

# **Independent Record Companies in the Digital Era**

**On threats and opportunities in a changing recording industry**

Master thesis Cultural Economics & Cultural Entrepreneurship

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***Written in gratitude and in complete dependence of my dear Almighty Father and my beloved Lord Jesus Christ.***

# Contents

<b>Preface .....</b>	<b>4</b>
<b>1 Introduction .....</b>	<b>6</b>
<b>2 Methodology .....</b>	<b>8</b>
2.1 Data collection .....	8
2.2 Data analysis .....	9
<b>3 The Recording Industry, Value Creation, Copyright Law and the Digitalization.....</b>	<b>10</b>
3.1 The recording industry as part of the cultural industries.....	10
3.2 The creation of value .....	12
3.3 Copyright and the music industry .....	13
3.4 The digitalization and its implications for the recording industry .....	16
3.5 Concluding remarks .....	21
<b>4 The Record Company .....</b>	<b>22</b>
4.1 The terms record company and record label.....	23
4.2 The record company and its place within the music industry .....	23
4.3 The record company and copyright exploitation.....	25
4.4 The record company and live performing .....	27
4.5 The record company and its core activities .....	27
4.6 The independent record company.....	34
4.7 Concluding remarks .....	40
<b>5 The Recording Industry, the Digitalization and Music Piracy .....</b>	<b>41</b>
5.1 Digital technology .....	41
5.2 The digitalization and music piracy.....	43
5.3 Music piracy and the recording industry .....	47
5.4 Concluding remarks .....	55
<b>6 Research Results .....</b>	<b>56</b>
<b>7 Conclusion.....</b>	<b>62</b>
<b>Appendix .....</b>	<b>64</b>
<b>Notes .....</b>	<b>75</b>
<b>Reference Bibliography.....</b>	<b>85</b>

## Preface

This thesis is about the recording industry and the digitalization.<sup>1</sup> More specifically it is written on the topic of what the influence of the digitalization is (or may be) on the recording industry in general and on the independent record companies in particular, and how this influence is dealt with by these parties.

Living in a western society for the last 10 years or so, it might have proven to be very difficult not to have come in contact with any information on the topic of a changing music industry. Whether it may be the steady flow of press releases about (unauthorized) up- and downloading<sup>2</sup> of music files from the Internet in general, or more in particular the news on the notorious file sharing program Napster which used a peer-to-peer (P2P) network<sup>3</sup>, the ongoing claims from the recording industry stating that unauthorized file sharing and commercial piracy is costing the record companies a great deal of turnover and that Internet piracy in particular is the main cause of the decline in recording sales that set in round about the beginning of the third millennium<sup>1</sup>, debates on the question how to manage copyrights in the digital environment, the introduction and the subsequent immense popularity of personal computers with integrated CD/DVD burners, third generation (3G) mobile phones, portable MP3 (MPEG-1 audio layer 3) players or the successful introduction of Apples iPod<sup>4</sup>: information on topics directly or indirectly concerning the music industry have been on and of the news frequently. Therefore it seems like stating the obvious that the topic this thesis is written on is of present interest and on the move constantly.

The choice for the focus on the relatively small independent record companies (the so called 'indies') was made fairly easily. First of all, I had the impression that the bulk of the reporting on record companies in context with the digitalization has been on the few largest record companies (the majors) or on the recording industry in general. In addition, on the whole the tenor of the reporting often seemed to show a strong coherence with the attitude of the majors in this matter. The small independent record companies and their position in all this, however, seemed to be relatively underexposed. Another reason was the idea that the management of an independent record company is easier to get in contact with than is the case with the management of a major, which is a much larger and therefore less approachable organization. Finally, I expected that the 'indies' to some extent experience and handle the influence of the digitalization on the recording industry differently than the majors do and have done in the past.

I found it interesting to do some modest investigation in this area. First of all this is because of the topicality, which makes the conducted research relevant in context with the present and developments in the near future. At the same time it is clear that within some years (or maybe even less) parts of this thesis may be partially outdated. However, this is inherent to the fact that developments in the field take place at such a rapid pace. In order to keep up with developments, publications should actually be updated every few years. Nevertheless I believe that the content of this thesis is useful and therefore meaningful. Besides, I am interested in the music industry as such. Intellectually because I find the connection between the artistic and the business side within modern music production intriguing, emotionally

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<sup>1</sup> For data on recording sales see tables 1-5 in the appendix.

because I simply love music and professionally because I hope to find my way within this industry as a musician in the future.

I would like to kindly thank the following persons for their participation in my research, for their hospitality and for their positive attitude: Anne de Jong (Challenge Records International), Bert de Ruiter (CoraZong Records), Henk Willemsen (VAN Records Company), Maykel Piron (Armada Music), Liesbeth Puts and Hans Peters (Music & Words), Bernard Kleikamp (Pan Records), Tom Peters (NRGY Music), Giel Bessels, Dirk van Dijk and Job Maarse (Pentatone Music), Marcel Albers (Flow Records), Jos Boerland (Skarster Music Investment), Jeroen van der Schaaf (Basta), Wally van Middendorp (Roadrunner International), Hein van der Ree (Epitaph Records/Epitaph Europe), Cees van der Zwan (Digidance), Geert De Blaere (N.E.W.S/N.E.W.S. Records Nederland), Ed van Zijl (Mascot-Provogue), Willem van Kooten (Red Bullet Productions) and Daan Reestman (Play It Again Sam/PIAS Nederland). I also would like to thank Bas de Koning (NVPI) for providing me with data I otherwise would not have been able to obtain.

# 1 Introduction

So there is and has been quite a fuzz about the music industry in general and the recording industry in particular in context with the digitalization. But why then is this the case?

As mentioned an important part of the discourse has been about the possibility the Internet<sup>5</sup> offers to share digital music files online and the attitude of the dominant part of the music industry towards this online file sharing. As copyright protected music is digitally distributed and downloaded without paying the holder(s) of the relevant intellectual property rights to do so, in context with current copyright law these owners (among who many record companies) rightfully claim that their intellectual property rights are violated. The same goes in context with physical piracy<sup>6</sup> (as opposed to the above-mentioned online/Internet piracy), which has become a much more serious threat to the music industry since the possibility to make high quality digital copies (both burned and pressed) of CDs and DVDs on a large scale and to sell these illegally.<sup>7</sup> Still, it must be noted that the question remains how to estimate the turnover the music industry misses out on because of these phenomena properly.

But the implications the digitalization in context with the music industry presents go further than just the clash between those who own certain copyrights in order to make a profit and those who violate copyrights by making use of the new possibilities the digitalization has brought along. When focussing on the recording industry, it basically comes down to an industry that always has worked with a business model that is characterized by the production, distribution and sale of physical (sound) recordings like LPs and CDs. However, due to the digitalization this industry is increasingly confronted with the necessity and/or the possibility to deal with new business models, ones that are based upon the production, distribution and sale of music in a digital format. In addition, the digitalization does not only poses threats to the music industry because of large-scale copyright infringement and the possibility of declining record sales because of this. It also may offer opportunities in the areas of production, distribution, marketing and the sale of music.

The foregoing is a given fact, but what the digitalization implies precisely for each actor within the music industry will vary (sometimes a lot). As is the case in context with the record companies<sup>8</sup>, since the relevant internal (such as business economic aspects) and external factors (such as specific market characteristics) they have to deal with differ. Moreover, arguably of equal importance is that its implications and the way record companies approach this phenomenon will not only vary among the companies as such, but also there are differences to be expected between the majors and the independents, as these two main types of record companies clearly show distinctive characteristics.<sup>9</sup>

The topic of research of this thesis can briefly be defined as follows: The influence of the digitalization on the independent record company and the way the independent record company deals with this influence.

Therefore the following central research question has been formulated: What is the influence of the digitalization on independent record companies and how do these companies deal with this influence?

Subsequently the following research sub-questions have been formulated: What points of concern are expressed by the managements of independent record companies in context

with the digitalization? How is the influence of the digitalization on their record companies perceived by the managements of independent record companies? Which (if any) opportunities and threats are perceived by the managements of independent record companies, with regard to their companies and in context with the digitalization? In cohesion with the foregoing question: 1) Why are the subjects that have been brought up by the managements perceived as opportunities and/or threats? 2) How are these opportunities and threats perceived and how are they dealt with? 3) Why are they dealt with in the way as brought up by the managements? How do the managements of independent record companies think that their position within the music/recording industry can be estimated and characterized in the (near) future and why do they think so?

The units of analysis are the independent record companies that participated in the research and the population from which these companies have been taken basically<sup>10</sup> consists of the independent record companies that are affiliated with the Dutch entertainment industry association NVPI (Nederlandse Vereniging van Producenten en Importeurs van beeld- en geluidsdragers), which on its turn is affiliated with the IFPI (International Federation of the Phonographic Industry). The reason for this choice of population for a large part is pragmatic and must be seen in line with the feasibility of the research, as this approach provided a workable and relatively comprehensive list of independents added up by the relevant (email) addresses, phone numbers and websites, without the necessary work in order to attain this information becoming too time consuming. In addition, as these companies were affiliated with the national recording industry's association a level of professionalism that was desired for the participation in the research was expected. In total 34 independent record companies were ultimately asked to participate in the research and 18 of these approached companies agreed to do so.<sup>11</sup>

In chapter 2 an overview of the research methods used is given. The theoretical framework which serves as the basis of this thesis is presented in chapter 3. This framework consists of the following core issues: the elementary characteristics of the recording industry, the record company as a value-creating enterprise, the essential role of copyrights as intellectual property rights in the music industry, and the digitalization and its theoretical implications for the recording industry. Attention to various aspects of importance related to the record company is given in chapter 4. In chapter 5 the impact of the digitalization on the recording industry and on the record companies is expounded in detail. Attention is paid to the essential digital technologies with reference to this subject, to what developments are implied by the existence of these technologies, and to the relation between the digitalization and music piracy. In addition, the relation between music piracy and the recording industry as well as the discourse about the alleged impact piracy is thought to have on the recording industry and on record companies is analyzed here. In chapter 6 the research results are discussed and by doing so answers are given to the central research question and the research sub-questions. The conclusion that can be drawn from the conducted research is presented in chapter 7.

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<sup>11</sup> For an overview of the participating record companies/persons see table 6 in the appendix.

## 2 Methodology

### 2.1 Data collection

The research approach that has been chosen is qualitative, implying that the conducted research is characterized by an inductive process. This means that, instead of testing a hypothesis which has been formulated before the start of the actual collecting of data (which is the case with a quantitative research approach), the data collection takes place prior to the formulation of actual theory in context with the research question(s), and that any possible theories are developed only after the data collection and with these collected data as basis. However, even though an explicit hypothesis is not tested, when prepared properly the researcher will always have certain ideas and preconceptions with reference to the subject of research. During the qualitative research process the researcher should therefore be aware of this factor in order not to search (whether consciously or not) for information that seems to be in line with initial expectations.

In order to collect the data necessary for the attempt to answer the central research question and the research sub-questions of this thesis, for the main part use was made of qualitative in-depth interviews. In the period 20 June 2006 - 24 August 2006, fourteen of this type of interviews have been conducted with members of the managements of fourteen different independent record companies.<sup>11</sup> In total these interviews accounted for a length of time of approximately 24 hours and 45 minutes. To be able to listen back to these interviews they were digitally recorded.

The choice to make use of qualitative in-depth interviewing was made because it enables the interviewee to express his/her thoughts on the relevant topics relatively freely without being restricted by pre-constructed closed questions or multiple choice questions. It therefore can be said that "open-ended and flexible questions are likely to get a more considered response than closed questions and therefore provide better access to interviewees' views, interpretations of events, understandings, experiences and opinions".<sup>12</sup> In addition, when necessary this interviewing technique provides the interviewer with the possibility to keep asking questions in order to go relatively deeply into the topics of conversation that are relevant for the research. Thus, when the interview is used for qualitative research, it are the here mentioned specific characteristics of the qualitative in-depth interview that arguably suit the inductive nature of this research approach best. After all, this inductive nature implies that, in order to gain insight into the core issues and themes<sup>13</sup> that prove to be connected to the topic of research and ultimately to the research question, it is of great importance that the obtained data is as balanced and comprehensive as possible.

Also use has been made of questionnaires with open questions. These have been send via the Internet to members of the managements of three different independent record companies.<sup>14</sup> The reason for this was pragmatic of nature: the persons involved did not want to participate in the time consuming face-to-face in-depth interviews, but they were willing to react to questions asked to them in writing.



A number of in-depth interviews had already been done before sending the first of these questionnaires, so with the formulation use has been made of insights gained by these preceding interviews.

Furthermore, one of the questionnaires was followed up by a qualitative interview over the telephone<sup>15</sup>, which provided the opportunity to go deeper into the topics initially dealt with in the questionnaire and into the answers given to the questions in this questionnaire.

Finally, one member of the management of an independent record company<sup>16</sup> made sure that a questionnaire (which made use of open questions) compatible with the topic of research of this thesis was received. He had replied to this questionnaire shortly before he was asked to participate in an in-depth interview.

In order to be able to write this thesis literature research had to be conducted as well. Use has been made of both primary and secondary sources. For an overview of these sources the reference bibliography can be consulted.

## **2.2 Data analysis**

Since the qualitative in-depth interviews have been recorded they were listened back to as intensively as needed. Any part of the conversations which was thought to be of interest has been written down. Most of the time this was done by summarizing the content of what has been said, but also phrases of particular interest have been cited literally. This data has been added up by the data collected by means of the interview via the telephone and the several questionnaires.

The data that was collected through the mentioned interviews and questionnaires has been analysed by making use of an approach that can be referred to as 'qualitative thematic analysis'.<sup>17</sup> This implies that the data has been analysed by focussing on the content that, as the research made progress, proved to be the core themes and issues in context with the topic of research and the research questions. Cohesively, attention has been given to essential similarities and differences in the data attached to the core issues and themes that kept coming forward, implying that by doing so certain patterns could be constructed. Hence, by arranging it and sorting it out in such a manner, the data has been effectively coded.

### **3 The Recording Industry, Value Creation, Copyright Law and the Digitalization**

#### ***3.1 The recording industry as part of the cultural industries***

The recording industry must be seen as an industry that specializes in the production and sale of sound recordings of musical works. It is an important part of both the music industry and the cultural industries, which are generally defined as those industries that combine mass-production of goods and services with artistic content.<sup>18</sup> The recording industry and the cultural industries share certain characteristics that shape the conditions under which they must operate. For a record company this implies that these specific conditions for a large part determine the behaviour of the company on the market and the context in which most choices are made. As this thesis is written on the subject of independent record companies and the digitalization, it therefore is necessary to give attention to the recording industry as part of the cultural industries. By doing so an essential perspective from out which record companies approach changes in the music industry will become clear.

A factor that normally colours the attitude of a record company towards production and more general towards the way that a record company should be managed is the fact that within the cultural industries demand for a specific product is highly uncertain.<sup>19</sup> For a record company this means that the way a certain production, for example a CD-album or a DVD, is received by the public cannot be determined well in advance of the release on the market.<sup>20</sup> Because in essence a record company has got a natural monopoly on a musical recording and at the same time a record must be seen as a luxury good, it is very difficult to estimate the sentiment of potential consumers, especially when this to be released record is of a to be newly released artist or band as well. And even though (because of the input of songwriters, recording artists, producers and sound engineers, among others) musical recordings in essence are unique and therefore mutually clearly differentiated, there still is strong competition for the attention and the money of the consumer, since both previously released productions and new releases are numerous, as well within a certain genre as between different genres. All this implies that it remains largely unclear whether upfront production and marketing costs will be recovered, let alone the question if a profit will ever be made.<sup>21</sup> It is obvious that the production and sale of music records is subject to an unusual high failure rate.<sup>22</sup> Even the participation of a star does not always add up to the predictability of the success of a particular production.<sup>23</sup> After all, it is the case that (figuratively speaking) those artists who are well known today often are nearly forgotten tomorrow. At the same time it must be pointed out that even though this persistent uncertainty of demand clearly exists within the recording industry, the majors have to cope more with this phenomenon than the smaller independent record companies often do. There are several reasons for this which are related to the type of market independents predominantly serve and their connection with this market, to the size and nature of investments made and to the characteristics of the organizational structure of the firm.

This uncertainty of demand is strongly emphasized within studies and publications on the subject of the cultural industries.<sup>24</sup> The reason for this must be seen in context with the

division of production costs within this industry. When a record company realizes the prototype of a new production it has got to cope with relatively high fixed costs which are mostly sunk as well, whereas the marginal costs of reproduction are relatively very low and even almost negligible compared to the fixed costs, especially on the long run. The reason why a large part of the fixed costs is sunk is because of the uniqueness of a new musical recording that exists per definition (hence the natural monopoly). This does not mean that each new piece of music necessarily is a true original in an esthetic context. What it does mean in context with the fixed costs, however, is that for the prototype of a new recording a new production process is required (Of course the extent of this production process may vary. For example, when a remix is concerned this is the case only minimally, making a remix lucrative in potential.) and that once investments in this process are made it is impossible to retrieve a large part (hence those costs that are sunk) of this investment when for some reason a change of plan is desirable.

It is clear that the existence of an unusual high failure rate in combination with relatively high fixed costs which are largely sunk makes investments in musical recordings a risky undertaking. On the contrary however, because of the relatively very low marginal costs of reproduction high profits can be made when a certain record proves to be commercially successful: once the break-even point is reached the marginal costs do not pressurize the increase of output.<sup>25</sup> Therefore it is the case that the fixed costs per product and the total costs per product (the average costs) diminish as the reproduction of the original increases, giving the curves of these costs their typical down-slope character. In principle these economies of scale (economies where increasing production to a certain limit implies decreasing average costs) exist in those industries where the marginal costs are lower than the average costs.<sup>26</sup> Hence, because of the here mentioned division of costs that characterizes the (re)production of music, economies of scale are an important feature of the recording industry. In addition, for a record company the use of economies of scale does not only give an advantage in context with production costs and profit. Also in context with distribution economies of scale present a clear advantage, since it is simply the case that the costs of transporting a high amount of copies of a record to a certain location imply less distribution costs per product than the transportation of a less high amount of copies would imply.<sup>27</sup>

Besides economies of scale, economies of scope are common within the recording industry as well. They are present when a record company offers different kinds of products on the market in order to increase profit and to make a more efficient use of the company's activities and infrastructure. In general these products are gathered around core aspects of the company such as artists or a certain genre they represent. Probably among the best known examples are the offering of (live) music DVDs and mastertones for cellular phones, but also the offering of merchandise from singing artists are part of the multi product production which economies of scope imply.

