

# **PRICING AND DISTRIBUTION OF MUSIC IN THE DIGITAL ERA**

**By Jacob Rasmussen**

Through the past decade, transformations have haunted the record business, causing a rock solid industry to stagnate. The transformation, mainly caused by the opportunities the Internet brought us, has provided new prospects for the consumer. It has opened the opportunity for artists to be more independent and entrepreneurial. More than ever artists have the opportunity to shape their career and reach their niche/audience free of the restrictive contracts. The Internet has caused a more flexible market for music, and made it more convenient to satisfy the demand. This flexibility has changed the mentality of the consumer, who today sees music as being a service rather than a product. The tendency can be reflected upon sale statistics, where the retailing of the tangible CD has been steadily declining. In addition, the amount of illegal downloads have had an impact on the monetary value of music. As I was taking my Sunday walk a few weeks back, I passed by The Virgin Mega Store on Massachusetts Avenue in Boston. The store was covered in “75% off closing sale” signs. The store was crowded with customers who wanted to benefit. I found this paradoxical since the store was closing as a result of the declining sales of CD’s. It showed that there are still people to buy music- if the price is right. In today’s culture the evolution of technology has made it hard for the CD to stand the competition against the broad selection of entertainment products.

In this paper I would like to focus on how the music industry is going to evolve in the digital age. Among the things I will include will be the distribution and future pricing of music.

Record company: These words have achieved a very ambivalent position in the minds of artists and consumers. Over the past years the shift in the business of music has raised the question whether there is any use for a “record company” in the future. It hasn’t always been like that. Before the digital era, artists looked at record companies as their way to achieve and excel in their careers. It was in a time where marketing and entertainment offers were simpler. Until the corporate powers took over the music industry, the marketing structure was simply based on flexible radio airplay as the way to sell music to the consumer. An LP would be released and played on the radio, which would attract the consumer’s attention. In today’s competitive world of entertainment this model has been antiquated. Along with the entertainment offers available, the digitalization of music has given the consumer the impression of music being a service rather than a product. With ubiquitous free access through online-services, and the overpriced CD available via retailers, the consumer has slowly lost interest. This tendency had its beginning when the CD was invented. Computer companies made it possible to convert music into a format and store it on home computers. With the invention of the CDrom drive, duplication of the CD was possible. This started a process where duplication became an attractive way for the consumer to obtain music. The music industry was aware that duplication could have a detrimental effect on future music sales and lobbied to make congress put a special tax on devices meant for CD duplication. This tax would be allocated to the music companies as a compensation for the lost income. From here an evil circle had started. The music companies launched Digital Rights Management (DRM) to maintain control over the consumer’s ability to freely reproduce music. With this invention a lock was put on the CD, which only made the music

accessible when using a CD player. This restriction created a gap between consumer and company. Having the opportunity for duplication taken away, made the consumer perceive the music industry as exercising authority and control over their freedom. In addition, it was still possible for the consumer to access music for free. With the creation of the peer-to-peer file-sharing network “Napster”, the gap between consumer and company was widened even more. Napster was created in 1999 with the purpose of facilitating the exchange of music files. Hence it was possible for users to download music without any payment to the copyright holder. The service reached significant popularity, especially among college students, with a total of over 26.4 million users before its shutdown in 2001. Several artists and the Recording Industry Association of America (RIAA) filed lawsuits to enjoin the illegal activities. The artists/RIAA won the lawsuit against Napster and as a result was perceived as being greedy by the consumers. The music companies were strongly trying to keep an iron grip on the old traditional model of providing music, rather than seeing a new trend. The public attention brought from the lawsuit, caused the consumer to focus on the new opportunity of acquiring music for free. This new standard created a new universal music economy, where the monetary value of music has slowly deteriorated. The music industry hasn’t yet managed to adjust to the new situation. The result is declining sales, which has led to limited funds for artist development and production. In addition, the current shape of the radio industry has caused distance between the music market and consumer.

The inconsistent talent production, along with the homogeneous assortment of music available through consolidated radio station’s play lists, has had a negative impact on the consumer’s admiration for music products. RIAA has claimed until today, that the declining CD sale is a direct result of illegal downloading. Harvard professor Felix Oberholzer claims in a music business analysis released in 2004, that “downloads have an effect on sales indistinguishable from zero.” It was as well concluded that more successful artists with consistent careers, are less likely to be downloaded than one-hit-wonders. The conclusion could be that in order to maintain the interest of the consumer, the music industry has to provide a diverse selection of quality records.

