

NEMODE

New Economic Models in the Digital Economy



New Business Strategies and the Reinforcement of Intellectual Property Rights in the Digital Economy

The Case of the Online Digital
Marketplace for Music



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Introduction

The online digital marketplace for music has proven to be extremely significant with regards to the wider creative economy in two key respects. First, the online sharing of music in digital formats has been at the leading edge of debates around intellectual property rights issues. The way in which the music industry has responded to the threats of digital piracy has set a precedent for the wider creative economy. Second, the technologies with which music is being distributed and consumed online are dynamic and changing rapidly, as, perhaps even more significantly, are consumer preferences. Again, this places the digital marketplace for music at the forefront of developments in the creative economy.

Aims and Objectives of the Report

1. Undertake an investigation of the online digital marketplace for music, with specific reference to the rise of music streaming services.
2. Critically evaluate the extent to which current patterns of online music consumption have emerged as a result of the complex relationship between disruptive new technologies, consumer preferences, and the need to reinforce intellectual property rights.
3. Provide an appraisal of the revenue generation capability and sustainability of current online music business models.

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The overall aim of the report is to undertake a survey of the contemporary online digital marketplace for music. This is a necessary and important task given that a) the very recent consumer preference for streaming content has rendered many recent academic and industry studies of online music already outdated; and b) business strategies and models in the music industry have had to adapt accordingly.

The Music Industry and Technological Change

The global music industry is an oligopolistic industry controlled by a very small number of large corporations. Until the turn of the decade, four major multinational dominated the contemporary global music industry as a result of various mergers and acquisitions; Universal Music Group, Sony BMG Music Entertainment (a product of a joint venture between Sony Music Entertainment and BMG in March 2004, and a subsequent merger in October 2008), EMI Music, and the Warner Music group. Further amalgamation took place in November 2011, when the Universal Group, already the dominant of the major music groups, consolidated this position with the purchase of EMI's recorded music division for a figure thought to be in excess of \$2bn (The Guardian, November 11th 2011). This purchase follows only five years after the rejection of EMI's \$4.5bn cash and shares bid for Warner Music in 2006 (The Times, May 24th 2006). These three corporations are strongly involved in technological innovation and are part of sophisticated global networks of marketing, promotion and distribution.

Given that the nature of these corporations, there has long been a close relationship between the music industry and technological developments: one of the music industry's major corporations, Sony, for example is a major producer of both technology and entertainment. From early innovations in sound reproduction, through the reproductive mediums of vinyl, audiotape and compact disc (CD), each technological development has in turn provided higher quality audio playback, as well as bringing about economic benefits across the musical economy, especially to record companies and music publishing companies - for example, the re-issuing of back-catalogues in new formats (see Lovering, 1998) - and to electronic companies producing new reproductive equipment. Following the introduction of the CD, for example, the music industry enjoyed about 15 years of steady growth in recorded music sales (Leyshon *et al.*, 2005). Thus a symbiotic relationship has existed between electronic companies who produce reproductive equipment and create consumer demand for new, higher quality audio playback, and the record companies producing music on the new medium.

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As Leyshon (2001) describes, given the economic benefits of these previous technological developments, the development of the internet as a vehicle for world digital distribution was largely seen as a positive one. It is now however widely known that rather than an opportunity for economic gain, this development would present one of the most significant challenges ever faced by the music industry in terms of its profitability. Indeed, it would fundamentally challenge the viability of the music industry in the form in which it had existed for many years (see Graham et al., 2004).

Yet, even as the music industry began to successfully deal with one technological challenge – the illegal sharing of digital music files online – with increasing revenues from new pay-to-download services such as iTunes, new disruptive innovations in technology, in particular music streaming, have presented new challenges the industry. Today, many listeners neither own nor collect music in physical format or in the form of downloaded digital audio files, but listen to music online via services such as YouTube and new subscription-based streaming services such as Spotify and Apple Music. As Wikström (2013; 4) suggests, *“The music industry has completely shifted its centre of gravity from the physical to the virtual – from the Disk to the Cloud.”*

Even as the music industry began to successfully deal with one technological challenge – the illegal sharing of digital music files online, further technological developments, in particular music streaming, have presented new challenges to the industry.