### **3.2 The creation of value**

To understand the behavior of record companies it also is of importance to keep in mind that such a company is a commercial organization which in general has a strong focus on the continuation of the firm. This implies that, in order to reach this goal, at least enough turnover must be realized to cover all costs that are made. It is stating the obvious that when this objective is not reached too often, a company finds itself under serious pressure, facing the threat of bankruptcy. Besides this a record company should make profit in order to grow in economic strength and when desirable in company size, thereby ensuring the possibility of an increase in production and growth in market share, creating the possibility of risk taking and new investments, ensuring financial healthiness and securing the satisfaction of share and stakeholders. Hence, the making of profit is an essential tool to reach the objectives of continuity of the firm and company safety.

An important part in the economic theory of the firm is the idea that decisions within commercial firms are made with the objective of profit maximization. Common criticism is that this is a too simplistic way of thinking and that there are other goals and motivations in context with which decisions are made as well.<sup>28</sup> Examples could be strategic choices (which may not contribute to the maximization of profit but rather contribute to a solid position on the market, to the attainability of future goals, or to the reduction of certain risks and therefore increase the possibilities of the continuation of the firm and the earning of profit in the future), or choices that are made with motivations which are rather philanthropic of nature. Even though record companies are commercial firms and therefore are interested in making profit, clearly not all managerial choices within these companies are made in order to maximize this profit. One could expect that the large 'majors' to a higher degree are eager to do so than the smaller independent record companies are, since the latter in general has a stronger emotional bond with the genre of music it produces and therefore may be more sensitive for philanthropic motivations.<sup>29</sup> However, indifferent to what extend this may be the case, it is clear that not all behavior of commercial firms must be seen in context with the concept of profit maximization.

As is the case with other commercial companies, a record company seeks to make profit and to ensure its continuation by means of production. In economics, production is seen as the conversion of resources into goods and services.<sup>30</sup> A record company uses a combination of artistic (such as performances of musicians) and commercial input (such as studio costs) in order to produce an output, such as for example an album in hard or soft copy format, a song which is available for downloading or a DVD with music videos or a live-registration. An essential aspect of production is that within the production process economic value is created, which forms a major incentive to produce any good or service. The idea is that the value of the output in potential inhibits a greater economic value than the sum of the economic values of each individual input necessary to achieve this output. In other words, a value surplus must be achieved at the output side of the firm. This is potentially the case because the economic value of the output cannot always be estimated well. It is the demand for a certain product on the market that many times determines this value for a large part. As mentioned, the demand for the output of a record company is highly uncertain and therefore the economic value of this output is uncertain as well. Once the demand for and sale of a particular record proves to be sufficient to surpass the break-even point, the economic value

of this output (meaning the prototype and not the reproduction of this prototype) can also be determined as greater than the sum of the economic values of the individual inputs. After all, the economic value of the here mentioned output is embedded in the intellectual property rights connected to it. This is why in many cases the value of a record company for an important part is determined by the (estimated) value of its catalogue.<sup>31</sup> Still, it obviously is the case that in order to secure the continuity of the company, on average the economic value of the produced products should prove to be greater than the economic value of the resources used to produce them. And therefore the managements of record companies run their businesses with this given fact clear on their minds.

It is worth mentioning that, besides economic value, within the production process of record companies cultural value is created as well.<sup>32</sup> In this context cultural value must be seen as the value of the cultural (non-economic) aspects of the product, whether this product is a piece of music in digital format or a record in physical format. The amount of cultural value represented by a certain production will differ for each individual, not in the least because tastes differ among individuals as well. What is important, however, is that there is a direct link between cultural value and consumer preferences in a way that the amount of cultural value a product inhibits for a certain consumer finds its reflection in the marginal utility a consumer benefits from consuming and experiencing this particular product. At the same time this implies that the cultural value inhibited within the reproduction of a certain production (a prototype) from a record company is an important deciding factor for the price that a consumer is willing to pay for this particular reproduction and consequently for the economic value of the prototype as well.

Besides, it must be mentioned that the creation of cultural value and therefore the cultural value of a certain production may also be of a great importance for the managing directors of a company in the cultural industries in general and of a record company in particular. In fact, the cultural value of the product they produce may be valued more than the economic value, at least from time to time and for certain record companies this will be the case.<sup>33</sup> This is another reason why profit maximization is not the only core element in the management of a company, especially not when the artistic and cultural component of the product produced is so essential and profound as is the case within the cultural industries.

### ***3.3 Copyright and the music industry***

As pointed out, a record company is a commercial organization which seeks to create economic and cultural value through the production of products which generally have music as their main content. Essential for the existence of the music industry as we know it in general, and the recording industry in particular, is the concept of music and recordings to be protected by copyright law and related to this the possibility for businesses to commercially exploit music, which exists because of this copyright protection. After all, it are the intellectual property rights that record companies own (or of which they have exclusive licenses) that enable them to sell music to the consumer, thereby creating the possibility to recover investments made and to make a profit.

Copyright can be defined as "the warrant of control granted by law to an author over his own work".<sup>34</sup> In practice this implies that the creator of a work within the areas of science, literature or art within certain limits has the right to decide what will happen with the work that is made by him or her. Therefore it has been said that copyright rather subsists than exists, since the existence of an original work (in copyright law terms) is necessary to link copyright to this work.<sup>35</sup> Even though in many countries it is necessary for a work to be fixed in a tangible medium of expression in order to be protected by copyright law, it should be kept in mind that it is the intellectual work originating with an author that is copyright protected (hence the term 'intellectual property law') and not a particular work in tangible form.<sup>36</sup> Thus, within copyright law ownership of the copyright is separated from the good it embodies. For instance, not a record, but the music on this record is protected. Whether this music is on the air by means of radio transmission, written down in musical notation or stored on the hard disk of a personal computer is indifferent for copyright protection.

There are two main reasons for copyright to exist. First, to ensure the possibility to make a profit out of the creation, production and reproduction of works in the areas mentioned above. To make this possible these works are protected by copyright law, granting the owner(s) of the copyright in a certain work the possibility of exclusive commercial exploitation. The idea behind this is that in this manner the incentive to create artistic and creative works is secured and therefore the production of these works is stimulated. By doing so the society on the whole should benefit. Second, to protect the position and the integrity of the intellectual creator of a work, thereby enforcing the reputation of the author as we know it in most modern societies.

Coherent with these two main reasons for the existence of copyright it is important to distinguish the two types of rights from which modern copyright law is built up, namely economic rights and moral rights. On the one hand there is the copyright as such, which consists of the economic rights. This gives the owner(s) the exclusive right to multiply the work and to make the work public and because of this, as mentioned above, the possibility to commercially exploit it.<sup>37</sup> On the other hand, in Europe authors have a moral right, which as the name indicates consists of the moral rights and also is referred to as the *droit moral*. This right protects the position of the 'true' author of a work by providing the right to claim first authorship (the paternity right) and makes it possible to take legal action against those who are felt to unjustifiably mutilate, adjust or distort his or her creation or the authorship (the integrity right), whether this author owns the copyright which enables him to exploit this work or not. In contrast with the rights to commercially exploit a certain work (the copyright), the moral rights are not alienable and thus they cannot be sold or be given away to another party. It needs to be said, however, that even though this moral right is the norm in Europe, in the U.S. it is not part of current copyright law.<sup>38</sup>

In addition, besides the above-mentioned rights in an original musical work, there are also the rights in the sound recording of such a work. Often these rights are referred to as the mechanical rights. In Europe these rights are understood as neighbouring rights while in the U.S. they are just regarded as copyright, since the U.S. copyright law has no concept of neighbouring rights. It is of importance to understand that whereas the copyrights in an original musical work are first owned by the original author of this work, the copyrights in a sound recording of a musical work are first owned by the producer of this recording.<sup>39</sup> The existence of mechanical rights is an essential feature of musical copyright and these rights predominantly are owned by the record companies, as they usually (in legal and economic

terms) are the producer of a musical recording. The mechanical rights consist of the right to record a certain composition in order to reproduce this recording and to sell it, which implies that they must be seen as the copyrights in the master recording of a song or a collection of songs, as is the case with an album.<sup>40</sup> Besides this, the owner of the mechanical rights in a sound recording has got the exclusive rights to make it heard in public, to make new recordings by making use of this recording and to broadcast it. Moreover, both a negotiated and a compulsory mechanical license exist. The prior comes into existence through negotiations between the owner(s) of the copyrights in a song and a record company. The latter implies that anyone is allowed to record and distribute a certain song by making use of the compulsory license after this song is recorded for the first time (but of course financial compensation is still required and the moral rights must still be respected), as is the case with covers. The reason why mechanical rights are such an important feature of musical copyright in context with the recording industry is evident, since the most fundamental source of income of record companies traditionally comes into existence through the sale of recorded music.

Finally, for the sake of completeness the existence of the rights of an artist in a performance should be mentioned here as well. These (neighbouring) rights are referred to as performers' rights or rights of the performer and therefore should not be confused with performance rights.<sup>41</sup> They consist of rights to withhold permission for the recording, transmission or broadcasting of a performance, the right to receive a equitable financial compensation from the holder of the copyrights in a recording (the mechanical rights) whenever it is communicated to the public and (outside the U.S.) some moral rights in the performances.<sup>42</sup>

The importance of copyright law for the music industry goes hand in hand with the possibility to efficiently manage copyright exploitation and to act against copyright infringement, which implies that these two aspects are of the utmost importance in order to secure the possibility for record companies to make a profit by producing products with artistic content. To own intellectual property rights obviously is idle when the owner does not receive financial compensation for the use of this property. And the existence of copyright law is somewhat hollow when copyright infringement is possible without punishment. Therefore it is clear that when copyright exploitation is not well managed and when the possibility to exclusively commercially exploit intellectual property rights decreases, it will prove to be even more difficult for a record company to reach the break-even point of a production in a market that is unusually capricious of itself, thereby reducing the incentive for many record companies to invest in musical recordings as well. At the same time, however, this dependence on copyright exploitation requests flexibility and inventiveness of record companies in order to keep pace with the spirit of the time, which finds its reflection in changing technology and changing consumer behavior.

### **3.4 The digitalization and its implications for the recording industry**

“Copyright owners continue to be ambivalent about the Internet. On the one hand, it represents a fantastic new medium for distribution; on the other, many in the publishing industry see it as one ‘giant, out of control copying machine’.”<sup>43</sup>

This quotation provides a vivid illustration of the attitude many copyright holders have towards the Internet. But when taking a closer look the quote says much more, as it (even though not referring to it explicitly) actually touches on the attitude many owners of different kinds of intellectual property rights have not only towards the Internet, but towards the digitalization in general. After all, the Internet itself clearly is not a copying machine, it is just a huge computer network. And even though within this citation only the publishing industry is explicitly mentioned, when reading carefully it becomes clear that actually all industries occupied with the commercial exploitation of copyrights are concerned.

So the entertainment industry in general and the recording industry in particular is and has been confronted with a transition from the use of analog technology to the use of digital technology, especially in the ‘modern’ western societies. And now record companies face the challenge of dealing with the implications that the digitalization presents to them. For instance, this increasing dominance of digital technology has brought and still is bringing many of these companies to work with a mixture of business models that deal with digital music files, besides the business model that deals with the ‘old fashioned’ physical musical recordings that has been in use since the beginning of the recording industry.<sup>44</sup> When looked at from the perspective of the record companies, it is clear that the here mentioned implications consist of both threats and opportunities. What then are the main threats and opportunities that, at least in theory, a record company is confronted with because of the digitalization?

As mentioned, the possibility to make (identical or compressed) digital copies of musical recordings and/or to distribute digital music files over the Internet is one of the main issues when the digitalization in context with the recording industry is concerned. The technology to do so inhibits a major threat to both the music and the recording industry, since recordings (both physical and in digital format) in fact are and have been multiplied, distributed, sold and consumed on a large scale without permission from and compensation to the legal owner of the relevant copyrights. After all, the whole music industry is built upon the concept of the commercial exploitation of copyrights by the legal owners of these rights.

But whereas the digitalization to some degree threatens this exploitation it actually has brought the record companies some fundamental opportunities as well. Of importance is that the digitalization has offered them possibilities to significantly reduce production and distribution costs. Because of the development of digital technology used for the recording of music it has increasingly become possible to make high-quality musical recordings for a fraction of what it would have cost to make a recording of comparable quality before this equipment was available. In addition, this equipment has become more and more easy in use, making it not longer a strict necessity to make use of expensive studio engineers.

When the production and distribution of hard copies is compared with the production of recordings in digital format and digital distribution, the latter form is clearly more efficient. Unsurprisingly there is not much disagreement about the statement that this digital



distribution is the most efficient distribution method the recording industry has ever used. When the recorded music is distributed in digital format, it is no longer necessary to spend money on the manufacturing of the physical sound carrier, the artwork/booklet of the record and on packaging. The digital distribution itself (for example by making use of a broadband connection or by transmitting the track wirelessly to a mobile phone) implies a further substantial decrease in costs, since in this case the costly physical distribution obviously is not necessary.<sup>45</sup> Besides, since it then is no longer necessary to physically store records this would seriously reduce warehouse costs and there would be no risk of manufacturing and distributing records that later have to be taken back because they did not sell.

For a record company these possibilities to reduce costs could be used to increase the return on sales, which also would imply that less recordings have to be sold in order to break even. In any market, but especially in a market where the demand for a particular record often is highly uncertain, this obviously is a positive development from the producing company's point of view. But it may also lead to a reduction of the wholesale price of recordings (whether in context with individual songs or a collection of songs, as is the case on an album), which should imply that the consumer benefits from a reduced retail price as well. For example, in 2003 the wholesale price that Apple paid for its iTunes Music Store downloads varied between \$0.52 and \$0.80 per song.<sup>46</sup> In 2002, however, the wholesale price (before discounts) paid to the majors for a newly released CD of a major artist was about \$11.75.<sup>47</sup> The most common format for a CD album is one that contains 10 to 14 songs. When the lowest reported wholesale price per song (\$0.52) is multiplied by 10 we come to a total amount of \$5.20, and when the highest reported wholesale price per song (\$0.80) is multiplied by 14 we come to a total amount of \$11.20. The first amount is \$6.55 and the latter amount is \$0.55 under the here mentioned wholesale price of \$11.75. Of course this example is not very precise and therefore only illustrative, but it does show that it is reasonable to suggest that the possibilities of cost reductions offered to the record companies by the digitalization will partially be translated into lower wholesale prices, especially since the relatively high wholesale prices per song are often used for hit singles and not for all songs taken from a record.<sup>48</sup>

The retail price for recordings in digital format can be reduced furthermore not only because of decreased wholesale prices, but also because the music download service (which may be a subscription service or a pay-per-download service) that delivers the songs to the consumer often basically functions as both a wholesaler and a retailer all together and at the same time. This construction makes the 'traditional' retailer at the end of the value chain, which in general takes a substantial percentage of the retail price (figures of 27% and even 39% are reported<sup>49</sup>) superfluous. For example, in 2003 Apple's iTunes sold single downloads for \$0.99 per song. Of this amount it took \$0.10 for itself, which is approximately 10% of the retail price, obviously much less than the traditional retailer generally takes. In addition, the record company may also sell and distribute its digital music files directly to the consumer, without making use of a distribution/retail affiliate in the like of the iTunes Store, eMusic, MSN Music, Sprint Music Store and 3MusicStore. In this case the company will determine the final retail price itself, meaning that in this scenario the consumer in theory could benefit from a decreased retail price again and/or the record company can have a higher profit margin per song, since no margins are added by the download store.

This substantiated (potential) decrease of retail prices for recorded music is not just beneficial for the consumer, but it is a positive development for the record companies too. As

the unauthorized downloading of music and physical piracy continues to take place on a large scale, a substantial decrease of retail prices might to some extent give consumers the much needed incentive to actually purchase music.<sup>50</sup> More in general a lower retail price implies that the products of record companies can compete better with other luxury goods. This is especially important since for many record companies the youth<sup>51</sup> traditionally is an essential group of consumers, yet at the same time a group that is generally characterized by a relatively low income.<sup>52</sup> Moreover, it is argued that whereas the youth of one and a half decade or so ago predominantly saved a part of its income to purchase a recording, the youth of today often tends to spend its money on other luxury goods like cellular phones and computer games (of which the latter are predominantly mentioned to compete heavily with the record companies' products), while music is frequently seen as a commodity that can be obtained for free on the Internet.<sup>53</sup>

Not only are digital distribution and the retailing of digital recordings by making use of both computers and mobile phones relatively new methods to distribute and sell recordings. It also are extra ways, as they (at least for the present) function next to the other distribution channels and retail methods, like record clubs and retailing in record stores or electronics stores. Moreover, besides the here mentioned extra distribution channels, the digitalization has brought the Internet stores in the likes of Bol.com, CD Now and Amazon.com into existence as well. These stores also provide the consumer with the possibility to purchase recordings without having to leave the house, similar to the various download services, record clubs and mail order companies. But whereas the music download services sell digital recordings (or offer the possibility to access music streaming<sup>54</sup>), the Internet stores sell hard copies. Therefore it is reasonable to suggest that, even though all retailers of musical recordings compete with each other, the recording selling Internet stores first of all compete with record clubs and the relevant mail order services. For the record companies, however, foregoing implies that because of the digitalization the number of mutually different ways that can be used in order to reach the consumer with their products has increased. From their point of view this can be seen as a positive development, as it enables them to meet the varied wishes of the consumer more precise and therefore better.

In addition, an important aspect of the digitalization in general and digital distribution in particular is that these phenomena made it possible for record companies to develop new products which have the potential to provide a solid extra revenue stream (as is already the case for some record companies and in some markets), besides the traditional sale of recordings (whether this concerns single songs or complete albums and whether this takes place in hard or soft copies).<sup>55</sup> The most important examples of these products are digital music videos, mastertones (also referred to as realtones) and ringback tones. What is particularly interesting about the music videos is that not only they can be downloaded (on a computer as well as on a third generation mobile phone) and sold as a substitute for a single track, but they also can be used as content on Internet-based platforms such as Yahoo! Music and YouTube. These businesses then can financially compensate the record companies for using their music videos, for example by sharing part of their advertising revenues (as far as sites that work with advertising-supported models such as Yahoo! Music are concerned) on a per-stream basis, or by making use of licensing deals (such as is the case with YouTube).