Some steps have been taken to meet the needs of the music-buyer. With the launching of iTunes, a new opportunity arose. Apple licensed the catalogues of all five major labels. All single songs were available for the consumer to download for the amount of 99 cents. Along with iTunes came the iPod, a device that made it possible to store music in the MP3 format. With this solution, the consumer became able to design a play list of single songs of their personal choice. This differed from the past when the consumer would have to pay for a full album in order to get access to their favorite song. This brought the CD a step closer to antiquation. By launching iTunes, a foundation has been created for entrepreneurs to invent optimal online music services. The first attempt to provide music for free has been the new website named “Spiral Frog.” Spiral Frog made a licensing agreement with Universal music group to access its catalogue. The service is free for the consumer and monetarily supported by advertisers, who in return get exposure on the web site. This model is requiring the consumer to view 90 seconds commercials during the downloading process. The advantage of the Spiral Frog model compared to other similar services is that the music can be transferred to any portable device. The disadvantage is that the popular iPod is not included as usable. Spiral Frog is still in its infant stage, which makes it hard to tell whether it has been a success. Experts

are looking towards Spiral Frog with skepticism. Wayne Rosso, President of Mashboxx, which is another legal P2P service, predicts in Billboard magazine, that the hype around Spiral Frog will fade soon. He states “you can’t pull in big ad bucks if you don’t have lots of traffic. And even if you can, what’s the value of something that you can turn your head away from while downloading”

Regardless of whether SpiralFrog becomes successful, music have lost its certain monetary value, but it has not lost its position in society as an attractive form of entertainment. So far in 2006 digital tracks sold 468.7 million, an increase of 68.8 percent from 2005. Digital albums sold 26 million with an increase of 108.2 percent from 2005. (Source: Billboard Magazine November 2006.) The popularity of downloading music and the different services launched to provide music to the consumer are still struggling with record labels. Digital Rights Management and lack of convenience for the consumer has made the process of providing music difficult, mainly because music is already accessible via websites for free.

The optimal theory on how to make music available has been offered by music futurist and Berklee graduate, Gerd Leonhard. Music Like Water is the name of the philosophy and is founded on the idea that music should be as omnipresent as water. The service would be identical to Verizon Wireless or Comcast Cable and give the consumer unlimited access to music downloads for a monthly flat fee. The model of “Music Like Water” could look like the following:

Estimating that around 200 million people in the US have access to Internet or cell phones, music could be available for the consumer to download and billed via a fixed monthly flat fee. The cell phone has gone under a magnificent transformation over the past 10 years where it has developed into a compressed comfortably sized device. A typical Verizon phone plan of today would give the consumer 400 minutes of connection time for the amount of \$45/a month. Lets assume that the phone network would include the opportunity for consumers to access, download and share music for an additional fixed flat fee per month. This would allow the consumer to benefit from the freedom to store music while the music companies would be compensated from the money derived from such flat fee. According to Forbes Online, 200 million people in the USA own cell phones. The monthly fee for such service could be \$5/a month added to your network bill. This could potentially result in an annual income of \$12 billion for the US music industry. In addition the European/Asian markets could be part of this service. In Europe, the government finances TV and radio stations. In my home country Denmark, all the TV channels available, are paid for via taxes. (Channels include BBC, CNN among others.) The Music Like Water theory could be applied to the European Union under the same system that other media is provided. A certain percentage of the Governments funds could be applied to providing free music. In a country like Germany with a population of 80 million, a monthly fee of \$5/per resident taken out of taxes, would hold a potential gross profit \$4.8 billion dollars.

The music market of the European Union has faced the backlash of CD overpricing over the past 10 years. Most governments have demanded special taxes on CD’s, which has made the consumer less likely to buy. Spain has especially caused misery to the music industry. In the August edition of Billboard, the article “The Pain In Spain” clarified that the country is estimated to be among the ten most valuable global music markets. It is also considered to be one of the ten worse countries with regards to illegal downloading.

By creating a universal solution for providing music as a flat fee service, the threat of illegal downloading will be eliminated, the government will secure tax money lost from illegal downloading, and most importantly, artists will become compensated. As a result it will be cheaper to distribute/introduce new artists to the consumer. Marketing costs will also be significantly reduced. Let's assume that the main devices for music access will be cell phones or a hitherto unknown "networked iPods". Advertisers could reach consumers via text messages or a "taste match" service. Such a service has already been provided by the web site "Pandora". The site, which has license to the full catalogue of the five major companies, is offering a service to compare and reveal artists matching the search requirements of the consumer. It is possible for a consumer to search for Prince and become introduced to the music of Sly and The family Stone, James Brown- i.e. other artists similar to the genre of Prince. This creation has made it easier for unknown artists, to be introduced to the music market. When a consumer would be searching for U2, he would automatically be introduced to a newly signed rock band similar to U2.

To increase the attraction to the music products, premium packages could be offered to the consumer for an additional charge. Access to live recordings, concerts, new/exclusive releases and custom compilations could be among the offers that could secure even more revenue and expand business opportunities for the artist.