Revenues from digital music have, as yet, failed to replace that which previously came from physical formats, and total industry revenues have been shrinking since the start of the 21st Century (Bustinza et al., 2012; Liebowitz, 2006). They continue to do so, with 2013 and 2014 seeing back-to-back declines of 4%, leaving revenue at US\$14.97 billion. Yet, since the turn of the decade revenue from digital channels has continued to increase. Recent figures from the International Federation of the Phonographic Industry (IFPI, 2015) demonstrate that digital music now accounts for 46% of overall global industry trade, an increase of 6.9% in 2014, and significantly in 2014 on a par with physical sales for the first time (which decreased by 8.1% in 2014 to US\$6.8 billion). The remaining 8% comes from performance rights and synchronisation with other media and technology sectors.



The music industry in the digital era: three key phases

1. MP3s, P-2-P Networks, and Litigation

Through the mid- to late-1990s early positivity regarding the possibility of digital music distribution gave way to a growing perception that a world of cabled connectivity was a serious threat to future profitability and the long-term survival of established record companies (Leyshon, 2001). The reason for this was a relatively unremarkable technological development: the development of the MP3 format as an international standard. At first a seemingly innocuous development, the creation of a compressed, standard file format for music, playable on most home PCs and a range of mobile music devices, would quickly result in the sharing of music online between listeners from computer to computer.

As Leyshon (2001) suggests, the size of these files had important consequences for their mobility, as they were small enough to be transferred from computer to computer via the 'narrow-band' dial-up modem connections typical in homes in the late 1990s and early 2000s. The copying of music on CDs into MP3 format and the subsequent sharing of this music on the internet would substantially undermine sales of recorded music, impacting directly on the economic viability of the music economy, and tipping a music industry already on the verge of crisis into a full-blown 'crisis of reproduction' (Leyshon, 2009). Furthermore, it threatened to loosen the grip that record companies exerted over musical networks of creativity, reproduction and distribution (Leyshon, 2003).

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Issues around the breach of intellectual property rights and illegal copying would abruptly come to the fore with the rise of peer-to-peer (p-2-p) file-sharing networks, which exposed just how heavily the music industry relied on the exploitation of copyright for generating profits. These networks, as Leyshon (2003) argues, destabilised the regime of governance that supports copyright capitalism by creating, and giving mass access to, a series of 'gift economies' in which the products of the music industry were given away for free, substituting for sales. Perhaps the best known of the peer-to-peer networks were Napster (see Case Study 1), which

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operated between June 1999 and July 2001 and which at its peak allowed tens of millions of users to share and download music for free through a user-friendly interface; and Kazaa, which began operating in March 2001 and which had a user based of around 140 million users with as many as four million users online at any one time (Leyshon, 2003; Leyshon, 2009).

Due to these networks, *“digitized music’s immateriality and hyper-mobility as code caused both the economic and legal property regimes associated with the pre-digital era to become outdated and impotent”* (Born, 2005; 25). In 2001, music sales fell by 5 percent, and then by over 9 percent in the first half of 2002, resulting in a reduction in the inflow of capital to the industry and disastrous losses for the leading firms in the sector (Leyshon *et al.*, 2005). The outcome was a crisis of funding across the wider musical economy, resulting in significant reductions in rosters of recording artists. As Arditi (2013, 421) describes: *“with the development of p2p software, major record labels were quickly losing their grasp on the control over access to the industry. Without long term structural changes to the music industry, the major record labels realized that they would no longer have a viable business model.”* MP3s offered the possibility of a new type of business model, linking artists directly to consumers, which threatened to bypass record companies (Garofalo, 1999: 349).

The response to the challenge by the industry’s major corporations was litigation against both file-sharing services and individual file sharers (see Bhattacharjee *et al.*, 2006; Choi and Perez, 2007), along with strong political lobbying. In 1998, the US Congress passed the ‘Digital Millennium Copyright ACT’ (DCMA), which made it illegal to circumvent the Digital Right Management (DRM) embedded into MP3 files (McCourt and Bukart, 2003). In the same year the Recording Industry Association of America (RIAA) – the trade organisation that represents the recording industry in the United States - began filing lawsuits against online music distributors (Arditi, 2013), and in 2003 began suing individual file sharers (Arditi, 2013). Similar bills to the DCMA have followed in Europe: in 2006, ‘Loi sur le Droit d’Auteur et les Droits Voisins dans la Société de l’Information’ (DADVSI) reformed French copyright law, focused on the exchange of copyrighted works over peer-to-peer networks and criminalising of circumvention of digital rights management (DRM) protection measures; while in 2010 in the UK, the ‘Digital Economy Act’ was passed by UK Parliament, which made provision about the online infringement of copyright and about penalties for infringement of copyright and performers’ rights.