Foregoing implies that the developments the digitalization has brought along offered record companies a chance to built a revenue stream from music video, whereas until recently music videos predominantly merely served as an expensive promotional tool. Another matter of interest is that both the development of mobile phones and the transition from analogue mobile phone networks to digital ones resulted in the replacement of polyphonic ringtones for mastertones. For record companies this offers a clear opportunity, because mastertones (as the name implies) are derived from master recordings, meaning that now besides the holder(s) of the copyrights in the relevant songs also the holder(s) of the mechanical rights (which as mentioned in general are the record companies) receive income for every mastertone sold.

Also in context with marketing activities, the search for new artists with relevant potential and in order to keep in touch with trends and developments on the market, the digitalization has offered the record companies new possibilities and opportunities. Illustrative examples of marketing efforts using digital techniques are exclusive concert downloads of a song performed at the attended concert, websites of artists with a broad variety of features including the possibility to purchase and/or listen to different kinds of (often exclusive) digital tracks and exclusive downloadable material for those who pre-order the digital version of a to be released album. It is the Internet that proves to be an increasingly important and versatile additional tool that can be used in order to perform the above-mentioned necessary activities. In contrary to most other media, the Internet offers the potential of world-wide exposure, as the nature of this medium implies. At the same time Internet communities in general have a highly international character. Because of this, the above-mentioned activities can take place on an international level much easier than it used to. But perhaps even more important is the fact that these activities can be linked to websites in general and especially to social networking sites in particular, and therefore can be focussed on the relevant target groups. Most certainly this all important fine-tuning on the multitude of socio-cultural groups, that at the same time represent groups of consumers as well, has become increasingly possible and affordable because of the Internet and the huge popularity of this medium. Finally, it must be said that peer-to-peer sites that enable the unauthorized up- and downloading of recordings do not solely harm the sale of music. They actually promote artists and their music as well, since they serve as communities of taste and therefore often increase the amount of exposure artists and their music get (in economic terms this is referred to as the exposure effect or the sampling effect, as it currently often is called). In certain cases, even though challenged heavily by the International Federation of the Phonographic Industry (IFPI), this increased exposure may have a positive effect on record sales and/or on the attendance of performances.<sup>56</sup>

Indeed the digitalization has provided the recording industry with opportunities, inhibiting benefits for both the record companies and the consumer. Nonetheless there are still many obstacles to take. Probably the most fundamental of those is the question how to get people to predominantly pay for the downloading of music as the same music can be downloaded for free as well? After all, no matter how low the retail price of a recorded song will be, when solely focussing on the price for free is as good as it gets. The existence of intellectual property rights itself certainly does often not provide sufficient incentive to make people financially compensate the owner(s) of the relevant property.<sup>57</sup> To be assured of the original, high quality and bug and virus/spyware free version of a song to some extend then may

provide the incentive needed for consumers to use legal music download services. To what extent this is and will be the case, however, is hard to say. The pay method which is used is also of interest. It should be safe, reliable and consumer friendly in order to stimulate the consumer to use these services. Furthermore, the freedom with which the consumer can use digital music files should meet the consumer's demands in order to stimulate purchases of these files, which implies that Digital Rights Management (DRM) should not frustrate this freedom of usage.

Another important aspect of digital distribution that should be mentioned here is the fact that the consumer predominantly downloads individual songs of a record and not the record in its totality, even though the number of authorized album downloads is increasing.<sup>58</sup> For the consumer the possibility to select individual songs from a record often proves to be beneficial, as only the songs that are liked best can be chosen. But for the record companies this is a serious disadvantage, since the amount of profit per song is much less than the amount of profit per complete album. This is especially the case for those record companies who tend not to focus on the sale of hit singles but primarily focus on the sale of albums. Though on the other hand, to have one or more hit singles generally used to turn the album from which they have been taken into a hit record as well. In context with digital distribution and the sale of music downloads, however, this has (and probably increasingly will as these distribution and retail methods become more common) become more difficult.

Moreover, the digitalization has not only confronted the record companies with developments and opportunities in the areas of production, distribution, retail and marketing. Surely it are the artists that can benefit from these developments as well. The fact that nowadays it is widely affordable to produce music at a professional standard, that it is relatively easy and affordable to distribute this music digitally, that because of this in potential retail prices can be kept relatively low and that it is becoming increasingly possible to promote oneself without the necessity of a large budget by making use of the possibilities the Internet offers (for example MySpace and other social networking sites, YouTube, MP3.com, webcasts, podcasts etc.), implies that the artist's dependence on record companies is (slowly) decreasing.<sup>59</sup> It is this decreasing dependence that can be seen as a threat to the current position of record companies in general in the recording industry. After all, it always has been the artist's dependence on the services often only a record company could provide on a professional level and in an effective manner that gave these companies their position of power in the recording industry.

But at the same time and on the contrary, the aforementioned developments with which the digitalization has confronted the recording industry also seem to be particularly in the benefit of the independent record companies, since they do not have the organizational size and the economic power that the huge majors have.<sup>60</sup> Economic strength is what predominantly always has been a crucial factor in the recording industry in context with the production, distribution and the promotion of a record on a professional level and on a large scale. Therefore it seems that the abovementioned opportunities may bring about a higher degree of competitiveness among the independents with respect to the majors. Still it is hard to say to what extent and exactly how the record companies' (both the independents and the majors) position of power, and the function these companies fulfil in the recording and music industry, will change. Even though these industries are going through a transition phase, the way they nowadays are arranged does not vary that much from the period before the digitalization started to increasingly confront record companies with the discussed threats

and opportunities. At least for the time being, for most artists record companies to a large extent enduringly prove to be a necessary partner in order to get their songs bought by at least a reasonably sized public. Especially in the mainstream market and in context with the marketing of their recordings this still proves to be the case. Nevertheless, due to the developments that the digitalization has brought about, some very important conditions for fundamental changes in both the music industry in general and the recording industry in particular are already present.

### **3.5 Concluding remarks**

The characteristics of the recording industry as a part of the cultural industries and of the market on which this industry operates, the creation of economic and cultural value and the dependence of record companies on the possibility of a commercial exploitation of copyrights together form a binding framework from out which record companies must operate. At the same time, however, their functioning within this framework is being challenged by the developments brought about by the digitalization. Nonetheless, even though the recording industry has to stand up to these developments and to the threats and opportunities that are implied by them, to a large extent the choices that are made within a record company remain to be linked closely to it, and it is within its given boundaries that record companies will have to search for ways to deal with the here mentioned developments. Therefore in this thesis this framework serves as the starting point from out which the behavior of record companies in context with the developments the digitalization has confronted them with is approached and is sought to be understood.

## 4 The Record Company

“Today it is impossible to think of almost any type of music without considering the role of recordings. I have often heard children say ‘That was a nice record’, when speaking of a live performance. Records and music are becoming almost synonymous.”<sup>61</sup>

The here mentioned citation illustrates the massive impact recordings have had and continue to have on the consumption of music and on how music itself is experienced. Even though (as the quotation is from 1983) the reference to the synonymy that almost existed between the traditional physical records and the notion of music is becoming increasingly outdated, this relation between sound recordings as such (meaning both hard and soft copies) and the notion of music is as strong as ever.

In the late 1870s the technique was invented to record music on a sound recording medium which could be reproduced and sold to the consumer.<sup>62</sup> Therefore the first massive milestone in the history of the recording industry was the introduction of commercial musical recordings, which was in 1889.<sup>63</sup> Only ten years later, in 1899, estimates suggest that 3,75 million recordings were sold each year.<sup>64</sup> It took another ten years, until the year 1909, for the yearly manufacturing of phonographs and cylinders to surpass 27 million pieces, which implies that by then the availability of phonographs had become relatively common in modern societies.<sup>65</sup>

Since those days up to the multibillion dollar business it represents nowadays, the recording industry clearly has come a long way.<sup>66</sup> Without the power of the industry to record and mass-reproduce music, monuments in popular music history as we know them in the likes of, for example, the Rolling Stones, Deep Purple, the Beatles, U2 and Pink Floyd certainly would not have existed. After all, what makes these names big is their popularity. And a crucial factor in the achievement of popularity is, besides making music that is potentially liked by many, to reach the audience not just by performing live, but by getting your music in the houses, the cars and the schools of the public. By means of LPs (long playings), 331/3 -rpm, 45-rpm and 78-rpm singles, CD (compact disc) albums and CD singles, super audio CDs, cassettes, minidiscs, digital downloads, video cassettes and DVDs (digital versatile discs) etc., but certainly also the radio and television, record companies have made it possible for music to disseminate on a large scale and scope, thereby breaking through boundaries of age, sex, race, class and nation.

Moreover the record company has not achieved a crucial position within the music industry alone. Also in the music scene and in society in general the record company fulfils an important role, as it functions as an essential gate-keeper between the enormous pool of artists and musicians at one side and the public at the other. At the same time this function is connected with often expressed criticism by various parties, which actually must be seen in line with criticism on the cultural industries as such, claiming that record companies do not choose to work with the most talented artists and musicians but rather with those who will enable them to earn the most money. In other words, record companies would treat music as a means for commercial production rather than as an art form.<sup>67</sup>

For outsiders it might be peculiar to see what kind of love-hate relationship many artists have with record companies in general and in particular with the majors. At one hand, there

is the notion of success when an artist or band is signed by a record company. A musician's status certainly increases among most colleagues in most music scenes when he or she is (finally) signed. An important reason for this is that to be signed by a record companies implies a crucial step in the life of those musicians who aspire to have a professional carrier, at the least because a business specialised in selling musical recordings obviously believes that the signed artist or band has got commercial potential. Furthermore, most artists and musicians prefer to deal with the business side of their profession as little as possible, in order to focus on music itself. In context with which a record company obviously proves to be most helpful. But at the other hand there is a lot of criticism, stating that record companies restrict artistic freedom, do not understand 'what it is all about', are only 'in it for the money' and are not really interested in music as such.<sup>68</sup>

What kind of reasoning one may have, the importance that a record company can have for an artist or group of musicians is evident. After all, it is the record company that generally has got the expertise, the money and the infrastructure to bring about a well-known name and to produce and sell records in a professional, effective and efficient manner.

#### ***4.1 The terms record company and record label***

Both the term record company and the term record label are used alternately to refer to the same type of business (as defined in note 8). But whereas in practice a record company often is referred to as 'a record label' or 'a label', in theory actually a distinction must be made between the two terms. This is because of the fact that, besides to a record company as such, the term record label may also refer to a division of a record company, or even to a trademark used by a record company.<sup>69</sup> This situation can easily lead to misunderstandings, therefore in this thesis the term (record) label will only be used when referring to a division of a record company or to a trademark used by a record company.

#### ***4.2 The record company and its place within the music industry***

The music industry can basically be divided into three main parts, namely music publishing, live performing and recording. All three of them have their own income streams and all three of them can have specific value chains attached to the products that are central in each sector. However, these three categories do not exist completely separated from each other. There are many mutual relations, connections and overlaps. In fact they are interrelated in a way that businesses within these categories make use of each others activities and that these activities many times fulfill important functions for all three of the categories. For example, when a band performs live not only money is made within the live performing sector, but often in the music publishing sector as well, since a music publisher may own the copyrights of the songs performed, implying at the same time that in general a compensation will be paid to the composer(s) of these songs. Moreover a record company that has recorded the songs that were performed live may find that because of the promotional impact of the performance more records are being sold. At the same time this may imply that a sum

of money will be paid to both recording artists as well as to the music publisher and eventually again to the composer(s) of the songs.

This relatively simple example illustrates how activities in one sector may influence and stimulate activities within another sector. Even though this is true, it must be said that nowadays the recording industry must be seen as the decisive factor within the music industry. Most music publishing income is a result of the production of (popular) music records and the by far largest part of the income generated through live performances is the result of artists who perform the songs they have recorded.<sup>70</sup> In context with the latter it is illustrative that in general the stars of the recording industry also are the stars of the live performing sector and that the large tours that these top acts conduct account for the far most largest part of total live performance revenues.<sup>71</sup> Besides, within the recording industry a lot more money is generated than is the case within the other two sectors. For example, in the year 2000 the retail value of total record sales in the U.S. was approximately US\$14,3 billion, compared to an approximate US\$1,98 billion that was generated by means of music publishing and an approximate US\$1,7 billion that was generated by means of live performances of the major acts, both in the U.S. and in the same year.<sup>72</sup> Certainly it is the case that without the recording industry, hence without the existence of record companies, the music industry would only be a fraction of what it actually represents nowadays.

Not coincidentally within the music publishing sector the most important businesses are the music publishers. They diverge from small 'vest-pocket publishers', which are publishing businesses that are basically operated by one person, to the huge music publishing companies which are often owned by the music conglomerates and affiliated with a major record company.<sup>73</sup> The main activities of a publishing company consist of the acquisition of copyrights in songs and the exploitation of these copyrights. The copyrights are acquired from songwriters (who nowadays many times actually also are the performers of the songs they have written, as is the case with many bands and artists) and once acquired they can be commercially exploited by means of licenses, the sale of sheet music and the collecting of royalties, hence by making use of administration rights.<sup>74</sup> For the songwriter this implies that the copyrights in his songs are effectively managed, but at the same time a part of the income from the copyrights in his songs ends up in the pockets of the publishing company. Moreover, many publishers function as management companies as well, investing in the development of both the skills of artists and the careers of these artists, trying to get them signed by a record company and make them co-write with songwriters of whom the publisher thinks that they have the ability to write music with commercial potential.

As the name implies, the concept of a live performance by artists is central within the live performing sector, which is also referred to as the concert industry or the concert business. This sector is of a reasonably profound promotional importance for artists (and thus for record companies as well), certainly for those who are not that well known and for those who are signed by a record company that lacks the funds for a big marketing campaign. In addition, it is by means of performing live that many artists and bands built both their audience and reputation, what eventually may lead to a contract with a record company because of an established potential to sell records. Also of importance is that when performing live an artist is able to show its qualities to an audience in a direct manner, hence without interference by studio engineers that are able to mask many of the artist's shortcomings. This implies that when an artist performs live well, in most genres this will



certainly add up to his or her credibility and therefore to his or her potential to sell records as well.

But, as pointed out, the most important and central sector within the music industry is the recording industry, and in their turn the most important and most central players within this sector are the record companies, who traditionally record music and sell musical recordings. It is the record company that functions as the most dominant gatekeeper within the music industry, not only operating as an intermediary between artists, the audience and different kinds of media, but also as a crucial partner of different sorts of companies within all three sectors the music industry consists of. It are the distribution companies that often distribute the music they have recorded, whether this distribution takes place physical or by means of digital techniques. Retail businesses sell the products they have produced, whether these businesses operate on-line or as 'old fashioned' music stores. The music seen and heard on television and the radio for a large part is there because of the marketing efforts made by record companies (though this is much less the case for the Internet) and the music used within computer games and movies often has been recorded by a record company, just to name a few examples. More in general it is the case that the production and marketing efforts of record companies for a large part make sure that (and determine what) music finds its way to the consumer and because of this the impact of the recording industry on the music industry as a whole is profound.

### **4.3 *The record company and copyright exploitation***

Record companies earn money by means of copyright exploitation. Traditionally this takes place through the (re)production and sale of musical recordings, which becomes possible for a record company because of the possession of copyrights in the recordings they have made. These so called mechanical rights, as mentioned, ensure a record company of the exclusive right to sell reproductions of the master recording they have made of a certain musical composition. At the same time, when this construction is used, it implies that in this case the copyrights in the song are not owned by the record company that recorded it, but by the author. In copyright sense this may be whoever legally owns the copyrights in a song, but in practice this will generally be a music publisher or the composer and/or lyricist. Hence, within this traditional construction a record company exploits the copyright in a recording of a song and not the song itself. (I prefer to use the term 'song' over the term 'musical composition', because a song may consist of both a musical composition and lyrics, both of which individually are the object of copyright protection.)

However, record companies of all sizes have increasingly been participating in the exploitation of copyrights in songs as well.<sup>75</sup> (Though it should be noted that often these companies accommodate their publishing activities in a separate corporate body which is affiliated with the record company and which very often also carries the same brand and/or brand name.) Besides, the major music conglomerates have actively been expanding their interest in music publishing since the late 1980s and they have done this to a level that at present the three largest music publishers in the world are owned by three of the four largest music conglomerates.<sup>76</sup> Not coincidentally these conglomerates also own three of the four largest record companies. There are four main interconnected reasons for a record company

or a music conglomerate to establish interest in the copyrights in songs besides the copyrights in recordings.<sup>77</sup> First, when a publishing company owns the copyrights in the songs that the affiliated record company recorded there is no need to pay mechanical royalties to another business.<sup>78</sup> This implies that the mechanical royalty expenses made by the record company can be written down as revenues by the affiliated publishing company, meaning that by means of this construction the possession of copyrights in songs implies a decrease in expenses. Second, the possession of copyrights in music ensures a record company or music conglomerate of extra revenues in form of royalties besides the income as the result of the sale of records.<sup>79</sup> Third, many of the royalty revenues are the result of the efforts a record company has made to market and promote a certain song, record or artist. Whether a song is on the radio, on television, used as a soundtrack for a computer game or motion picture, performed live or when sheet music is sold, in all of these cases the owner of the copyrights in this song is ought to receive royalties and in all of these cases the exposure of this song can be seen as a direct result of marketing efforts made by a record company.<sup>80</sup> Because of this it seems only logic for record companies and music conglomerates to seek interest in music publishing. Finally, in the history of the music industry it was common for most record companies to predominantly work with artists that got their to be recorded songs delivered by music publishing companies. So in this case music publishers acquired the copyrights in songs written by songwriters and record companies recorded these songs by making use of other musicians. But since the 1990s this situation largely changed in a way that since then most recording artists also write their own songs.<sup>81</sup> This strongly diminished the need for record companies to work with a music publisher as intermediary between a pool of talented songwriters at the one side and the recording artists at the other. In the current situation many recording artists (still) own the copyright in the songs they want to record and it are the record companies and music conglomerates that often want to have (at least some) interest in these copyrights.