The way to establish a model for how to share the income could be as follows: The music companies will voluntarily issue a license to the digital network providers for the use of the music. The license will compensate right holders, record companies, composers and publishers. The income will be split equally between record company and artist after deducting the service fee charged by the digital network provider.

This proposal seems viable as it secures income for music companies. In addition it provides convenience for the consumer, by selling what seems to them like free music.

Even though this scheme potentially could work, it would take years to execute. International intellectual property treaties such as The Berne Convention, the RIAA and the major labels may be the largest barriers to achieving this vision. Music companies would resist giving up their control over their works. This control aligns with the provisions of the copyright-law, which also would need modification. The Berne Convention, which has existed since 1886, has protected artistic works under rigid standards. In order to launch a Music-Like-Water model, a new mind-set has to be attained that acknowledges that music is ubiquitous and available. Instead of restricting these opportunities, music companies will have to define a new model for music sale, which can be applied the technical world of today.

Technology has created the foundation for a new economy in the music market. This economy will require the current music companies, to take on another role. The works of artists of the future would be advertised in a more simple way, reducing the costs their companies bear. For example, 1-3 songs could be released at a time, rather than a whole album. This could potentially help to build long-term careers, as the material of a whole album would last longer. The music companies will be able to use this method to launch a new artist without financial risk involved. This could happen by offer shorter contracts, allowing the music companies to evaluate the success rate of the 1-3 songs released. As distribution costs are minimized, they may attempt to participate in the touring, promotion, management, publishing and merchandizing of the artists, in addition to collecting the money from the service providers or governments who

disseminate their works. Under this new model, investing in new artists would involve less risk. This will make the business more likely to invest in new talent production and development.

Many suggestions and attempts for how to sell music are currently being considered by the industry but a final solution hasn't been found yet. In the meantime retailers are becoming insolvent, the industry is losing millions of dollars and the consumer is looking with skepticism at the industry's methods. In my opinion the music industry has never been more full of opportunities for anyone willing to embrace them. Over the years artists have yearned for more artistic freedom through the years. Today artists can work, release and perform, without the assistance of music labels. One of the best examples of the benefit of being an independent artist is Prince, who after terminating his contract with Warner Brothers developed his own label NPG Records. In 2004 Prince generated \$56 million in gross earnings, being the most successful artist of the year (source: Rolling Stones Magazine August 2004). This total income was exclusively based on the release of the Musicology album and a subsequent US tour. In addition, Prince made his music available to download for subscribed members on his website ([www.NPGmusicclub.com](http://www.NPGmusicclub.com)). The web site allowed members to attain exclusive recordings, concert tickets and merchandise for more favorable prices than purchasing cd's in traditional record stores. This independent model has shown the path for artists and given a partial view of a successful future model.

The market for ring tones for cell phones has revolutionized the business of music. An article in the November 29 issue of USA TODAY, clarifies the consumer's attraction to ring tones. A paradox in this trend is the consumer's willingness to pay for a low quality music clip, rather than investing in the full version. The ring/master tone is three times as expensive as the original recording on bought on iTunes. This demand for ring tones has created a new income source for the music industry. This opportunity could eventually draw the music industry in a direction of embracing technology as the prime way of distributing music. Ring/master tones sales are estimated to exceed \$6.8 billion in 2010 (source: Informa Telecoms and Media, USA TODAY 11/29/06)

This tendency can be seen as another contribution to "The active participation culture" described and defined by Harvard Professor and author Robert Putnam in his book "Bowling Alone." One of the aspects to the active participation culture is the need for individualism. With the array of devices and services available to us, comes the opportunity for the consumer to reflect his/her personality through the technical devices. For instance the iPod/iTunes products give the consumer the opportunity to design, store and play a personal favorite collection of songs. Furthermore with the new ring tone market, the consumer can personalize his/her phone with a tone consisting of their favorite tune.

For a long time, the music industry has been paranoid and paralytic with the prospects of the digital era. I do think that the period of transition we are in now will come to a point where the ways of producing and selling music will be beneficial for all parties involved. It is going to take some time to find the right model that will comply with the copyright law while allowing consumers to enjoy the necessary freedom of obtaining music without any restriction. In addition, music labels and artists have to come to an agreement of sharing revenue derived from the new model. Ironically the interest for music has never been larger. Despite decreasing record sales, almost every person

walking the streets in New York, Copenhagen, London or Paris possesses an Ipod. The fan culture may not be as prevalent as the mid-eighties, where music fan could identify their idols through MTV. But the market still exists, and has never been easier to reach. The question is how to access the new market while dealing with the old standards of commerce. This creates an opportunity for entrepreneurs and legislators to create a solution. I predict that the music industry is heading towards a reinvention, where money will flow more consistently to the benefit of artists, music companies and the consumer.

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