Perhaps the most significant court ruling however came in the case of Grokster and Streamcast (maker of the Morpheus file sharing software) versus a consortium of 28 large entertainment companies led by Metro-Goldwyn-Mayer studios. The US Supreme Court ruled against Grokster and Streamcast, ruling that they could be sued for inducing copyright infringement in their marketing of file sharing software. Crucially, the ruling – which has subsequently come to be known as the ‘Grokster decision’ - more widely meant that any company which actively helps users steal copyright could be held responsible for copyright theft.

Case study 1: Napster



Napster was an independent peer-to-peer file sharing service that operated between June 1999 and July 2001, allowing users to freely share music files in MP3 format via internet networks that were quickly increasing in bandwidth. The service functioned as a music search engine that linked participants to a large and constantly updated library of MP3s all provided by users, and between February and August 2000 the number of Napster users rose from 1.1 million to 6.7 million (McCourt and Burkart, 2003).

As major record companies realised the threat posed by Napster and other similar services, legal action came quickly. In a landmark case, on 7th December 1999 the Recording Industry Association of America (RIAA) filed suit against Napster, on grounds of copyright infringement under the US Digital Millennium Copyright Act. Legal action centred on the fact that Napster advertised and provided a brokering service that managed a real-time index of music files, effectively making Napster a music piracy service (McCourt and Burkart, 2003). In late July 2000 an injunction was ordered against Napster, which was subsequently upheld in February 2001; Napster shut down in July 2001 and declared bankruptcy in 2002. Legal action would follow against a range of peer-to-peer networks, and in some cases, individuals sharing large numbers of files through these networks (in the case of Kazaa users, for example).

As McCourt and Burkart (2003) suggest, the Napster decision formalised the implementation of intellectual property controls on the Internet, and consolidated the advantages of the major corporations in gatekeeping content and distributing products.



2. Legalised Online Music Downloading

The impact of MP3s on the music industry, while extremely negative in the short term, did not however result in the end of the control of the major corporations over the music industry as many had predicted (see for example Graham et al., 2004). One can point to two significant developments in this regard.

First, as outlined above, litigation formed an important and highly successful part of the response of record companies to the challenges of software formats and Internet distribution system, particularly with regards to peer-to-peer networks, and this litigation has largely proved to be successful.

Second, with the debut of Apple's iTunes in 2003 (Case Study 2), there arrived for the first time a major platform that could direct digital content to consumers and charge them for it. Thus it provided both a platform that gave people a place to download music without risking a lawsuit, and a platform that could generate profits for major record labels. For Arditi (2013), iTunes can be seen as the music industry's response to what it constructed as *"rampant criminal behaviour in the form of p2p file sharers violating copyright law by downloading music from one another"* (2003; 422).

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It quickly became clear that many consumers were willing to pay for music downloads. It also became apparent that, given that few costs associated with online distribution compared to manufacturing a physical object, record companies can sell music online for a relatively low cost and yet with similar if not higher profit margins (McLeod, 2005). In 2008, iTunes became the largest music retailer in the US, and by 2011 it sold over 38% of the retail music market. When considered alongside the closure of major high-street music retailers such as HMV and Virgin stores in the UK, this indicated a huge sea-change in the way people were purchasing music. Its success, Arditi (2013) argues was a result not just of the ingenuity of the platform, but also the industry's *"desperate need to compete with free music online"* (2013; 417) and to redefine the purchase of music to be a *"one-time non-transferable transaction that limits the purchase to a definite medium"* (2013; 418).