Thus, in many cases the term 'record company' may be partially outdated, since many of these companies do not solely produce and sell recordings anymore, but also have interest in music publishing. It only takes a look at the back of the albums in a music store to see how many record companies (often in combination with their affiliated publishing businesses) and music conglomerates actually own both the copyrights in the recording as well as the copyrights in the recorded songs. Naturally it is the case that not all record companies are equally active in the exploitation of the copyrights in songs and surely many record companies can be found that still exclusively focus on the production, marketing and sale of musical recordings alone. Nonetheless the internalization of music publishing as an activity next to the exploitation of mechanical rights (thus implying both vertical and horizontal integration) is a common and widespread phenomenon among record companies and music conglomerates. Where the music industry predominantly must be seen as a copyright industry, record companies may increasingly have to be approached as businesses that seek to commercially exploit a bundle of copyrights, whether this are copyrights in sound recordings or copyrights in songs.

But to the contrary of record companies that integrate music publishing, there also are publishing companies that increasingly have been participating in the recording business.<sup>82</sup> A main reason for this is that by producing a recording that is of sufficient quality to be sold to the public the chance that a record company is willing to put this recording in the market is greater than when a publisher delivers the record company a plain demo recording alone.

These publishing companies may evolve (and have evolved) into organizations that participate both in music publishing and the production and sale of recordings, similar to the record companies discussed above, only with a different starting point in development and a different incentive for this development.

#### **4.4 The record company and live performing**

Record companies also invest in the concert business, even though most of them do not try to make a profit within this sector in a direct manner.<sup>83</sup> First, it is the case that the live performances of signed artists may be used as an outlet for the sale of these artists' albums. Obviously this is interesting for record companies since the presence of the audience during the show implies a lot of potential consumers with a more than average willingness to buy, since most of the audience is fan of the performing artist(s) up to a certain degree. Second, as mentioned before, performing live is part of the promotion of artists and their albums. By investing in live performances a record company hopes to increase the sale of recordings. The company may provide extra funding for advertisements and other promotional activities linked to a certain concert or tour. Another approach that is chosen is to guarantee that a certain amount of money will be earned by the performing artist(s), so that in case of shortfall the record company makes up for the difference between the guaranteed amount and the actual amount that has been generated by performing live. By doing so a record company makes it possible to conduct a tour even when without this support losses would have been made. Even though the money spend on tour support by a record company is ought to increase record sales of a release, and because of the public exposure of the artist(s) of future releases as well, these funds are commonly treated as an advance and thus are recoupable out of the royalties that an artist or band earns from the sale of records.<sup>84</sup>

#### **4.5 The record company and its core activities**

A record company generally has to perform various different activities in order to be able to make profit by selling records. These activities must be seen in line with the value chain of a record.<sup>III</sup> For a record company this implies that artists and/or master recordings must be acquired and often artwork must be created in order to produce a recording ready to be sold to the consumer. Once such a product is produced, it then must be manufactured (obviously only when hard copies are concerned), put in the market and distributed. When the line of necessary activities is summarized, it can be said that the two core functions of a record company are the acquisition of master recordings (the production function) and the marketing of these recordings (the marketing function).

Therefore the artist and repertoire (A&R) department is one of the core departments of a record company, since its main responsibility corresponds with one of these two core

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<sup>III</sup> For the value chain of both a physical and digital recording see figure 1 and 2 in the appendix.

functions, namely the acquisition of marketable master recordings. More specific the A&R department is responsible for keeping track of the needs and tastes of the consumer and for product development. Furthermore an A&R staff may also be occupied with the accompaniment of signed artists within various aspects of their relationship with the record company, such as the writing and recording of songs or when a liaison with staff employed in an other department is needed.<sup>85</sup> Because the attraction of new artists and songs and the introduction of them on the market in most cases is necessary in order to remain profitable on the long run, the A&R department has got an important task in ensuring a record company of its continuity and among all departments a record company may consist of, A&R is at the basis of its functioning.<sup>86</sup> Its obvious that without the possession of master recordings and the corresponding mechanical rights there are no albums to be sold to the consumer and thus in such a case no money will be earned by means of record production. The two core dimensions in context with which the A&R department approaches its responsibility of product creation are the style and quality of the (to be) recorded artist or band and the packaging of the product ready to be sold to the consumer. Both of these elements should be tuned to the demand and taste of the potential consumer, but the style and genre of the other products offered by the record company should be taken into consideration as well.

There are two main ways by which an A&R department acquires master recordings. First, it can sign an artist or band, hereby obtaining exclusive recording rights in order to produce a certain number of master recordings which then can be reproduced and sold. Second, it can acquire master recordings that have already been made by an other party (this can be done both through licensing and purchasing), which may be one or more artists, some other production entity or a record company. The latter approach inhibits less financial risk than the first one does, since in this case the result of the recordings is already known, which reduces uncertainties linked to investments made because a clearer picture exists of what kind of product will be put in the market. In connection with this often is chosen for the release of some sort of reissue of a record that has been successfully released before. Digital remasterings, greatest hits albums, repackages, boxed sets or a combination of these examples all are frequently produced and marketed. The advantage of this approach is that, besides the fact that the result of the recordings are known up front, they also have been marketed before and therefore a market already has been established, a situation which reduces financial risks attached to the release of a recording furthermore. But to the contrary, to sign and develop a 'new' artist or band in general implies that both royalties and advances will be lower than is the case with well known artists. This is because, since they have not been signed before, the amount of records they can sell is obscure, which seriously weakens their bargaining position when negotiating with a record company about their contract. In addition, when successful a newly signed artist or band often is obliged to record more albums for a record company (as a result of the initial relatively weak bargaining position as well) than those that have proven their ability to sell a substantial amount of recordings. All this implies that even though to invest in 'new' artists inhibits a greater financial risk than is the case with established artists, when successful the earned profits will prove to be relatively higher as well.

As the A&R department has the task to deliver a complete and marketable product it supervises the process of the recording of songs. This phase within the production process of a record is quite critical, since the outcome of the executed recordings for a considerable

part determines whether a record can be commercially successful. A central figure within the making of musical recordings is the producer, who basically must be seen as a manager of both the artistic and the business side of recording an album. Before the rock and roll era almost all producers were part of a record company's A&R department.<sup>87</sup> At present the producer of a record may still be so, but mostly it is produced by an independent producer from outside the record company or by the recording artist(s) themselves (though often assisted by an independent producer). Besides, it should be pointed out that since the shift towards a producer that does not work directly for a record company, producers in general receive a royalty on the sales of recordings that they have worked on, just as the recording artists do.

The department which responsibility partially corresponds with the second core function (the marketing of recordings) of a record company is the marketing department. After all, when the A&R department delivers a finished recording the next essential step for a record company is to get this recording sufficiently sold. In business, thus in the recording business as well, marketing is an essential tool in order to reach this goal. Marketing has broadly been defined as "whatever comes between production and consumption."<sup>88</sup> Though this definition is rather vague it does make clear that an important part of marketing consists of bringing about a linkage between production and consumption. More precisely it can be said that "marketing consists of individual and organizational activities that facilitate and expedite satisfying exchange relationships in a dynamic environment through the creation, distribution, promotion and pricing of goods, services and ideas."<sup>89</sup> Another way to describe what marketing consists of is to state that it is "the process of planning and executing the conception, pricing, promotion, and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational goals."<sup>90</sup> More practically marketing can be approached by referring to (and by making use of) the often cited four P's of the (most basic) marketing mix.<sup>91</sup> The idea behind this concept is that in order to handle the marketing of a product effectively the four core functions (all beginning with a P) marketing is involved with must be sufficiently dealt with. These functions are described as product (product creation), price (pricing), place (distribution/retailing) and promotion.

Even though in general all of these activities must be carried out in order to produce and sell a record in a professional manner, most of the record companies do not have a marketing department that actually performs them all. As mentioned, product creation is an important responsibility of the A&R department. Moreover, both distribution and retailing are handled outside the marketing department as well. The foregoing implies that the marketing department of a record company primarily is occupied with the sales and promotion functions.

As the products that record companies produce are highly differentiated because of their uniqueness, a record company does not focus on product differentiation in its marketing. This implies that the marketing departments do not take the effort to convince the consumer of the idea that the product produced by their company is significantly different and better than a similar product of the competitor. It is the task of the A&R department to create a product with commercial potential and when this product is ready to be marketed it is assumed to be sufficiently differentiated. Instead the marketing department of a record company focuses on the achievement of product awareness among the consumers. Though this approach is logical, its success largely depends on to what degree the consumer in practice actually

perceives the differentiation and if this provides enough incentive for the consumer to buy the product.

It is by making use of promotion that the marketing department seeks to establish product awareness, something which is very important in order to sell records, since the supply of records on the market is huge. Therefore for record companies in general and for the record companies that operate in the mainstream of the market in particular (as in the latter market segment popular acts tend to trade places relatively fast and the consumer tends to have a less pro-active attitude with regard to bands and artists than often is the case in the niche markets), a promotion campaign that sufficiently manages to catch the consumer's attention on the related product often is a crucial determinant of a well selling release. Within its promotional activities a record company has got the primary goal is to make its productions heard among the public. Reason for this is the record companies' belief that the consumer predominantly needs the stimulus of hearing at least part of a record or a song in order to make a purchase.<sup>92</sup> Therefore, promotional activity within which recordings are not being made heard is of secondary importance. Advertising (both in general and in retail stores) and record reviews are examples of this kind of promotional activity which are often used. Examples of promotional activity that receives primary priority are airplay on the radio, television and in record stores, the possibility to listen to music for free in a (music) store and live performing. Moreover the use of streaming on the Internet is becoming increasingly important. A form of promotion that is not directly controlled by a record company but can be of (sometimes great) importance is word-of-mouth promotion. Certainly this is the case for the record companies that focuses on niche markets which are coherent with subcultures and specific genres, since this cohesion implies that there is a relatively intensive social interaction between the consumers within these markets.

Traditionally the marketing department of a record company prices records by making use of a suggested retail price, the Suggested Retail List Price (SRLP), at three levels. First, there is the price used for the so called front line products, which for a large part are relatively new releases of major artists. These recordings are connected with the highest SRLP. Second, there is the mid-price (coherent with mid-line products) which predominantly is used for products that have been on the market for a while (which are also referred to as catalogue products) and sometimes for new artists as well. Third, the lowest SRLP or budget price (coherent with budget line products) is predominantly used for recordings of artists whose popularity has decreased significantly and for the so called deep catalogue products, which are recordings that have been on the market for a longer period of time, compared to the products of the other two price levels.<sup>93</sup> Moreover, these suggested retail list prices are connected to three levels of wholesale prices as well. Nonetheless this does not mean that each retailer pays the same wholesale price for a particular recording, since record companies use a range of discount programs which a retailer can make use of. Characteristic for the recording industry is the fact that there is not much competition on the overall prices of the three SRLP levels. There is a tendency among record companies to mutually coordinate suggested retail prices, thereby ensuring some stability in an unusually tumultuous industry. Besides, to intensively compete on the SRLP of albums is not a fruitful occupation, since the offering of various forms of discount is the norm and because retailers in practice price records in context with their own goals. Instead there is a lot of movement of albums between the different SRLP categories. Most common is the movement down to a lower price level, but the opposite takes place as well.

The effect of pricing on consumer demand seems to be binary and somewhat contradictory at first sight, as it has been said that the demand for records is relatively price inelastic.<sup>94</sup> The latter statement is logical when it is put in perspective with the idea that there is a strong incentive for the consumer to buy the music of his/her choice, because of the high amount of cultural value it possesses for these individuals, which finds its reflection in the phenomenon that many consumers are fan of a certain artist, band and/or genre and in the existence of hit recordings. But if this is the case, one could reason, why then do the different SRLP levels exist and why are albums frequently moved from one category to another? After all, a price inelastic demand suggests that all record companies would be keen to keep all prices as high as possible. But it proves to be the case that whereas the price in frontline products is of a relatively lesser importance in context with consumer demand (of course this is the case within given boundaries), when mid-line and budget line products are concerned the price actually is an effective tool to stimulate sales.

Not surprisingly the amount of marginal utility a certain record inhibits for the consumer is of decisive importance in this matter. Therefore it can be said that in general a hit album or a new release of a band or artist with a solid fan base will sell substantial amounts in the frontline category under conditions of a relatively price inelastic demand, because the willingness to buy such an album is high among a (large) part of the consumers. (It should be noted though that, not in the least because of the fierce competition, record companies should be careful not to price themselves out of the market, even though records are thought of to be a highly differentiated product. Besides price increases should be approached carefully in context with the possibilities of unauthorized digital downloading, digital copying and buying used CDs.) Once sales are sufficiently declining a record company then may decide to move its product to a category with a lower SRLP, hoping that the record in combination with a reduced price will embody enough marginal utility for a new group of consumers to buy it. These may be, for example, persons who like an artist or band but are not fan enough to pay the price corresponding with the highest SRLP, persons who are replacing LPs and music cassettes for CDs or persons who simply do not have enough money to (frequently) buy frontline products. To the contrary there also are albums which are being sold as front line products for a long time, which may be an indication that the selling record company perceives and/or believes that there remains enough incentive among the consumers to buy the album at full price in order to maximize profits.

The foregoing makes clear that it is more accurate to state that the demand for recordings only is price inelastic under certain conditions and within certain limits. When the group of consumers with the highest incentive to buy a certain recording is concerned, the demand for this product indeed can be characterized as relatively price inelastic. These persons definitely want to possess a particular album of their choice and therefore they are not really concerned (within reasonable limits) about the price of this album. But to the contrary, for those consumers who have less incentive to buy a particular album price is of importance and thus the demand of this group of consumers should be characterized as price elastic. Besides, as stated before, the price inelastic demand is under serious pressure due to the digitalization. Illustrative is the fact that in 2003 Universal Music Group lowered its SRLP of front line products and the corresponding wholesale prices with the argument that with this price reduction they expected to pull the consumer back to the music stores (thus back from buying pirate recordings, copying and downloading) and thereby increase sales.<sup>95</sup>

It can be concluded that when used wisely the pricing of records at three price levels is an effective tool in order to maximize profits. Dependent on the estimated demand on the market and the costs made within the production process of a record the choice which particular price level brings along the best possibility to reach this goal must be made.

In order to be able to sell a recording in hard copy (the 'traditional' recording) it first must be physically distributed to a retailer.<sup>IV</sup> The current situation in the recording industry is that whereas the major record companies as part of an even larger music conglomerate have the disposal of their 'own' (international) distribution system, the relatively small independent record companies predominantly do not. And when it is possible for them to take care of the distribution of records internally this typically is only on a relatively small scale, meaning that in such a case the records at best can be distributed to a limited number of countries (but often only nationally) and to a limited number of retailers. That is why the independents in the ordinary course of events outsource the necessary distribution of their recordings by making use of independent distribution companies, or sometimes by making use of the distribution system connected to a major record company, the so called branch distributor. (Actually the latter option also increases the chance of its records to end up at a large retailer.) Even though independent distributors typically sell records to single record stores or to very small record store chains and branch distributors sometimes will sell records to very large individual record stores, often a one-stop is in between the independent distributor and the branch distributor at one side and the retailers at the other side.

Thus, a one-stop will buy records from both the independent and branch distributors and will try to sell these to any kind of retailer (though it may prove to be difficult to get the records of most independents, especially the smaller ones, into the large record stores and record store chains), but it should be noted that there are independent distributors that at the same time function as a one-stop as well. The foregoing implies that the independent distributors, the branch distributors and the one-stops function as wholesale distributors (with the exception of the situation where a branch distributor distributes records of the major record company to which it is linked), since they gather a multitude of recordings from different companies in order to sell these to different retailers.<sup>96</sup> Finally recordings may also be distributed by licensees, as for example sometimes is done with foreign distribution. The difference between a licensee and the discussed wholesale distributors is that the former is allowed to manufacture and distribute records, whereas the latter ones buy and sell the recordings that are manufactured by the record companies themselves.

Though fulfilling the necessity of the transportation of musical recordings from the record company to the consumer, the digital distribution of recordings is radically different from the way the distribution of hard copies traditionally (as described above) is organized within the recording industry.<sup>V</sup> As mentioned, a main and fundamental difference is that by making use of digital distribution the costly and logistically complicated physical distribution obviously is no longer necessary. In theory a record company now should be capable of delivering their digital music files directly to a download service which sells digital tracks to the consumer. In practice, however, this has proven to be difficult for many of the small independent record companies, as these services often have not been interested in dealing with each indie

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<sup>IV</sup> See figure 3 in the appendix for an overview of the distribution of hard copies.

<sup>V</sup> See figure 4 in the appendix for an overview of the distribution of soft copies.



separately, since the size and/or the genre of the independent's catalogue often did/does not provide the interest necessary for these companies to engage in a direct business relationship. Because of this, because of the occupations connected with the handling of the digital distribution internally (which imply a lot of extra investments in terms of working hours and money), and because of the fact that most independents are not able to handle the digital distribution in an effective and efficient manner themselves, the independents often make use of the services of wholesale distributors in connection with the sale of downloads as well, just as they do with regard to the sale of music on the traditional physical sound recording media.<sup>97</sup> These digital distributors, such as The Orchard and Vital PIAS Digital (VPD), which is part of the well-known PIAS Group, often do not solely distribute digital tracks but also provide other services, such as the necessary marketing activities and accounting. But at the same time and to the contrary the 'new digital intermediaries'<sup>98</sup> came into existence because many download services do not have the resources necessary to be able to sign and obtain licenses from a multitude of different independent record companies, even though in principle they have been interested in their recordings. By making use of digital distributors, it became viable for these services to also sell the music the independents have to offer.

Event though with regard to digital distribution it predominantly is necessary for the independent record companies to make use of these aggregators, this still is a big step forward for them compared to the way most indies have to physically distribute their products. It most certainly offers them the possibility of far more effective and efficient distribution, as now their products can truly be distributed and sold on a worldwide level without having to deal with numerous different parties. It is clear that from this perspective the independents generally benefit more from digital distribution than the majors do.<sup>99</sup>

Though retailing is an important phase between production and consumption (coherent with the function 'place' from the marketing mix) which must be fulfilled, record companies generally are not directly engaged in the retailing of their products besides the sale during live shows and at their home-page on the Internet.<sup>100</sup> But because of the importance that the retailing of recordings inhibits for a record company and because of the fact that record companies do try to have some influence on the retailing business in general and on record stores in particular, some attention to the retailing of recordings will be given here.

