artist's goal amount once the artist has reached his goal. There is also an administration fee added to every deposit made by individuals who buy parts.

Success stories include the Dutch singer Hind whose album Crosspop entered the Dutch album charts at number 8 just behind Robbie Williams and Phil Collins. The Japanese metal band raised \$50 000 in just two months. Which led to a deal with Universal music Japan. Sellaband has also attracted major artists, such as the American Hip Hop group Public

Enemy who achieved a record funding project of \$75 0000. The group stating, “ we are proud to have broken ground into a new paradigm of music financing”.⁸

MyMajorCompany

MyMajorCompany was created in France in 2007. The business model differs slightly from sites such as Sellaband in that artists featured on the website are proposed the sites own A&R team. Mymajorcompany functions more like a traditional label but with the help of crowd funding. Before an album is released the artist has to raise 100 000 euros from its fan base. Since its creation My Major Label has launched a number of acts, one of the most successful being the French singer Grégoire who has sold more than 1 million copies of his debut album. Fans who initially invested in him saw a return of around 20 times their initial investment.⁹ The business model developed by My major company has certainly been successful The company launched its platform in the UK in 2010, Mymajorcompany UK and the first band to reach the £100 000 target, Ivyrise did so in 4 days.¹⁰

To conclude we could say that more than a decade after Napster shook up the music industry, the growing popularity of the Internet may actually be its greatest opportunity. Traditional record labels have been slow in adapting to the numerical revolution and we have only seen the tip of the iceberg of the effects that his revolution has brought and it well certainly continue to transform the industry in the future.

⁸ <https://www.sellaband.com/en/projects/publicenemy/incentives>

⁹ <http://www.crowdsourcing.org/document/my-major-company-mixes-traditional-record-label-ar-with-crowdfunding/1940>

¹⁰ <http://eu.techcrunch.com/2010/12/08/my-major-company-mixes-traditional-record-label-ar-with-crowdfunding/>