Case study 2: iTunes



The launch of the iTunes online music retail platform in 2003 represents a significant turning point in the fortunes of the recorded music industry, and was the first time that major record labels fully supported the sale of digital music online (Arditi, 2015).

iTunes operates a pay-per-download model, with users paying a small fee to download a single in digital format, with the options to also buy full albums. In 2008 iTunes became the largest music retailer in the US; and by 2010 over 10 billion songs had been downloaded and a library of over 13 million songs was available for download. Today, it has a library of over 43 million songs available for download, and is by far the largest online retailer of music. This success has in part built on the size of the music catalogue available for download, but more significantly the incorporation of the service into its iOS operating systems on its devices, notably the iPod, iPhone, and iPad.

Research undertaken by data journalist David McCandless and reported in the Guardian (2015) suggests that of the \$0.99 currently charged for an individual track download, a record label can expect to receive around 47%, while an artist will receive 23%, with the remainder going to the retailer/distributor. The same proportions apply to a full album download, which typically sells for \$9.99. Given that these proportions are similar to those that apply to a physical format, which may retail for up to \$12.00, the revenue obtained from digital formats sales through iTunes for both record companies and artists are comparable to physical format sales.

Yet initial support for the iTunes platform from the major record companies was arguably as much about the security of the format as about potential revenues. The AAC files available from iTunes will only operate on Apple devices registered to particular users, with user authentication required to access songs, and as such are not freely shareable in the same manner as the MP3 format.

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Through the late 2000s and into the 2010s, the revenue from online music sales would significantly increase, and the digital music market now forms an increasingly important part of the global music market. Before the Grotzker decision in 2004, digital music accounted for just 1.5% of music industry revenue. By 2012, digital music accounted for over a third of total industry revenues (35%), with 4.3 billion digital singles and albums being legally downloaded. Recent figures from the IFPI 'Recording Industry in Numbers' Report (2015) highlights that the digital share of overall global music industry trade grew to 46% in 2014, resulting in revenues of US\$6.85. In five of the top 20 markets, digital channels now account for more than 50 per cent of record companies' revenues, whilst globally record companies have licensed 37 million tracks and more than 500 digital music services worldwide (IFPI, 2014).

3. The Rise of Streaming

Downloads remain the biggest source of global digital revenues, accounting for 52% of the digital market in 2014. Yet, the IFPI data for 2015 also demonstrates that this share is declining, dropping by 8% in 2014. In their place, global revenues from subscription services and advertising-supported streams now account for 32% of digital revenues (23% and 9% respectively), up from 14% in 2011 and 20% in 2012, with revenues from subscription services increasing by 39% in 2014 to US\$1.6 billion. The IFPI (2015) estimates that more than 41 million people worldwide now pay for a music subscription, up from just eight million in 2010.

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Streaming has overtaken download revenue in 37 national markets, representing a shift from ownership to access models as the dominant channel of delivering recorded music to consumers (Barr, 2013). Much of this growth can be attributed to the streaming service Spotify (Case Study 3) which according to figures released in 2014 had 10 million paid subscribers. The success of Spotify is indicative of changes not only in the way in which people pay for music – a shift from paying for ownership of a music library to paying for access to a much larger library – but also the way in which people access and listen to music. In 2014 80% of all subscribers to the service signed-up through mobile phones.



Case study 3: Spotify



The Spotify commercial music streaming service was launched in October 2008 and operates what has been termed a 'freemium' model, whereby users can choose between an advertising-supported free service or a subscription-based premium service. The service has grown to become by-far the largest streaming music platform in the world, available in 58 national markets and giving users access to over 30 million songs. Figures released by Spotify in 2014 revealed that the streaming service had 40 million active users, 10 million of whom were paid subscribers. In the same year, Billboard magazine estimated that Spotify would pay up to US\$1 billion to record labels. Figures subsequently released by Spotify at the start of 2015 suggested that the service had 60 million active users, 15 million of whom were paid subscribers. By June 2015 this had increased to 75 million active users and 20 million subscribers, a growth of 10 million subscribers in just one year. Yet, while these figures suggest a high level of success for Spotify, its growth has also revealed a number significant issues with the streaming business model:

1. In 2014, Billboard Magazine reported that Spotify had yet to turn a profit. This is due to the way in which the licensing fees it pays to record labels rise with listeners' usage, rather than being a flat rate. In the same year Bloomberg Business suggested that Spotify may have lost up to US\$200 million since it was founded.
2. Spotify provides its advertising-supported free service with the aim of eventually converting listeners into paid subscribers as they use the service more regularly. However, three in every four of its users remain on the free.
3. Spotify has courted much media controversy for the rates it pays to artists. Research undertaken by data journalist David McCandless and reported in the Guardian (2015) suggests that artists receive a cut of just 20% of per-track streaming revenue - just US\$0.0011 per play of a track - while record labels receive a cut of 55%. Furthermore, the complexities of the play-based royalty system operated by Spotify - in which subscription income is pooled and then distributed by number of plays - is heavily tilted towards artists with large numbers of plays, who receive more than their listeners have paid in subscription fees, while artists with less plays receive far less than their listeners have paid.

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The IFPI (2015) estimates that there are now over 400 digital music services worldwide, including many streaming services. Alongside Spotify, some of the most significant on-demand services include Deezer, YouTube, Vevo, and Xbox. Launches of new streaming services are happening apace. In June 2015, Amazon launched Prime Music in the US, charging an annual subscription of US\$99 for an advert-free music streaming service that also includes TV and film, but with a modest catalogue of only 1 million songs. In October 2014, the streaming service Tidal was launched, billed as the first artist-owned platform for streaming music and video, with co-owners including Jay-Z, Madonna, Beyoncé, Kanye West, and a number of other major artists. The service offers 25 million tracks, with a standard subscription of US\$9.99 per month and 'high fidelity' option for US\$19.99 per month. The launch of this artist-owned service was seen as a response to the very low levels of royalties being paid to artists by Spotify. Meanwhile, Spotify continues to launch in new markets.

However, the most recent and perhaps most significant development in streaming came with the launch of Apple Music (Case Study 4) in June 2015. Building on the dominance of iTunes in the global digital download market, Apple Music offers a US\$9.99 per month subscription streaming service, giving access to a catalogue of over 30 million songs, as well as Beats 1, Apple's first ever live radio station dedicated entirely to music and music culture. Alongside standard individual subscriptions, both Apple Music and Spotify offer family subscriptions allowing for multiple listeners at a reduced rate.

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As Bustinza et al. (2013; 18-19) describe, the shift to streaming represents new business models for the music industry that *"reflect a theoretical shift in understanding what music retail is, presenting music to consumers not as a product but as a service"*.



Case study 4: Apple Music



Following the launch of the iTunes music download platform in 2003, the technology giant Apple became the leading retailer in the digital music industry. Yet, less than a decade later, shifting consumer demands in both technology and music listening were in danger of leaving iTunes outdated. At the end of 2013, Apple reported a 52% decline in sales of the iPod, a device defined by its ability to store a large digital music catalogue. Instead, users began to shift to mobile devices for music listening, which with smaller storage and internet capability on-the-move through Wi-Fi and 3G/4G helped drive the shift in listening habits from downloads to streaming. This shift has been demonstrated through the success of the Spotify streaming service, with smartphone users able to freely download the Spotify App to their devices in order to stream music. Figures reported by the Wall Street Journal towards the end of 2014 suggested that music sales via the iTunes Store fell between 13% and 14% world-wide from the start of the year (Wall Street Journal, 2014).

In response to changing consumer demands, in 2014 Apple bought the subscription streaming service Beats Music as part of a \$3 billion acquisition that included headphone maker Beats Electronics. The rebranded *Apple Music* launched on June 30, 2015, in 100 countries, bundled with an update to its iOS operating system on millions of devices. Following a three-month trial subscription, users are charged a monthly fee of US\$9.99. Confidence in the future success of Apple Music stems from the size of Apple's consumer base, with access to some 800 million credit card accounts (IFPI, 2015). Figures reported widely across the press in August 2015 suggested that 11 million subscribers registered for the free trial. If all of these trial users convert to paid subscriptions, it would give Apple Music over half the number of subscribers of Spotify, which has been in operation since 2008. However the likely level of conversion cannot yet be determined.