What makes the retailer particularly important for record companies is the fact that they embody the crucial last link between them and the consumer, as the retailer is the final stop in the distribution chain of a recording. In order to make it possible for a record company to earn a profit by producing recordings, they obviously first must be sold and it is the retailer who does just that. At the same time this implies that a retailer potentially can give a record company a last chance to influence the consumer at the place of purchase, which often takes place in the form of a retailer selling advertising space and selling in-store airplay, as mentioned before. In addition product placement within the record store is also a tool which can be used by a record company when trying to maximize sales. In practice this means that a record company may rent those particular spaces with high visibility and high consumer traffic from a retailer, so that its products have a more than average chance to be subject of an impulse purchase. But in order to influence in-store consumer purchases a record company must first make sure that its products actually are sold by a certain retailer. An important way to stimulate this necessity is to give the retailer the possibility to return

recordings that prove difficult to sell in the amount in which they were initially purchased. In fact, sometimes a record company will grant a certain retailer a 100-percent return privilege.

There are many different sorts of retailers that sell recordings. They differ in size and type of ownership, such as the small independent record store which is often specialized in a certain genre and is typically provided by an independent distributor and an independent one-stop, and the large retail chains with sometimes very large stores which are typically provided by a one-stop which is owned by the parent company of the retail chain. They use a physical place to sell recordings, as is the case with the 'traditional' record store in the street, or a non-physical place, such as mail-order businesses and online retailers do. Finally, they sell both hard and soft copies.<sup>101</sup>

#### **4.6 *The independent record company***

Record companies operate on a market that can be typified as an oligopoly. The term oligopoly can be defined as "a form of industry (market) structure characterized by a few dominant firms".<sup>102</sup> More precisely it can be said that the recording industry is in a tight oligopolistic state, meaning that within this industry four large firms together hold at least 60 percent of the market.<sup>103</sup> In fact, in 2005 the four largest record companies (Universal Music, EMI Music, Warner Music and Sony BMG Music Entertainment<sup>104</sup>) took account for 81.87 percent of this market.<sup>105</sup> Often these four largest record companies are referred to as 'the big four', just as prior to the merger between the music conglomerates Sony Music Entertainment and BMG (Bertelsmann Music Group) Entertainment in 2004 the five largest record companies often were called 'the big five'. In addition these largest record companies are regularly called 'the majors'. Both terms refer to the fact that these cooperations are very large compared to the other record companies which operate on the market.<sup>106</sup> Within this disjunction between the four largest record companies and 'the others', the latter are often named the independent record companies, or the 'independents' or 'indies' as they are called for short.

But even though there is little discussion about the practice to call the four largest record companies the majors (not to be confused with 'a major record company', which could refer to any large record company), there is not quite the same unanimity on the subject of what kind of record company should be seen as a 'true' independent.<sup>107</sup> An important reason for the disunity on this matter is the fact that the record companies who are not part of the big four are mutually strongly diversified. This diversification manifests itself in many areas, such as the size of the company, the kind of ownership, the music genre it focuses on, the way the independent distributes its records, the existence and nature of cooperation with a major and the forms in which this cooperation takes place, the way an independent is managed, the extent to which a commercial attitude exists, the level of professionalism, etc. Consequently there are people who think of a 'true' independent as a record company which is not part of the big four and in addition is distributed by an independent distributor as well.<sup>108</sup> Others may point at the music genre and state that a 'true' independent is occupied with the production of alternative music (leaving the difficulty of a precise definition of the term 'alternative music'). Another group of individuals may claim that a 'true' independent should not be occupied with the production of recordings with the goal to make profit by doing so, but merely for the sake

of art. Besides, one can be critical on the term 'independent' as such and within this context the question of what such a record company is independent from should be asked.<sup>109</sup> An obvious answer would be that it is independent from the majors, since it is not owned by them. An even more independent stance could be claimed when this indie does not need the major to distribute its records as well. But then again, to be independent from distribution by a large music conglomerate at the same time regularly implies to be dependent of another distributor and the same generally goes in context with the manufacturing of records. Another issue is the statement that an indie can make its artistic and commercial choices independent from a major, which of course is true. But also this independence is only limited since these choices still have to be made and any record company, both majors and independents, has to deal with the same economic laws as far as they are relevant for the recording industry. After all, not many persons are willing and/or able to make continuous deficits due to a passion for a certain type of music that proves to be difficult to sell on a profitable basis.

At the same time, however, it can be said that in general most independents share some distinct characteristics that set them apart from the majors. Of great importance is the different approach of the production and sale of recordings that both parties generally choose. Whereas the majors tend to focus on the sale of a large amount of a relatively low number of releases (in context with their market share),<sup>110</sup> the independents in general are able to make a profit by selling much less of a certain release, as the break-even point of their productions predominantly is much lower. The majors often invest high amounts of capital both in the production and in the marketing of a record, with the logical implication that a high number of this particular recording must be sold in order to break even. In other words, the majors often aim at the so called 'hit recording', which even implies that, because of the approach that they have chosen, the majors actually need a certain number of hit recordings in a year in order to stay in business, meaning that they cannot afford to have poor years in terms of recording sales to many times in a row.<sup>111</sup> Furthermore, the majors have to deal with relatively large overhead costs, which must be paid for by the sale of recordings as well. To the contrary most independents operate and produce with (compared to the majors) low production and marketing costs, while at the same time their overhead costs are small compared to those made by the majors.<sup>112</sup>

A factor that strengthens the possibility of an independent to make profit with relatively low sales numbers is the strong connection they often have with the market they serve. Many independents have got this connection because they are specialized in serving a particular niche market, which actually distinguishes them from the majors as well. (Even though it must be said that the majors have got labels that often also are focussed on niche markets.) The fact that many independents are an important part of the subculture attached to the niche market they serve, enables them to have a better view on the preferences of their potential customers than the majors most of the time have, which implies that for independents the notorious uncertainty of demand often is less dominantly present than is the case for the majors. It is this situation in combination with the possibility of independents to function with relatively low costs that generally results in a more positive success-failure rate of released productions than the rate with which the majors have to cope.

This unique position of the independents in context with subcultures and niche markets implies that they fulfil an important function within both the recording and the music industry.

For a sizable part it are the indies that provide the market with diversity and specialty music, meaning that they serve a large and diverse group of consumers that would not be served well without them, since the relatively small sales volumes which are implied by the consumers specific tastes are often not enough for one of the majors to consider to deal with. In line with this phenomenon it appears to be so that the independents often have been approached more positively (though not always rightly) in what has been written on the music/recording industry than has been the case with the majors, not in the least because a relatively large market share of the majors often has been said to result in a relatively low diversity of musical output.<sup>113</sup> Furthermore, because of their position the independents tend to function as important discoverers of new talent and new musical directions. In context with this there is often expressed criticism on the majors as well, stating that they treat independents as some sort of external A&R department, which in a way is true. When interested in artists signed by an indie of whom the majors think that they have commercial potential, they often make sure that these artists are incorporated with them in one way or another. Basically there are three ways to make sure this happens: the major can simply wait until the contract between the band or artist and the indie is fulfilled and then try to get the artist(s) signed, it can acquire the contract initially signed with the independent or it can buy the complete independent record company itself, as PolyGram did with Island Records, thereby incorporating U2.<sup>114</sup> But it must be said that at the same time there are many relations between independents and majors that are characterized by cooperation rather than incorporation, something which often proves to be beneficial for both sides. Within this cooperation the indies fulfil the necessary A&R activities by discovering and developing 'new' talent and by producing a recording on which this talent performs. When this is done they often sign (international) licensing and distribution deals with the majors, who then generally take care of the relevant marketing and distribution activities. Sometimes this cooperation even goes one step further as a major may finance part of the independent's A&R activities under certain fixed conditions.<sup>115</sup>

When a situation occurs in context with which it is needed to act swiftly, for example when the opportunity to sign new talent or a big name in (part of) the music business arises under circumstances where time is of essence, it are the independents who generally are better capable to do so than the majors are. An important reason for this is the fact that most indies have got a (sometimes very) flat organizational structure, whereas the majors can be characterized as large, bureaucratic organizations.<sup>116</sup> This essential difference in organizational structure implies that independents have got the capacity to communicate and to make choices relatively fast. The majors, however, need time to mobilize its unwieldy organization, not in the least because of the conservative and bureaucratic elements that are present. More in general the difference in organizational structure implies that indies simply are (much) more flexible than the majors are, meaning that from out this perspective they should be better capable to react to changes in the environment of the organization or at least be able to adjust to these changes sooner.

What can be seen as a typicality of most independents as well is their approachability and the relatively personal contact they maintain with their contracted artists. Even though it is a cliché and an exaggeration to state that the relation between indies and 'their' artists is built upon understanding, whereas the relation between the majors and the artists they have signed is characterized by a businesslike attitude, there certainly is an element of truth within this comparison. Most artists indeed have a less personal contact with one of the majors than

is the case with most indies. Again an important reason for this is the fact that independent record companies are relatively small: it is their company size that enables them to be approachable.<sup>117</sup> In addition, the size of the majors implies that they have a much higher number of artists under contract. Therefore most of their attention often goes to the 'big names', whereas many independents invest time and energy in their artists on a less unequal basis. Often indies have not contracted a star, but at least as important is the fact that in essence they do not have to, since they do not depend on hit recordings in order to make up for the losses made on many commercially unsuccessful releases, as the majors do.

Moreover, independents have got the reputation (not in the least among artists themselves) to accommodate their artists with a more thorough knowledge and understanding in context with the artistic side of their professional relationship and the musical genre the artists perform. An important factor that influences this phenomenon is the fact that the management and personnel of the indies often both are fan and connoisseurs of the musical genre their company specializes in. Of course this may be the case within the majors as well, but the flat organization structure of an independent gives the management of such a company a better possibility to act in accordance with these qualities, thereby granting their artists more artistic freedom than the A&R departments within the majors' labels often do and/or can. After all, as they are part of very large record companies there must be internally dealt with (and account must be given to) several levels of management, thereby increasing the chance of internal conflict due to different aims and opinions. (Even though this difference between independents and the majors in general can be said to exist, it should not be exaggerated. The labels the majors consist of most certainly have their amount of creative autonomy as well, since they for a large part function as relatively freestanding units occupied with A&R and marketing.) Besides the majors generally both want and need the artistic content of a production to have more commercial potential than independent record companies do. As mentioned, the independents can be profitable with (a lot) less sales numbers than the majors generally can. This means that they can invest in productions with artistic content (and be enthusiastic about this content), that will not be accepted by one of the majors because for them the commercial potential of the music is too little.

Important competitive advantages of the majors that distinguish them from the independents are connected with their size, their economic strength and their direct access to a large international distribution system.

Because of their economic strength the majors are able to work with much larger budgets than the indies usually can, which finds its reflection in basically every fundamental aspect of the management of these companies as well as in the production and marketing of their products. A good example of this phenomenon is the so called 'mega deal', a term which refers to exceptionally high multimillion-dollar advances a band or artist receives when signing a recording contract.<sup>118</sup> Also part of such an agreement may be unusual high royalties, possibly even 20% or more, of the total retail turnover.<sup>119</sup> These record deals only exist with respect to the biggest stars in the music industry and are simply out of reach of the independents because of, compared to the majors, their lack of economic power. This situation implies that the biggest selling artists tend to sign a contract with one of the majors and not with an independent. Another illustrative example is the mentioned practice of the majors to buy a contract initially signed with an independent or even a complete independent

record company in order to incorporate the desired artist(s). The majors can do this relatively easily because of their economic strength, whereas it tends to be rather difficult, if not impossible, for most independents in most situations.

The advantage of their economic strength also becomes particularly clear when the marketing of an album is taken into consideration. To promote an album massively and on an international scale by making use of a wide variety of promotional instruments is very expensive and no other record company but one of the majors is capable of doing this frequently. However, in order to sell a high number of a certain record, let alone when a hit-single is desired, intensive and large scale promotion regularly proves to be a crucial factor. For example, nowadays the availability of a well-produced and eye-catching music video often is a very important part of the promotion of a song, as well as the promotion of an album and the featured artist(s). But to produce such a video at a professional level is expensive.<sup>120</sup> In fact it is that expensive that most independents are not able to produce these videos at the standard the majors can and/or are not able to produce them frequently or even not at all. Another example is the possibility they have to make use of pluggers intensively and on a large scale, which is expensive as well and not possible for most independents.<sup>121</sup> (As is the practice of 'payola' on a large scale.<sup>122</sup>) As mentioned the primary goal of record promotion is to make it heard among the public. Therefore radio and television airplay (the latter predominantly on MTV-like television stations) remain of high importance nowadays and even though to make use of the Internet as a promotional tool is becoming increasingly relevant, for most record companies and record labels it still is not a patch on the importance of the former two types of promotion.<sup>123</sup>

The advantage the majors have because of their size and economic strength is obvious when promotion is considered in context with retail stores. Whether the sale of in-store advertising space, in-store airplay or highly visible shelf space exposed to high consumer traffic is concerned: the majors clearly have a competitive advantage with respect to the independents. Not only are they better capable of buying these promotional tools, but when desired they also are able to do this in the largest stores available and in a high number of stores (in traditional 'brick and mortar' stores as well as on the Internet) all over the world.

Because of their size and their focus on selling hit recordings, each major has got several stars and other well known artists under contract. This fact, in combination with a very large music catalogue and a well-functioning global distribution system which is at their disposal gives them the possibility to get their releases into the various retail stores relatively easily. Most retailers are eager to sell the hit recordings of the moment and records of big names in general. In addition, the size of their catalogues implies that they have a strong bargaining position and the clout to deal with the relevant major decision-makers frequently, efficiently and effectively. This gives the majors the opportunity to pressurize the retailers in order to sell their less well-known releases besides their hit recordings and to dedicate a considerable part of the store capacity to their products. But the same combination of factors also implies that the majors can use a more aggressive wholesale policy than the independents generally can. Not only are they better capable to use (bulk) discounts effectively, they also may combine a more attractive wholesale price with demands in favour of the major in context with the use of the available in-store space. A striking example of this is Universal Music, who in 2003 lowered its wholesale prices but at the same time discontinued most of its wholesale discount activities. Instead the major demanded that retailers buying at the new wholesale price level use at least 25 percent of their in-store retail space to Universal Music

products.<sup>124</sup> However, it should be noted that foregoing advantages should not solely be seen in context with products that have originally been produced by a major, but also with products that have been produced by an independent but that are distributed by a major. Therefore it can be said that recordings (meaning CDs/DVDs etc. originally produced by a major as well as by an independent) which are distributed by a major's branch distributor have better access to shelf space in retail stores than products which are distributed by independent distributors, especially when the very large 'mega-stores' and the large retail chains are concerned.

Finally, the majors are provided with outlets on a global scale because of their direct access to an internationally operating branch distributor. This is a luxury most independents have not got (obviously with exception of those whose products are distributed by a major's branch distributor), since international physical distribution is very labour and capital intensive and requires expertise which is different from the expertise needed to run a record company. Therefore most indies need to make use of (a lot of) different distributors for many different countries. In addition they tend to license their recordings to several other foreign independent record companies in order to get their records sold abroad.<sup>125</sup> It is clear that the majors, because of the mentioned factors, distribute their products in a more efficient and often in a more effective manner than most independent record companies both can and do. In this perspective, when possible, an international distribution and/or export licensing deal with one of the majors will certainly be a good option for an independent, as it has the potential to provide international distribution/sale without the complicated and time consuming procedure of negotiating deals with many different distribution and record companies.

#### **4.7 Concluding remarks**

Nowadays it are the record companies that fulfil a crucial and the most central role in the music industry. Not only are they the most important businesses in the recording industry, but they also are a driving force behind the publishing and live performing sector, since most of the money generated in these sectors must be seen in line with the production and marketing of (popular) recordings. In addition, record companies and music conglomerates have been investing interest in music publishing. The two core functions a record company can be said to fulfil are the production and marketing function. The typical artist and repertoire department and the marketing department mainly correspond with these functions. While facing a demand for recordings which is unusually uncertain, the A&R department should deliver a product to the marketing department with enough quality (approached from different perspectives, of which the dominance of each may vary) to be put on the market. Promotion is the all-important element in the marketing of a record. To achieve sufficient product awareness among the consumers often is crucial in order to release a recording successfully. As the market on which record companies operate is an oligopoly, there are a few huge firms, the so called majors, that take account for the lions share of the total sales on this market. To the contrary there is a multitude of relatively small record companies who are referred to as the independents or indies. Besides being huge and small, the majors and the indies in general have got some specific characteristics (implying both strengths and weaknesses) that set them apart from each other, though it should be noted that the extent in which these differences occur varies.



## 5 The Recording Industry, the Digitalization and Music Piracy

### 5.1 Digital technology

“The precondition for the entertainment revolution was the widespread use of digital technology. Until the mid-1980s, the dominant ways of storing and transmitting popular entertainment all relied upon ‘analog’ technology, in which information is stored or represented in the form of some continuously variable quantity: the shape of a record groove, voltage, the position of magnetic particles on a tape, and so on. One after another, each analog system has been or is being replaced with digital means of representing information, in which complex messages (such as the sounds emitted by an orchestra or the pattern of colors in an image) are represented by combinations of electronic pulses and the spaces left between them.”<sup>126</sup>

When the recording industry is looked at in context with the digitalization, there are a few popular and mutually compatible digital technologies in particular, and the possibilities implied by them because of their specific characteristics, that have had a major impact on this industry.