Towards a sustainable business model for the music industry

The nature and speed of technological change in the music industry, as outlined above, has split opinion both within the music industry and the academic community as to the likely outcomes for the music industry as it moves further into the digital era. Writing as recently as 2011, for example, Warr and Goode examine three possible scenarios – ‘The good’ (the record industry survives), ‘The bad’ (the record industry dies slowly), and ‘The ugly’ (the record industry dies quickly) - suggesting that the most likely outcome for the industry was a slow death. Yet such as scenario is, as yet, far from occurring, and the recent work of Arditi (2015) has persuasively argued that the digital revolution has allowed the major record companies to strengthen their control over networks of music production and consumption.

More modestly, Leyshon (2014; ix) suggests that “...*there are signs that the industry is now finally stabilizing around the new social and technological arrangements associated with MP3 and other purely digital formats. However, this process of adjustment has been slow and painful, and has radically transformed the way in which the music industry reproduces itself.*” In 2013, for example, Warner Music Group (WMG) revenues topped US\$3 billion for the first time in five years. Total recorded music revenue grew by 6%, with total digital revenue increasing by 11% to US\$1.1 billion. Streaming revenues were \$215million, increasing by \$75 million. There was also strong growth in artist services and expanded rights, a category which now represents 13% of WMG revenues and includes strong gains in concert promotion revenue (Peoples, 2014).

The music industry is currently dealing with three digital transitions simultaneously: from physical to digital formats; from digital downloads to streaming; and from PC to mobile platforms.

There remains however significant uncertainty regarding how the music industry will look in the future and the business models it will adopt to create a sustainable future. Currently, the music industry remains a ‘portfolio’ business (IFPI, 2015) with revenues coming from a diverse range of sources: digital downloads, music subscription services, physical formats (CDs, vinyl LPs, performance right licencing, and synchronisation deals).

The music industry is currently dealing with three digital transitions simultaneously: from physical to digital formats; from digital downloads to streaming; and from PC to mobile platforms. The future sustainability of the industry depends on how well it manages these three transitions.

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Streaming

Streaming has in a very short time become extremely important to music consumption. The popularity of streaming services is largely attributable to the ways in which increasingly people listen to music on mobile devices on which storage of a large number of digital files is not desirable, yet access to a large library of music is. Thomes (2013), in his economic analysis of streaming music services, suggests that such services represent the music industry's greatest prospective source of revenue, and are well established amongst consumers. McCourt and Burkart (2003) suggest that subscription models are potentially extremely lucrative, generating a steady cash flow, including maximising profits from customers who are not regular users of the service, and who otherwise would not have been regular purchasers of music. They also provide a convenient benchmark by which to measure growth.

Yet significant questions remain regarding the revenues that can actually be obtained from streaming. Bearing in mind that digital revenues make up 46% of total music industry revenues, in 2014 only 32% of digital revenues came from streaming, compared to 52% from downloads. Of this 32%, only 9% came from advertisement-supporting streaming, i.e. only 4% of total industry revenues, despite the fact that many more listeners use such services than subscription services. Thus, as McCourt and Burkart (2003: 346) argue, *"While cyberspace affords new means of packaging and delivery, the ultimate commercial value of music is not an inherent character of the product, but of the manner in which it reaches the user"* (see also McCourt, 2005).

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While digital revenues continue to grow, they are not yet able to compensate for the decline in sales of physical formats (with the exception of the US music market). The digital picture is further complicated by the fact that in 2014, both physical formats and download sales decreased by roughly 8%, something which streaming growth could not compensate for, resulting in an overall decline in music revenues of 0.4% (IFPI, 2015). Perhaps the key challenge is developing strategies to give value to paid subscriptions above advertisement-supported free services that will give a greater ratio of paid to free users. However, strategies



adopted to date, including access to exclusive content, increased audio quality, and advanced user-curated playlist facilities, have proven to have relatively limited success in this regard.

Another strategy may be to vary payment models to give greater diversity beyond 'free' and 'premium' services which typically charge US\$9.99 a month, but once again consideration needs to be given to the value at each tier. A further way to increase subscribers would be to link music streaming platforms to the purchase of phone and broadband technologies services. This includes the availability and desirability of subscription services on mobile devices (for example Apple Music), and the 'bundling' of music subscriptions into internet/phone subscriptions in a variety of ways.

The fact that the majority of users remain on advertising-supported free music services demonstrates an expectation amongst many consumers that music will be freely-available on the internet without cost.

While streaming services would appear offer an alternative to piracy, the fact that the majority of users remain on advertising-supported free music services demonstrates an expectation amongst many consumers that music will be freely-available on the internet without cost, and furthermore that they are highly tolerant of advertising (Thomes, 2013). The continued presence of advertising-supported streaming services would seem to be essential to avoid future increases in piracy. This highlights the need to develop strategies to increase revenues from advertising-supported services.

Doing so would tap in to the revenue potential of the many millions of listeners worldwide listening to music subscription-free on the internet through services such as Spotify and YouTube, but who are unwilling to pay subscriptions, as well as potentially those currently involved in illegal file-sharing. However, there exists a tension between the drive by streaming services to push listeners onto premium subscription services, and the need to have sufficient audiences on free services to attract advertisers, which is yet to be resolved. It also relies on there being a sufficient number of potential advertisers in the market (Thomes, 2013). As Wikström (2013; 177) notes, *"Advertising-based music services compete on the same ad market as every other online service, and the prices they are able to charge their advertisers are determined by that market and not by the music rights holders."* As such, there is a limit to the advertising revenues that online music services can pay to record companies and artists without accruing large financial deficits (as seen in the case of Spotify) and eventually going bankrupt.

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Performance Rights and Synchronisation

As the major companies have recognised that music by itself is decreasing in value (McLeod, 2005), they have sought to diversify their activities through multimedia and other new revenue streams. Performance rights, for example (that money paid to record companies to license music to be played on radio and in public places) was the fastest growing sector in the music industry in 2012, accounting for 6 per cent of global recorded music revenues; while revenues from synchronisation deals (the use of music in TV adverts, films and brand partnerships) were worth US\$337 million (IFPI, 2014).

As the major companies have recognised that music by itself is decreasing in value, they have sought to diversify their activities through multimedia and other new revenue streams.

Another area in which music industry are looking to increase revenues from music releases is through synergistic, cross-marketing arrangements with technology and computer games companies. Arditi (2015) describes two significant examples of recent synergies:

- In 2013, Samsung paid rap artist Jay-Z and his label group (Roc-A-Fella, part of Universal) five dollars per album on one million albums to be released exclusively through an app on their Galaxy smart phones, five days before its official release.
- The Grand Theft Auto V video game, which in 2013 set the record for the largest first-day release of an entertainment product at \$800 million in sales, licenced 240 music tracks, as well as commissioning new songs exclusively for the game.

Thus, as Leyshon *et al.* suggested in 2005, the emergence of software formats represented a 'tipping point' that triggered a re-organisation of the music industry towards a new business model; it is now emerging as one of reduced capital flow; smaller artist rosters (focused on those few artists with strong cross-marketing potential); a strong focus on online distribution channels and multimedia; as well as continued strict enforcement of copyright through litigation against online 'piracy'.



Concluding Discussion

This report has provided an evaluation of the changes that have occurred, and continue to occur in the music industry as it has become increasingly digitalised over the past three decades. From a digital crisis in the late 1990s caused by illegal file sharing, the music industry has responded through litigation and the reorganisation of business models around legal online downloading and specifically iTunes, in ways which preserve the oligopoly of the major corporations (see Arditi, 2015). As McCourt and Burkart (2003; 345) suggest, this is evidenced in the growing scope and density of legal ties and technologies that protect the music industry oligopoly. Yet, even as the music industry has been steadying itself in this respect, the advent and success of music streaming services such as Spotify has presented new challenges that industry is only just starting to address. As Wikström (2013; 177) notes *“It remains to be seen whether services such as Pandora, Spotify and the others that try to operate a revenue model that combines advertising revenues and subscription revenues are viable or not”*.

Furthermore, the issue of illegal file-sharing is far from resolved, and the economic losses due to file-sharing have not been significantly impacted by the availability of music on downloads sites such as iTunes (see Waldfoegel, 2010). Neither do they seem to be being reduced by the more recent availability of streaming services. As Leyshon (2014) notes, IFPI figures suggest that a third of all internet users regularly access unlicensed sites for music. Furthermore Leyshon points to industry research undertaken by consultancy Musicmetric, which reported that US and UK file sharers using the peer-to-peer network BitTorrent illegally downloaded 1.1 billion tracks in the first six months of 2012 alone. Furthermore, recent research by Bustinza et al. (2013) across ten countries suggests that over a quarter of the population participates in illegal file sharing.