First of all, the existence and the enormous popularity of the Internet as a worldwide network of interconnected computers (which still has a huge growing potential) should be named in this respect. Not only is it a precondition for large scale online music piracy to exist because of its capability to be used to exchange digital files, as mentioned it also increasingly proves to be an important medium used for the distribution, marketing and retail of record companies’ products and for their A&R activities. In January 2007 countries which represent key music markets such as the U.S., Japan, the UK and Germany had an approximate Internet penetration rate of 69.6%, 67.1%, 62.3% and 61.3% respectively. This implies approximately 210 million, 86.3 million, 37.6 million and 50.6 million Internet users per country.<sup>127</sup> In June 2007 world regions such as Asia, Europe and North America had an approximate Internet penetration rate of 11% (however, with developed countries and regions as Japan, Hong Kong, Singapore, South Korea and Taiwan among the top 25 countries with the highest Internet penetration<sup>128</sup>), 39.4% and 69% respectively, implying approximately 409.4 million, 319.1 million and 231 million Internet users per world region. Besides, in the period 2000-2007 these world regions were subject of an approximate Internet usage growth of respectively 258.2%, 203.6% and 113.7%. Though world regions as Africa and the Middle East are running behind in context with Internet usage and Internet penetration (respectively only 2.9% and 1.7% of the world total and a penetration rate of approximately 3.6% and 10%), nonetheless they were subject of a strong usage growth (respectively a rate of approximately 640.3% and 491.4% in the period 2000-2007). And even though in 2007 the Internet penetration rate of the world in total is still only an approximate 17.2%, this does imply the enormous amount of approximately 1.133 billion Internet users.<sup>129</sup>

In addition, the introduction and growing use of modern broadband connections has increased the significance of the Internet in context with the recording industry furthermore. It

is this high data-transmission rate Internet connection (such as DSL, FTTP and cable modem) that made it possible to up- and download relatively large data files such as songs and music videos much faster than was the case with the 'old fashioned' dial-up modems. As in the early 2000s these broadband connections became increasingly popular in the developed countries in general, but also particularly in the countries that represent the most important music markets, for the recording industry the Internet had developed into a force to be reckoned with fast. The U.S. went from 4.5 broadband subscribers per 100 inhabitants in 2001 to 19.2 subscribers per 100 inhabitants in June 2006. For the UK, Japan and Germany this was respectively from 0.6 to 19.4, from 2.2 to 19.0 and from 2.3 to 15.1. The Netherlands, which represents a reasonably important music market<sup>130</sup> (especially when compared to its number of inhabitants), showed one of the strongest increases in broadband usage as it went from 3.8 subscribers per 100 inhabitants in 2001 to 28.8 subscribers per 100 inhabitants in June 2006.<sup>131</sup> For the record companies this increase in broadband usage clearly has two sides. At one hand, because of it the Internet can be used for the distribution of their products in a far more effective and efficient manner, thereby stimulating the sale of music downloads and giving way to the digital distribution and sale of 'large file products' such as music videos as well.<sup>132</sup> At the other hand, the heavily decreased up- and download times and the improved file quality made possible by the use of modern broadband technology are also at the disposal of those who for various reasons are not willing to financially compensate the record companies for the consumption of the content produced by them, which implies that broadband technology provides a major stimulus for activities referred to as online piracy.

Furthermore, of great importance is that digital technology made it possible to make identical copies of (sound) recordings. Whereas copying by making use of analogue recording devices such as (video) cassette recorders per definition results in recordings that are inferior to the original, when desirable copying by making use of computers and digital recording devices (such as primarily and most importantly CD/DVD duplicators and CD/DVD burners) will result in an identical recording. Moreover, by making use of this technology in theory an unlimited number of copies from copies can be made without the occurrence of any loss of sound and/or image quality compared to the original recording. When making use of analogue recording devices, however, this proves to be impossible. After a certain number of copies from copies the result will inevitably be a sound recording that is degraded to an unacceptable level of quality. Again, for the record companies the implication of these possibilities is two-sided. Not only do they stimulate the (large scale) copying of (original) recordings, but also the consumer can burn a purchased digital file of for example a song, an album or a music video on a physical sound carrier or copy it to a portable multimedia player without any loss of quality, which on its turn provides an important incentive for the consumer to purchase the record companies' products in digital format.

To conclude, an essential feature of digital technology in context with the recording industry is the possibility to compress digital sound recordings and the fact that this can be done by 'general-purpose' computers as they are used within common households. An album stored on a compact disc, for instance, often contains between six and seven hundred megabytes. This is a relatively large file, as are the files of the individual songs the album consists of. By compressing these digital music files they become much smaller and therefore more handy in use, making it easier to store a large amount of them (for example on the computer's hard disk or on a portable digital audio player) and less time consuming to up- and download them

on/from the Internet, which implies that distribution by making use of the Internet becomes more efficient. By far the most used audio compression standard is the MP3 format. This compression technology can reduce the original file of a song from a CD by a ratio of up to twelve to one.<sup>133</sup> Even though it must be said that the compression of digital music files inevitably reduces the sound quality, given the massive use of these files to most people this proves not to be of concern. Besides, audio compression technology continues to be developed and improved, meaning that the loss of sound quality can be increasingly minimized without compromising on the compression of the file itself. It are the benefits of the possibility to compress digital audio and video files that played a decisive role in the come about of the huge popularity of various types of portable digital media players, such as MP3 players, the various iPODs, music phones and 3G mobile phones. And on its turn this is an important stimulus for the sale of compatible products such as digital audio/video files and real tones.<sup>134</sup> Thus, there is a direct and fundamental linkage between the popularity of these devices and the existence of relatively new and additional revenue streams for record companies. At the same time, however, the discussed advantages of the usage of compressed digital files as well as the here mentioned popularity of portable digital media players are not just at the benefit of the record companies, as they also provide a major incentive for the up- and downloading of copyright protected content without permission of and/or compensating the relevant copyright holders.<sup>135</sup>

## ***5.2 The digitalization and music piracy***

“By the turn of the twenty-first century, the industry again faced a new technological challenge: the control of its recordings and compositions in a digital era. In 1999 Napster woke the industry from its dream about digital distribution of recordings for pay into the nightmare of digital distribution of millions of illegal copies for free. The industry began legal and technological battles to protect its works. Others began to predict the demise of the industry.”<sup>136</sup>

The Internet, digital copying technology and digital compression technology are mutually compatible technologies that are widely used and that are still growing in popularity around the world. It is because of the possibilities offered by them, their compatibility (as well as the compatibility of the relevant digital devices, such as computers, mobile phones and media players) and their huge popularity that made this combination of digital technologies (and in a less extend digital copying technology individually) a potential threat to the music industry in general and the recording industry in particular, especially when Internet access takes place by means of a broadband connection. The reason for this is that this technology has reshaped the existing music piracy as well as resulted in truly new forms, all of which could not have taken place without the discussed technology itself and thus was not an issue when analogue technology still was the norm.

In this respect, first physical piracy should be mentioned in context with the possibility to make identical copies from a recording and the possibility to make unlimited copies from copies without quality loss by making use of digital copying technology. Three main types of physical pirate recordings should be distinguished, namely counterfeit recordings (which are

sought to resemble the original), non-counterfeit pirate recordings (which are not sought to resemble the original and therefore of which the fact that they are pirated copies is more or less obvious to see) and bootleg recordings. However, it should be noted that the latter type plays a negligible role in (physical) music piracy with reference to the potential threat piracy poses to the recording industry. This is mainly because bootlegs consist of material (such as studio outtakes and live recordings) that has never been officially released by a record company, meaning that (if at all) they do not compete directly with legitimate recordings, because bootlegging and the search for/purchase of bootlegs must be seen as an underground activity in which a relatively low number of persons is involved and because bootlegs in principle are by far not as massively produced as the other two types of physical pirate recordings are.<sup>137</sup> In addition, though cassettes still are used substantially, the majority of physical pirate recordings nowadays consists of CD-Rs/DVD-Rs on which content is burned, but also pressed CDs/DVDs by making use of manufacturing lines exist in high numbers.

But whereas digital technology fundamentally changed the way in which physical piracy takes place, in the shape of online/Internet piracy the digitalization also brought about a totally new type of music piracy. It basically consists of digital content piracy by making use of download websites (such as the infamous Allofmp3.com and Mp3sparks.com), file sharing programs (such as Napster, LimeWire and KaZaA) that make use of peer-to-peer networks (such as eDonkey, FastTrack and Gnutella), file transfer protocol (FTP) sites and Internet relay chat (IRC) technology. Of these forms of Internet piracy the peer-to-peer networks have been most heavily discussed over the years. Important reasons for this are their huge popularity and therefore the dominance these networks have reached compared to the other forms of Internet piracy, the fact that these networks proved to be an incredible efficient and effective way to distribute and consume music (thereby offering a music library to the consumer with a huge variation), the obstinacy of their existence and the dichotomy between the music/recording industry (and certain artists) they have brought about. In context with Internet piracy the International Federation of the Phonographic Industry (IFPI) states that it is “the biggest single obstacle to the development of the digital music market” and that “the problem is as fast-changing as the distribution technologies behind it”, claiming that “today (meaning 2006) P2P networks provide the dominant source of online piracy” and that “the number of infringing music files on the Internet stands at just under one billion.”<sup>138</sup>

Finally, over the last years several other new types of music piracy making use of digital technology have emerged on a scale that makes it necessary to mention them here. It concerns ‘digital stream ripping’, Local Area Network (LAN) file-sharing and ‘mobile music piracy’. Digital stream ripping refers to the possibility to convert online music streaming into a stored file, quite similar (though not equal) to the recording of a radio broadcast on a tape as was common in the analogue era. LAN file-sharing refers to digital file swapping by making use of computers that are connected via a local area network. Mobile music piracy refers to the fact that mobile phones can be used for the sharing of digital music files, for example by using a Bluetooth connection or by swapping memory cards.

In the first six months of 1999 already almost 3 billion MP3 files were downloaded from the Internet without permission from the relevant copyright holders.<sup>139</sup> However, it soon became clear that this was only the beginning after in August 1999 the famous file sharing service Napster was introduced. Before the existence of Napster it proved to be rather difficult and

time consuming to find the wished for songs in MP3 format on the Internet. But its come about changed this fundamentally and drastically. All now had to be done was to log on to its central server and make a query for a song title. After that a connection with a providing computer could be established and the song could be downloaded. This new way of obtaining songs was globally embraced by millions. For example, it is estimated that the users of Napster downloaded 1.3 billion digital tracks in September 2000 alone and at its peak it had 1.5 million users simultaneously of whom on average each shared 220 files.<sup>140</sup> Before it stopped to exist in its original form the service is said to have had an approximate 70 million subscribers.<sup>141</sup> As could be expected, the activities Napster enabled met great resistance from the recording industry, the music publishing industry and some well-known artists. In December 1999 the Recording Industry Association of America (RIAA) filed suit against the file sharing service on behalf of 18 record companies (among which the majors as they existed in that year) and in July 2000 it was confronted with a preliminary injunction, which ordered the company to cease “facilitating others in copying, downloading, uploading, transmitting, or distributing plaintiffs’ copyrighted musical compositions and sound recordings.”<sup>142</sup> During the injunction process Napster was charged with “vicarious and contributory copyright infringement”, which implied that “the program itself did not infringe copyright but that it knowingly aided others in infringing.”<sup>143</sup> The core of Napster’s defence was the claim that in this case copyright was not violated because its users were making personal and non-commercial copies of songs, thereby referring to the important principle of ‘fair use’. This defence seemed to be well-founded, as in 1979 a similar case was decided in favour of Sony. After all, back then the U.S. Supreme court found this company not guilty of contributing to copyright infringement by the sale of VCRs, because the recording of broadcasted content from TV was seen as fair use and thus copyright was not infringed by doing so. The U.S. court, however, rejected Napster’s claim and stated that the “repeated and exploitive copying of copyrighted works, even if the copies are not offered for sale, may constitute a commercial use.”<sup>144</sup> Thus, Napster was founded guilty as charged as the court accepted the record companies’ rhetoric that the unauthorized downloading of MP3 files occurs “to save the expense of purchasing authorized copies” and therefore results in decreasing record sales.<sup>145</sup> In addition, in April 2000 Napster was also brought into court by the famous heavy metal band Metallica, which was later joined by the perhaps equally famous rapper Dr. Dre. The result was that it had to block the songs of these artists and remove more than 550.000 people who downloaded unauthorized copies of their music from its service. The decline of what is thought to fall under the notion of fair use clearly proves to be of great importance for record companies with respect to Internet piracy, as it seriously enforces the position of copyright holders in this matter. By the summer of 2001 Napster already was largely shut down, but its ultimate shut-down was on March 25, 2002.<sup>146</sup> In addition, because it was not able to reach a settlement with the record companies that was acceptable for both parties, the company filed for bankruptcy on June 3, 2002.

But as we all know, the end of Napster in its original form did not imply the end of Internet piracy at all. To the contrary, Napster basically cleared the way for the emergence of many newer file-sharing services (such as for example Morpheus, Grokster, LimeWire and KaZaA). Though, whereas in the case of Napster (using a centralized peer-to-peer network) it was necessary to log on to a central server in order to be able to download other users’ MP3 files, these newer types of file sharing programs use decentralized peer-to-peer networks. Because these networks do not make use of a central server, they are “much less vulnerable

to closure through judicial decree<sup>147</sup> and thus it is more difficult for the recording industry to combat them. After all, without a central server it is very difficult to track the users of a file sharing program or the files these users have shared and above this it obviously is not possible to destroy the peer-to-peer network used by such a file sharing program just by closing down a central server.

This overview of 'the rise and fall' of Napster makes the attitude of the recording industry in general towards unauthorized file sharing over the Internet, but certainly also towards music piracy in its totality, very clear. But even though success is reached from time to time with fighting piracy by means of jurisdiction<sup>148</sup> (whether it is actively involved by filing charges and/or pressurizing governments or not), it must be said that so far the recording industry has not been able to seriously reduce piracy by doing so.<sup>149</sup> Rather, when taking a positive stance, one could say that it helped to contain the phenomenon.

As distinct from the combat of the various forms of music piracy by means of jurisdiction the recording industry has also sought to counteract piracy by means of the technological protection of music content. Two terms should be explicitly mentioned in this respect, namely Digital Rights Management (DRM) and Copy Control Technology (CCT). In context with the recording industry DRM refers to technologies which aim to control and regulate the use and access of copyright protected soft copies. The appliance of these technologies has resulted in a lot of criticism, mainly because (in their current implementation) it seriously limits the consumer's freedom of usage of the purchased music in general and the possibilities to transfer this music between the relevant services and (portable) devices in particular. Nonetheless, the IFPI states that for the recording industry "DRM is the enabler of flexible music offerings" and that the current numerous limitations in the usage of purchased digital music files do not exist because of "DRM itself", but because of "the deployment by some technology companies of non-interoperable proprietary DRM systems."<sup>150</sup> Clearly, the claim postulated by the recording industry in general that Digital Rights Management is necessary in order to establish and maintain a healthy digital music business is debatable, even if the problems in context with the freedom of usage of digital music files get completely solved. And whether DRM effectively combats music piracy is difficult to measure but remains at least doubtful as well. After all, it is the case that for by far the largest part of purchasable music files the alternative to acquire an unauthorized copy exists and the usage of DRM has not changed this at all. Copy Control Technology refers to technology applied to physical recordings in order to prevent the copying and 'ripping' of content. However, nowadays Copy Control Technology has become out of use because it proved to be ineffective in reaching the intended goals. Besides, the consumer often experienced a variety of difficulties with the usage of recordings to which CCT is applied, causing a lot of tumult.

### **5.3 Music piracy and the recording industry**

“The music industry fights piracy because if it did not, the music industry would quite simply not exist. We have already seen our business” (meaning the recording business) “decimated by piracy in certain regions of the world. The music market of Latin America today” (meaning 2005) “is two fifths of what it was in 1997; the Asian market outside Japan has shrunk by almost half in the same period. Our industry” (meaning the recording industry) “is a risk business which depends totally on the protection of our core intellectual property – artist recordings.”<sup>151</sup>

As the above-mentioned quotation illustrates, the recording industry in general claims that it is threatened by piracy. More precisely, it tends to argue that the various forms of music piracy result in a loss of income for the industry and in decreasing recording sales (predominantly in the most significant music markets the latter is argued to be particularly because of the relatively new Internet piracy).<sup>152</sup> Clearly the way in which this claim is made explicit by the recording industry is often not as nuanced as it could (and as many of us think it should) be. The fact that there is ongoing debate about this claim, and that because of this it is subject to various (much welcome) adjustments and modifications, for an important part must be seen as a result from this lack of subtlety. However, it must be said that those who argue that the recording industry’s claim that (Internet) piracy has resulted/results in a decrease in sales lacks credibility often show a lack of subtlety in their argumentation as well.

As a reaction on the recording industry’s claim that physical piracy is costing it a lot of income often is said that recordings have always been copied since the (analogue) technology to do so came available and that this industry reacted back then in the same defensive manner as it does at present. And that despite the existence of these analogue recording devices the recording industry showed a healthy growth over the years. Furthermore, often is stated that the copying of recordings actually stimulates their sale as well, since by doing so music disseminates more thoroughly and rapidly, thereby in potential reaching new fans and consumers who want to own ‘the original’. But even though these statements are sensible and bring about a more balanced point of view, the fact remains that the copying of recordings changed fundamentally because of digital technology and so did physical piracy as well, which implies that for mentioned reasons a physical pirate recording created by making use of digital copying technology clearly is a closer substitute for the original than is the case when use is made of analogue copying technology. This fact strengthens the recording industry’s claim and shows that it cannot be brushed aside all too rashly. In addition, a distinction should be made between the copying of content from original recordings to a blank sound carrier as such and ‘commercial piracy’ by making use of physical recordings, which consists of the unauthorized copying of content and the subsequent illegal sale of the copies. It is the latter form of copying that is predominantly being mentioned by the recording industry with reference to the income it argues to lose because of physical piracy and of which the IFPI publishes data. However, this been said, the implications this organization assigns to this data indeed should be critically examined.

With reference to this form of commercial piracy the IFPI states that the estimated total value of physical pirate sales in the period 1999-2005 was respectively US\$4.1 billion, US\$4.2 billion, US\$4.3 billion, US\$4.6 billion, US\$4.5 billion, US\$4.6 billion and US\$4.5 billion.<sup>153</sup> In context with these estimates and during the above-mentioned period the organization points out in its publications that the estimated value is based on pirate prices, that the increase of the estimated total value has been contained by the decrease of the prices of physical pirate recordings and that because of this the actual losses suffered by the record companies should be estimated to be much greater.<sup>154</sup> Thus, even though not mentioning it explicitly, the latter statement implies that the IFPI thinks that the record companies' actual losses due to physical piracy should basically be estimated more or less in the region of the result of the multiplication of the authorized hard copies' average wholesale price by the number of physical pirate recordings sold.