While there remains a large degree of uncertainty as to the future of the industry, it would now seem likely that the immediate future will see further decreases in revenue, due to continuing declines in physical sales and only modest increases in digital revenues as streaming revenues increase but download revenues fall. Therefore, as well as placing an increased importance on revenues from performance rights and synchronisation, as Thomes (2013; 81) argues *“opening up new sources of income from digital markets has gained tremendous importance for record companies.”* Based on the discussion presented in this report, one can identify a number of priority areas for developing sustainable digital business models for the digital age:

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First; in order to fully replace the revenue lost from declining physical sales, there is a need to develop strategies to move subscription streaming into mass-markets in the way physical format sales have been in the past. This requires both higher uptake of subscription services, and the higher conversion rates from advertisement-supported free services to paid subscription services. It is likely that music consumption through streaming sites will continue to increase as consumers become more familiar with these new digital formats and have the time to learn and adapt to new digital technologies (see Parry et al., 2012). As such, Cesareo and Pastore (2014) argue that music companies should seek to increase consumer knowledge about the legal music access opportunities that new technologies offer them.

Second; and linking to the above, the music industry must recognise the expectation amongst many listeners that music will be freely available via the internet (as evidenced through continued high levels of illegal file sharing), which will limit the take-up of paid subscription services. While litigation against file sharing services and communities may be necessary in some instances, academic analyses of motivations for file-sharing suggest that the effectiveness of the threat of litigation in preventing file sharing is likely to be limited (see for example Sinha and Mandel, 2008). Furthermore, as Easley (2005) notes, litigation by record companies against consumers raises particular ethical questions. A potentially more effective response may be the continued provision of free legal online music services. Such services provide a potential platform to recover illegal file sharers as a source of revenue. However, if the industry cannot find ways to increase revenues from advertisement –supported services (which despite many millions of listeners currently generate only 4% of total industry revenues), or new ways to convert listeners onto paid subscription services, global music revenues are likely to continue to decrease. As Barr (2013; 10-11) argues, *“the battle for control of digital music distribution and music service provision has never been simply a battle between the legal and the illegal. Rather, it is a battle between new technologies and business models to establish legitimacy”*.

Finally; the IFPI (2015) identify the ‘value-gap’ that arises from the significant mismatch between the value that digital platforms extract from music and the value returned to rights owners, as the most pressing issue affecting the music industry. This includes developing more equitable royalties systems which address the issue of the very low royalty payments currently paid to artists from music streaming. However, as identified through the case study of Spotify, this is not straight-forward as streaming services are yet to generate sufficient profits to be able to increase these returns, especially via advertisement-supported services.

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Implications for the Wider Creative Economy

The music industry is frequently viewed as a bellwether for the wider creative economy, not least in terms of how the various sectors of the creative economy may be impacted by transitions to digital technologies and distribution formats, and how these industries might appropriately respond to the challenges presented.

Perhaps the most significant impact in this respect is the way in which the growth of digital music, and in particular online piracy, is often cited as evidence of the need for legislation (Parry et al., 2014). As highlighted in this report, through lobbying and litigation, it is the major corporations of the music industry that have played the key role in the creation of legislation - such as the 'Digital Millennium Copyright ACT' in the US and the 'Digital Economy Act' in the UK - to address the issue of copyright piracy. This is legislation which impacts directly on other creative industry sectors such as motion pictures, video games and books.

As Choi and Perez (2007) argue, when the existing business models of incumbent media and software companies are severely challenged (as is being seen in the case of the music industry) these companies must take necessary steps to reconfigure their business models. The music industry is responding to its latest challenge – the rise of consumer use of streaming services in both paid subscription and advertisement-supported free platform - through a shift in retail business models from presenting a product to the consumer to presenting a service to the consumer (Barr, 2013). Such a shift is likely to set a precedent for business models in other creative economy sectors where content is increasingly distributed online and on-demand to consumers. We are already seeing evidence of this with the recent rise of on-demand subscription television and film services such as Netflix and Amazon Prime, a sector which has itself experienced significant issues with online piracy.



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