But clearly, for two main reasons, this assumption is incorrect. First, a pirate recording is not a perfect substitute for an authorized recording, even though as mentioned it often has become a closer substitute because of the use of digital technology.<sup>155</sup> Furthermore, there are several types of physical pirate recordings which are produced in various formats (for example, counterfeit and non-counterfeit pirate products in CD/DVD/cassette format) and these may vary in quality between the different types and formats as well as between different products within the same category. Second, both common sense and economic theory suggest that the fact that pirate prices are below the retail prices of authorized recordings implies that more products will be sold at pirate prices than would be the case for the more expensive authorized products. Hence, what follows from the foregoing is that for the mentioned reasons the number of pirate recordings sold cannot directly be used as a reasonably precise indication for the number of authorized recordings that did not sell due to these pirate sales. Nor can, because of this fact, the number of pirate sales be used in the same direct manner to measure the record companies' loss of income because of these sales (though the IFPI implicitly mentions it should). And neither can the estimated total value of physical pirate sales be used as a precise measurement of this loss of income. What in theory would be a solution to these measurement difficulties is to make use of cross-elasticity of demand (% change in quantity of authorized recordings sold due to % change in pirate prices)<sup>156</sup>, since it can be used to estimate the extra demand for authorized recordings if both pirate and 'legal' prices would have been equal while at the same time taken into account the fact that these recordings and pirate recordings are not perfect substitutes for each other at all. And thus it could be used in order to estimate the record companies' loss of income as the result of physical pirate sales. In practice, however, because the 'ceteris paribus' (all other things being equal) condition must be taken into account in order to make the estimated impact of pirate sales on the sale of authorized recordings plausible, in this case the use of cross-elasticity of demand will prove to be inoperable and therefore unusable.

Still, the fact that it proves to be very difficult to precisely estimate the record companies' loss of income due to (commercial) physical piracy and that therefore the claims of the IFPI should be examined critically does not imply that this form of piracy does not harm the recording industry at all. It can be said that in general for the consumer the by far most important part of a physical recording is the musical content and it is exactly this part (but often also the appearance of the original, as is the case with counterfeiting) that is being reproduced and sold illegally on a large scale. To obtain the same musical content once more by buying (for a substantially higher price) an authorized recording will therefore often



prove not to provide the purchasers of the pirate recording with enough utility to do so. And as nowadays pirate recordings are mostly and increasingly sold in disc format (implying that identical digital copies are being made and sold), arguably this utility is at an all-time low. It thus can be concluded that it is reasonable to suggest that the large scale sale of physical pirate recordings results in a substantial loss of potential income for the record companies and in certain countries to some extent in a decline of music sales.

The recording industry saw a steep decline in both recording sales and income in the period 2001-2003. Moreover, though somewhat less significant, this decline already started in 2000 and the declining trend continued in the period 2004-2006.<sup>157</sup> For example, IFPI data suggest that the figures for the industry's total world sales of physical recordings (calculated as the total album equivalent<sup>158</sup>) were 2893.3 million in 1991, 3360.3 million in 1995 and 3508.2 million in 1999. Though 3342.9 million in 2000, 3171.8 million in 2001, 2935.7 million in 2002 and only 2782.6 million in 2003. With reference to these amounts the retail value (in current value) is reported to have been respectively US\$27476.2 million, US\$39717.3 million, US\$38671.2 million, US\$36887.5 million, US\$34800.9 million, US\$32562.7 million and US\$32375.2 million.<sup>159</sup>

The figures for the total U.S. sales of physical recordings were 865.7 million in 1990, 1112.7 million in 1995 and 1160.6 million in 1999. But 1079.2 million in 2000, 968.5 million in 2001, 859.7 million in 2002 and only 798.4 million in 2003. And the retail value (in current value) with reference to these amounts is reported to have been respectively US\$7541.1 million, US\$12320.3 million, US\$14584.7 million, US\$14323.7 million, US\$13740.9 million, US\$12614.2 million and US\$11854.4 million.<sup>160</sup>

To a large extent the recording industry sees music piracy in general, but particularly the Internet piracy which showed an explosive growth around the same period, as the cause for this decline. As could be expected this claim has received much criticism, among which that already mentioned in context with physical piracy. The criticism predominantly expressed with reference to Internet piracy mainly consists of the following arguments: First, that a worldwide fall of consumer expenditure as the result of a slow world economy is an important reason for the decline in the recording industry's sales and income (implying that since the record companies' products must be seen as luxury goods, these companies are among the first to notice the results of a sluggish world economy in their sales numbers). Second, that the consumer's disinterest in the majors' formulaic output and (in line with this argument) a lack of stars with mass appeal is another important reason for the decline. Third, that during the 1990s the sale of recordings has been boosted by the replacement of already purchased recordings in the format of cassettes and LPs by the same recordings in the CD format (known as catalogue replacement sales), and that the downturn of music sales since 2000 to an important extent has been the result of these replacements coming to an end.<sup>161</sup> Besides these three main arguments it is often argued that the youth's consumption pattern has changed, implying that this group of consumers nowadays tends to spend less money on recordings than it used to because often is chosen to purchase other luxury products like computer games, which in particular are said to compete with the record companies' products.<sup>162</sup> Since the youth traditionally has been a vital group of consumers for the recording industry, this new consumption pattern (or, in other words, the popularity of gaming) is said to be an important reason for the decline in recording sales.

Even though those who have been sceptical about the recording industry's claim that Internet piracy is an immediate and the most important cause for the decline in music sales have been rightfully critical on the fact that this industry directly connected these two phenomena with each other without truly taking other possible explanations into account, it must be said that much of the above-mentioned arguments either is outmoded or has not been plausible in the first place and that therefore these arguments should be refined as well.

In context with the first-mentioned argument it has become clear that, though it arguably should have had a certain influence, the state of the world economy in the first years of the third millennium in general has proven not to be a credible and satisfactory explanation for the sudden, strong and ongoing decline of the recording industry's music sales<sup>163</sup>, especially not in context with the relatively wealthy countries who at the same time represent the most important music markets.<sup>164</sup> If this was the case, than the sales numbers should have been rising back in the direction of the level they were on before their drop, as the world economy in general as well as the economies of the here mentioned wealthy nations have seriously been picking up over the last years. Or at the least some recovery should have been perceivable. But to the contrary, this did not happen at all. For instance, the figures for total world sales of physical recordings<sup>165</sup> were 2772.6 million in 2004 and 2364.8 million in 2005. With reference to the years in the period 2004-2006 the total retail value (in current value) is reported to have been respectively US\$33632.9 million, US\$33456 million (of which a reported 5% as the result of digital sales) and US\$31813 million (of which a reported 11% as the result of digital sales).<sup>166</sup> Furthermore, in the period 2004-2006 the figures for total U.S. sales of physical recordings were respectively 814.1 million, 748.7 million and 642.6 million. The retail value (in current value) of these sales is reported to have been respectively US\$12154.7 million, US\$11195.0 million and US\$9651.4 million. When the retail value of digital sales (in current value) is added up to these amounts we come to a total retail value of respectively US\$12338.1 million, US\$12269.5 million and US\$11510.2 million.<sup>167</sup> Foregoing data illustrate that the decline of the recording industry's income is partially countered by the sale of music in digital format, but nevertheless a distinct decline can still be observed. For example, the fact is that the recording industry's total sales of physical recordings of 2004 and 2005 are respectively 120.7 million and 528.5 million units below the amount of 1991, and that the retail values of the total world sales (thus including digital sales when relevant) of the years 2004, 2005 and 2006 are respectively an approximately US\$2.49 billion, US\$2.66 billion and US\$4.31 billion below that of 1994.<sup>168</sup> In addition, that U.S. total sales of physical recordings of 2004, 2005 and 2006 are respectively just 13.1 million units above the amount of 1991, 52.3 million units below the amount of 1991 and 158.4 million units below the amount of 1991. That the retail value of U.S. total sales of physical recordings added up by the retail value of U.S. total digital sales with reference to 2004 and 2005 are respectively just a bit above that of 1995 and below that of 1995 (namely US\$17.8 million and US\$50.8 million). And that the retail value of U.S. total sales of physical recordings and this value added up by the retail value of U.S. total digital sales with reference to 2006 are respectively well below that of 1993 and 1994 (namely US\$395.2 million and US\$557.8 million).<sup>169</sup> Finally, in his book 'Promises to Keep' (which was published in 2004) W.W. Fisher mentions, in line with what here has been substantiated, that "a recent study of the history of the music industry suggests that, over the past fifty years, sales of sound recordings and the overall state of the economy have not been positively correlated".<sup>170</sup>

Clearly the assumption that the fact that the majors' output often is rather formulaic (and that because of this there is and/or has been a lack of stars with appeal to the consumer) must be seen as an important cause of the strong decline of recording sales does not seem to be viable. It actually is highly doubtful if it is a cause at all. After all, it is not the case that this formulaic output suddenly came into existence in the 2000s. But to the contrary and for example, in the 1990s the so called 'boy bands' (such as Backstreet Boys, 'N Sync and Take That), all-female pop groups (such as Spice Girls) and 'eurodance' acts (such as 2 Unlimited) all saw huge popularity and were commercially very successful. And surely the groups within these categories often can be seen as icons of formulaic popular music (as are the mentioned examples). More in general it can be said that formulaic popular music to a certain degree has always been present in the music industry and that recordings within this category have often sold massively over the years. That a lack of stars with mass appeal is not an issue is plain to see when looking at the artists behind the best selling albums. For example, in 2000 among these were very big names such as Bon Jovi, Madonna, and U2, who already were big stars and commercially very successful in/throughout the 1980s and throughout the 1990s. But there also were relatively new stars among these artists such as Eminem (who is one of the best selling rappers of all time), Moby, Back Street Boys and Britney Spears, who also all had significant commercial success before the start of the third millennium (and of who the music performed by the latter two are good examples of formulaic pop). In 2001 among these were 'N Sync (another plain example of a group that performs formulaic pop) and Shaggy, both of who already had commercial success in the 1990s, but in particular Shaggy who had its first big hit (Oh Carolina) as early as 1993 and remained successful throughout the rest of this decade. Lastly, in 2004 among these artists were Usher, Eminem, Shania Twain, U2 and Guns N' Roses, and among the best selling artists of 2005 were names such as Green Day, Madonna and Mariah Carey. Again, all of these artists have been commercially very successful in/throughout the 1990s, while U2, Madonna and Guns N' Roses already sold millions of records in/throughout the 1980s.<sup>171</sup>

The argument that the catalogue replacement sales for the by far largest part had come to an end by the beginning of the third millennium and that this must be seen as an important reason for the decline of recording sales may prove to be viable to a certain degree, though at the same time to a large extent it may also prove to be not. Indeed global recording sales saw a strong growth during the first six years of the 1990s and after this (though U.S. sales already levelled off in 1994) remained fairly constant until the end of this decade. And surely an important cause for this growth initially were catalogue replacement sales. However, it is questionable if these replacement sales largely came to an end as late as round about 2001. Already in 1996 the chairman of the RIAA stated with reference to the U.S. market that "it is safe to say that, with rare exceptions, we have pretty much exhausted the catalogue-replacement business. What is selling now is what is being released now".<sup>172</sup> Of course this quotation does not make clear in what year the replacement sales predominantly have come to a halt, but it does illustrate that the opinions on this matter differ. What obviously is needed in order to gain more clarity is to find out exactly which part of the annual sales during the 1990s until now has consisted of catalogue replacement sales and which part has consisted of newly released material. Nonetheless there are important indications that the discussed decline of recording sales is not so much caused by the replacement sales coming to an end as is often alleged. During the 1990s not only album sales rose significantly, but also single sales saw substantial growth. And in line with the overall decline of recording sales, these

single sales have been seriously declining as well. World sales of physical singles are reported to have declined from 438.8 million units in 1999 to 232.5 million units in 2003, and U.S. sales of physical singles are reported to have declined from 75.4 million units in 1999 to 12.1 million units in 2003.<sup>173</sup> As singles are connected with newly released albums, foregoing implies that not only it is highly probable that during the 1990s total recording sales also (thus besides the catalogue replacement sales) rose because of a higher consumption of newly released products, but that it is most likely that an important reason for the discussed decline in recording sales is that newly released products on average began to sell relatively less as well. With reference to the here mentioned figures and statement it should be noted that even though single track downloads have proven to be the most popular digital format since the sale of digital recordings began, authorized digital music sales only just started to take off in the course of 2003 and because of this accounted for a very minor part of the total sales of that year.<sup>174</sup> Moreover, the here mentioned single track downloads are not necessarily the equivalent of a physical single, as these downloads basically can consist of any song available and thus are not necessarily linked to a new release. For these reasons it is not possible that the fast decline in physical single sales during the above-mentioned years is the result of a growing popularity of the authorized digital single. Further support for the notion that an important reason for the decline in recording sales is that new releases on average have sold less well (as opposed to the alleged coming to an end of catalogue replacement sales) can be found when the sales figures of the recording industry's top selling albums during the 2000s are taken into account. For example, despite the presence of records from big names such as Shaggy, 'N Sync, Linkin Park and Alicia Keys, in the U.S. the ten best selling albums from 2001 sold an approximate 40 million copies, compared to an approximate 60 million in 2000, implying a decline of approximately 33%.<sup>175</sup> And, despite the presence of albums from stars such as Green Day and Mariah Carey (who is by far one of the best selling artists of the 1990s), in the U.S. the five best selling albums from 2005 only sold approximately 19.7 million units, compared to an approximate 38 million with reference to the top five from 2000, thus implying a decline of almost 50%.<sup>176</sup>

A changing consumption pattern of the youth, in particular in favour of the computer game industry, to some extent indeed may be a cause of the discussed decline in recording sales. However, at the same time for two main reasons the importance of this alleged cause seems to be exaggerated. First of all, the youth's share of the total recordings consumption in the most important music markets appears to have become less significant throughout the 1990s until now. For example, when looking at the U.S. sales by age of consumers (expressed as a percentage of total dollar volume) it becomes clear that in 1990 the most important group of consumers still was under 25 years of age, as it was responsible for 42.4% of total sales. In this year the group of consumers of 40 years and older only accounted for 18.9% of the total. But in 1995 the share the former group had dropped to 40.4%, while the latter group had increased its importance to a share of 23.6%. In 2000 these groups respectively took account for 34.3% and 33.4%. And in 2002 the share of the under-25 group was 33.7%, while the 40-and-over group even surpassed this percentage with a share of 35.4% of total sales in that year.<sup>177</sup> It must be said that round about the start of the 2000s the decline of the importance of the youth as consumer group arguably has accelerated because of the practice of unauthorized downloading (and thus perhaps to some extent also because of the popularity of gaming). Nonetheless, due to the proportional increase of the ageing population this decline clearly has started years before these factors became an issue and as this

ageing continued, the decline because of this ageing continued as well after the here mentioned factors came into being. For instance, in 2004 the under-25 group and the 40-and-over group respectively took account for 30.5% and 37.3% of total U.S. sales, and in 2006 this was respectively 30.2% and 35.1%.<sup>178</sup> Second and perhaps more importantly, even though the phenomenon of gaming saw a strong growth in popularity during the same period that recording sales saw a steep decline<sup>179</sup>, one should be careful with (to a large extent) directly attributing this decline in recording sales to the popularity of gaming. After all, this statement would imply that after decades of relatively heavy music consumption since round about the year 2000 the youth suddenly and increasingly lost its interest in popular music and therefore chose to spend (most of) its budget formerly reserved for recording purchases on other products (and thus in particular on computer games) instead. This, however, surely is not the case as nowadays (popular) music generally plays an equal important role in youth culture(s) as it did before recording sales started to decline drastically. For example, the fact that portable digital music players (such as mp3 players and music phones) are tremendously popular among the youth and that the sale of these devices saw strong growth while recording sales declined both underlines and illustrates this.<sup>180</sup> In addition, this reasoning proves not to be particularly strong all the more so because computer games have been relatively popular among the youth during the 1990s as well. What appears to be more plausible is the notion that not the youth's consumption (per capita) of music in general, but rather its consumption (per capita) of legally sold music has decreased. This then would imply that recording sales do not/have not decline(d) because of the youth's changed consumption pattern as the result of its alleged disinterest in recordings and its increased interest in computer games, but that the youth's consumption pattern has partially changed (and could do so) because it can obtain its music virtually for free, in which case the latter (the obtainment of unauthorized copies of recordings) and not the former factor (the youth's changing consumption pattern) results/has resulted in declining recording sales. Clearly one should not confuse cause and effect in this matter. Foregoing argumentation is supported by the fact that it seems to be the case that the youth is the most active in the unauthorized downloading of music files.<sup>181</sup> For example, Geoffrey P. Hull states in his book 'The Recording Industry' (second edition, published in 2004) that "a survey done for NARM in 2002 found that over 70 percent of heavy downloaders were under 25 and that two-thirds of them were male; this had traditionally been the heaviest music buying audience".<sup>182</sup>

Since Internet piracy in general and unauthorized file-sharing in particular became an issue, those who argue that Internet piracy results in decreasing recording sales and those who argue that it does not (and sometimes state that it actually stimulates these sales) often have sought to enforce their claims by referring to research done to the relationship between unauthorized downloading and the consumption of recordings.<sup>183</sup> For example, in 2005 the IFPI reported that research done by Forrester Research in August 2004 showed that 36% of the participants said to buy less music as the result of unauthorized downloading, while 10% said to buy more and 54% said that their unauthorized downloading had no impact on their music purchases. Furthermore this organization states that "this result" (meaning the outcome of the conducted research which shows that unauthorized downloading harms recording sales) "has been confirmed repeatedly in the bulk of all respectable third-party research".<sup>184</sup> And in 2006 the IFPI reported that "research by IFPI/Jupiter in November 2005 among European Internet users found that more than one third (35%) of illegal file sharers are buying fewer CDs as a result of their downloading" and that "NPD research in the U.S.

among Internet users aged 13+ (NPD Digital Music Study, Dec. 2005) suggests that a quarter (26%) of the decline in CD units in 2005 was replaced by music consumption via illegal file-sharing".<sup>185</sup> But to the contrary, while arguing that the recording industry has unjustly claimed that unauthorized file-swapping and downloading harm recording sales and that therefore these acts are essentially different from home taping, Reebee Garofalo states in his article 'I want my MP3: who owns Internet music?' (published in 2003) that "a study conducted by the Norman Lear Center at USC in June 2000, in the wake of the Napster hearings, showed (...) that MP3 usage does not reduce students' CD consumption patterns" because "73 percent of students who download MP3s reported that they still bought either the same number of CDs or more".<sup>186</sup>

Nonetheless, even though this contradiction within the discourse about the influence of unauthorized downloading on the consumption of recordings clearly exists, it is argued that by far most of the relatively recent research published in scientific papers finds that to a certain degree recording sales indeed are harmed by unauthorized downloading.<sup>187</sup> For instance, in his paper 'The Impact of Digital File Sharing on the Music Industry: An Empirical Analysis' (published in 2006), Norbert J. Michel states that "music industry representatives argue that the practice" (meaning Internet file sharing) "decreases CD sales, while supporters of file-sharing allege the practice could actually increase sales. Using household-level data from the Consumer Expenditure Survey, we find support for the claim that file-sharing has decreased sales" and that these findings are "broadly consistent with recent research".<sup>188</sup> And Stan J. Liebowitz states in his working paper 'File Sharing: Creative Destruction or just Plain Destruction?' (published in December 2004) that "(...) there is strong evidence that the impact of file-sharing has been to bring significant harm to the recording industry" and that "this conclusion is not likely to have been a surprise to most anyone, prior to this topic becoming so highly politicized. (...) When given the choice of free copies versus purchased originals, a significant number of individuals who might have purchased originals will chose to substitute the free copy. It would be amazing if there were not a strong substitution effect".<sup>189</sup> Furthermore, in the abstract of the final version of this paper, as published in *The Journal of Law & Economics* in April 2006, is written that "although file sharing has been imperfectly and inconsistently measured, it nevertheless appears to reveal a fairly close linkage between changes in file sharing and changes in record sales. Explanations, other than file sharing, for the recent decline in record sales seem to have little or no support. Because economic theories of the impacts of copying hold out little hope for a benign impact of file sharing, these results should not be surprising. These findings reinforce the econometric results from most of an expanding literature".<sup>190</sup>

Hence, given what has been substantiated in the foregoing paragraphs and with reference to conducted research it can be argued that Internet piracy is very likely to be an important cause of the decline in recording sales which started round about the beginning of the third millennium. The fact that other factors to some extend may also have (had) a negative impact on the sale of recordings does not alter this conclusion, especially not because (as has been expounded) most of what has been brought up besides Internet piracy as reasons for the decline in recording sales should be modified and refined, or even appears not to be plausible at all.

#### **5.4 Concluding remarks**

The Internet, the making of identical copies of recordings by making use of digital copying technology and the compression of digital music files by making use of digital compression technology are phenomena that together and combined have seriously shaken up the recording industry. Not only have they provided this industry with various opportunities, but they also brought along new forms of music piracy, of which Internet piracy is the most important in this context. Moreover, digital copying technology fundamentally reshaped the way in which physical music piracy takes place. The recording industry in general claims that both physical and Internet piracy result in a major loss of potential income and in addition that the decline in recording sales that started round about the beginning of the third millennium is largely caused by Internet piracy, which boomed round about the same period as the decline set in. This claim has been heavily criticized and has been subject to several modifications. In addition, it proves to be very difficult to precisely measure the losses to the recording industry due to music piracy in terms of money and recording sales. Nonetheless, it is most likely that music piracy in general results in a substantial loss of the recording industry's income and that Internet piracy in particular brings/has brought significant harm to recording sales.

## 6 Research Results

In this chapter the results of the conducted research are presented. This is done by focussing on the subjects that proved to be core issues during the interviews. By doing so the information comes forward that provides answers to the central research question and the research sub-questions as they are stated in the introduction (chapter 1).

### *Unauthorized downloading*

“I would not call it a phenomenon, but rather a plague.” “Illegal downloading is theft, nothing more and nothing less. That is how I thought and still think about it.”<sup>191</sup>

As these quotations of two of the interviewees make clear, the attitude of the participating independents towards unauthorized downloading can predominantly be characterized as hostile. A deep-seated feeling of injustice proved to be present. Clearly unauthorized downloading was seen as an unlawful act: by doing so they felt that intellectual property rights, and thus also those owned by record companies, are being violated. In line with this argumentation the necessity for the legislator to act against copyright infringement has often been stressed.

At the same time, however, it has regularly been pointed out that unauthorized downloading/file-sharing may also have some promotional effect on the sale of physical recordings, implying that it was thought that the downloading of a track in some cases may result in the downloader's desire to own the 'original' physical recording. It should be noted though that this does not mean that they therefore felt that the act of unauthorized downloading is less wrong.

It has been stressed that the music industry in general has been presented as rich to the public for many years, and that in particular the majors and certain artists have created such an image for themselves (whether on purpose or not). This is said to have resulted in an attitude of indifference of the consumer towards unauthorized downloading.

An important insight is that most of the independents thought that their recording sales are not hurt by unauthorized downloading very much in a direct manner (meaning the unauthorized downloading of 'their' music) because they serve a particular niche market (or niche markets) that is connected to the specific musical genre (or genres) in which they are specialised. Examples of these genres are classical music, world music/ethnic music, hard rock/heavy metal, blues/blues rock, jazz etc. Many of them stated that the consumer they mainly serve is a typical 'music lover' who has an interest in the genre and artist(s) of his/her choice that is well above the average. Therefore, they said, this consumer generally wishes to own a complete and authentic physical recording, including a booklet with information, artwork, pictures etc. The age that this consumer was often said to have is also a factor of main importance that was brought forward. Since their consumer predominantly was said to be part of age groups which belong to the relatively high categories (for example 35+, 40+ and 50+ have been mentioned), it was believed that the unauthorized downloading of their



recordings is not an issue, simply because persons from these age groups were thought not or hardly to be involved in unauthorized downloading. In addition to and in combination with these two main factors (thus a consumer that is a music lover and the age of this consumer), the idea that their consumer is relatively wealthy has been brought up a few times as well as a reason for not to be involved in unauthorized downloading.

In contrast with the foregoing, it was generally thought that the youth (which appeared to imply teenagers or “the kids” as they were sometimes called and persons in their twenties) is mainly responsible for the total amount of unauthorized downloading and cohesively that therefore the market for mainstream popular music (the hits, top-40/chart music) is predominantly and most severely directly harmed by this phenomenon. After all, it was argued, it is this type of music that for the by far largest part is consumed by the youth. In addition, it was believed that the consumer of this music generally has a relatively weak bond with the concerning music genres and artists (as opposed to the discussed music lover as main consumer), a factor which was thought to increase the possibility of unauthorized downloading to take place. From this follows that the believe that the majors were/are mainly and mostly harmed by unauthorized downloading has clearly come forward during the conducted research. This is because the majors are by far the most active in the market for mainstream popular music in general and chart music in particular.

This connection that was thought to exist between unauthorized downloading, the youth and mainstream pop/chart music appears to be underlined by the research results concerning the only participating independent that primarily focuses on chart music and young persons. This interviewee expressed that he felt that (whereas the others focussing on the discussed niche markets predominantly did not) his sales are significantly harmed by the unauthorized downloading of his music. He estimated the typical consumer of his independent to be in an age group of 13-20 years, saying in context with unauthorized downloading that these teenagers “all have their mutual networks. That is just how it is.” Moreover he indeed brought forward that he thought that this unauthorized downloading was relatively persistent because his artists do not have a loyal fan base.

Even though most participants made clear that they felt not to be harmed very much by unauthorized downloading in a direct manner, many of them did feel that this phenomenon has caused/causes them damage in an indirect way. They pointed out that because unauthorized downloading is a main cause for the decrease in recording sales it has brought significant damage to the recording industry and the music business in its totality, with the result that the market for recorded music is and has been under serious pressure. Because of this situation many retailers have closed down. In this respect, the closing down of retailers that are specialised in one or a few specific genres was regretted in particular, as these proved to be valued greatly by the independents because they are thought to be a vital outlet for their products. (This is because they are said to fulfil a central role in their niche markets.) The increasing popularity of online retailers of physical recordings was thought to encounter this development only partially. In addition it proved to be the case that retailers are (much) less willing to run any risk and therefore often either put less of the independents' products on their shelves or are not interested in their products at all. Foregoing implies that they believed that unauthorized downloading has resulted in less relevant outlet possibilities for their products and that this on its turn has a negative impact on their recording sales.

The research revealed that some worries exist about the way part of the consumers perceive recorded music. Because it can be downloaded from the Internet without

compensation to the copyright holders it is feared that recordings are and increasingly will be seen as a commodity that can be obtained for free, especially by the youth. It was wondered if this attitude will change as the youth grows older.

### ***Fysical piracy and home copying***

Fysical piracy and home copying by making use of CD/DVD burners have not been as intensively discussed during the interviews as has been the case with unauthorized downloading. When fysical piracy was mentioned, however, it was seen as a substantial problem for the recording industry in general but also for the concerning record company. It appears to be the case that home copying in itself (thus when taking place separate from unauthorized downloading) was not perceived as a main issue. Perhaps this must be seen in line with what has been discussed in connection with the niche markets of most participating companies. Only one single interviewee mentioned that when a group of individuals visits one of its artists' concerts, he feels that often just one of them purchases a CD which later is copied at home and handed out to the rest of the group.

### ***Recording sales***

"Nobody sells that 11 million copies from the Offspring anymore, not even a major." "Before, when you released an album you would sell 2 or 3 thousand units without doing anything. Nowadays you really need to work hard to even sell a thousand copies."

Most of the independents said that their average recording sales have significantly decreased since round about the millennium. In spite of the fact that Internet piracy exploded round about the same period, for above-mentioned reasons most of the interviewees did not see unauthorized downloading as a major direct but rather as an important indirect cause of these decreasing sales. But two other main reasons of importance for the overall decline of sales in the recording industry have regularly been pointed out as well. Moreover, these causes have been said to have/have had a substantial direct and indirect negative impact on the sale of their own products. First of all, in this respect a changed consumption pattern of the consumer has been mentioned, in particular with reference to the youth. The consumer was thought to spend substantially less money on recordings than used to be the case a decade or so ago. For example, the youth was often said to prefer to purchase products such as mobile phones (which was said to result in expenses for the usage of this device as well) and computer games. Second, the coming to an end of the catalogue replacement sales has been brought forward as a major point of concern.

It also has been said that in an attempt to increase sales the majors have lowered their suggested retail prices of their fysical recordings massively, and that in addition they move their recordings to a lower price category (thus for example from the highest to the mid-price category) much faster than used to be the case. For the independents this proves to be a harmful situation: in order to be able to get their products in the record stores to a certain

extend they need to follow the majors in these actions. After all, the majors are the market leaders as their sales make up for the by far largest part of the market. But for the independents this implies that their margins get thinner: what it basically comes down to is that they feel that the majors are spoiling the market for them.

### ***New productions***

“We have put half of the ten to fifteen pop bands who we wanted to make famous out of the door; did not renew contracts, did not sign any new things; have acted very carefully. But particularly in the area of pop music.”

The conducted research has made clear that because of the circumstances in the recording industry the independents often were much more cautious to invest in new productions/new talent than was the case before the recording sales started to decline. And when the decision was made to start a new production the break-even point was often estimated to be at a lower amount of units sold, implying that the budgets of both production and marketing were adjusted in line with this estimate.

Another issue that came forward during the interviews was that unauthorized downloading indirectly may potentially provide opportunities for the independents as well. As the majors are harmed relatively heavily by this phenomenon, they tend to sign much less artists of interest than used to be the case. Moreover, they also make sure their pool of contracted artists becomes smaller. This implies that independents may be able to increase their market share and/or sign relatively big names that otherwise would have been contracted by a major.

### ***Additional sources of income***

“You have to make sure that a package of rights is attained (...) a few independents have done this very well, and we have also done it quite all right.”

Another way in which several independents showed to deal with the difficult circumstances on the market for recordings is by seeking income out of other sources than solely the sale of recordings. These sources must be seen in relation with the core activities of a record company, namely artist/product development and the marketing/promotion of artist and recordings. The primary objective appears to be to attain income related to publishing. But also income generation related to artist management activities by the record company and the attainment of a percentage of the artist's live performing and merchandise income were mentioned. The concerning interviewees felt that it is fair to share in the here mentioned sources of income, because they invest a lot of money and effort in the career building and promotion of an artist with a substantial risk not to recover these investments. And these sources of income, they argued, are for an important part the fruits of their investments.

### ***Digital distribution***

“How good can it be, if you are able to turn illegal downloading into legal downloading.” “It is developing quickly, it is a very positive story if you are able to make money out of it.”

As these quotations indicate the general attitude of the independents towards the distribution and sale of digital recordings is rather positive. The biggest advantages implied by digital distribution via the Internet that were continuously mentioned are the possibility of worldwide distribution, that when used the manufacturing of a physical product is no longer necessary and that a stock of physical products becomes superfluous (which on its turn implies no storage costs and no overstock that does not sell). In cohesion with these benefits it was pointed out that digital distribution therefore has the potential to result in clear cost advantages.

However, for the time being most of the independents' sales numbers of digital recordings have been very low or even negligible compared to their sale of physical recordings and many of the participants were still orientating themselves on the market for downloads. Only one company which focuses on dance music showed a truly substantial amount of (monthly growing) turnover as the result of the sale of various kinds of digital formats. Moreover, many of the interviewees strongly believed that physical products are valued much more by their customers than digital formats are. All this implies that as long as the production and distribution of their physical products remains the norm, digital distribution will be of only minor importance and therefore the theoretical benefits of digital distribution will not (truly) be experienced in practice.

Many of the independents experienced difficulties with respect to the making available of their content in the digital format. Problems that were brought forward concerned the digitalization of their catalogue in the exact way the downloadstores demanded, the labour intensive administration connected to the digital distribution, the reliability of necessary companies such as aggregators and downloadstores and the possibility to sell their content by making use of downloadstores, something which often proved not to be feasible without calling in intermediating companies in the like of aggregators.

### ***The Internet as marketing tool***

On the average the Internet was seen as a marketing tool with a lot of potential in the areas of direct marketing and promotion. It was said to make it possible to target promotional efforts relatively precisely on the relevant groups of consumer. Some of the interviewees thought that the Internet has the potential to make promotion more effective and efficient just because of this. On the other hand and to the contrary, however, for many of the independents the Internet was just an extra way to reach their customer, instead of largely replacing the more traditional forms of media (such as for example radio, press, television etc.). Some of the independents who brought up the latter point of view thought that for them marketing has/will become more expensive, as more different marketing channels should be used: “more opportunities, more costs”.

***Future expectations***

Though concerns were expressed in context with unauthorized downloading and the overall situation of the recording industry, on the average the independents were quite positive with regard to their future perspectives. They made clear that they are relatively flexible organizations, well capable of anticipating on (market) developments. What appears to be an important factor is that they are used to the making of profit with the sale of relatively low amounts of recordings, something which under the current market conditions often proves to be vital. In addition, they showed to believe in the products they produce. It was often put forward that the quality of the produced content is of essence and that this is not altered by the late developments in the recording industry.

## 7 Conclusion

With respect to the feasibility of the research it was not possible to draw a random sample out of the pool of available independent record companies. After all, the success of the to be conducted research depended highly on the goodwill of the approached companies. This implies that the group of participants cannot be said to be scientifically representative. Therefore, one should be careful with generalizing the research results in context with other independents than the ones that participated in this particular research. In addition, the presented results consist of what proved to be important issues and opinions as they have been brought forward by the largest part of the participants and/or on which there appeared to be consensus. So also within the group the conducted research has focussed on opinions can be found that deviate from what has been presented. Nonetheless, there most certainly are some conclusive and eye catching indications, which will be presented here.

- Most of the independents have experienced a decrease in recording sales since round about the millennium.

- The genre in which an independent record company is specialised appears to play a decisive role in context with the amount of harm that is perceived because of unauthorized downloading. Those companies that felt to have a 'music lover' as main consumer did not think that their recording sales have decreased because of unauthorized downloading. This consumer, they reckon, prefers to own the authentic physical recording.

- Because of their focus on niche markets the specialized record store is valued greatly by most independents. The fact that retailers in general and this type of retailer in particular disappear is a major point of concern to them. They feel that the decrease of relevant record stores as the result of the current bad condition of the general music market is a main reason for the declining recording sales they have experienced themselves.

- Unauthorized downloading is seen as a major cause for the overall decrease of recording sales and therefore for the disappearing of (specialised) retailers as well. But certainly it was not seen as the only major cause, as the coming to an end of catalogue replacement sales and a changing consumption pattern of the consumer have been repeatedly and explicitly put forward as well.

- Because the independents' recording sales have been decreasing they are much more careful with respect to investments in new productions and the signing of new artists. It is sought to estimate the break-even point at a relatively low number of units sold. In addition, there appears to be a trend among the independents to seek income out of sources such as publishing, live performing of their artists, merchandise and artist management activities.

- Predominantly digital distribution was seen as an efficient and effective way to distribute their content worldwide. Furthermore it was thought that clear cost advantages can be achieved by doing so. But to the contrary, most of the independents sold very little products in the digital format. It appears to be the case that their consumer values hard copies over soft copies. Foregoing again seems to be connected with the niche markets they focus on.
- Though the Internet was generally believed to be a valuable tool for marketing activities, the medium appears not (yet) to have taken over the more traditional media. It predominantly was treated as an extra marketing channel. And even though marketing by making use of the Internet was often thought to be potentially of high effectiveness, in most cases it did not appear to result in substantial cost benefits.
- Even though substantial worries were expressed regarding the overall state of the recording industry, the independents were confident to stay in business. The possession of content of good quality is and will remain to be of main importance to them. When this content is paired up with their flexible attitude and their capacity to make profit with relatively low sales numbers, they feel that a positive stance regarding their future position in the recording industry is justified.
- It proves to be the case that in order to gain a more penetrating insight in the topic of research the independents should be selected by genre, as much of their perceptions in context with this topic seem to be connected with the genre of their choice and cohesively with the niche market they are active in.

## Appendix

**Table 1.** *Total world sales of physical recordings for the period 1991-1999.*

\* Values are in current value.

\* Total retail value is calculated as the total retail value of net unit shipments.

\* The amount of total units is calculated as the 'total album equivalent', meaning that three singles are counted as one album.

\* Figures are in millions.

	<b>Total Units</b>	<b>Total Retail Value (US\$)</b>
<b>1991</b>	2,893.3	27,476.2
<b>1992</b>	2,953.6	29,464.1
<b>1993</b>	3,045.5	31,158.0
<b>1994</b>	3,317.8	36,124.0
<b>1995</b>	3,360.3	39,717.3
<b>1996</b>	3,526.9	39,812.0
<b>1997</b>	3,488.2	38,532.6
<b>1998</b>	3,463.1	38,262.3
<b>1999</b>	3,508.2	38,671.2

For data see IFPI (2001), *The Recording Industry In Numbers 2001*, page 17.



**Table 2.** *Total world sales of physical recordings for the period 2000-2005.*

\* Total value is calculated as the total retail value of net unit shipments.

\* The amount of total units is calculated as the 'total album equivalent', meaning that three singles are counted as one album.

\* Figures are in millions (when relevant).

	<b>Total Units</b>	<b>Total Retail Value (US\$, variable)</b>	<b>Total Retail Value (US\$, fixed)</b>	<b>Annual Unit Change</b>
<b>2000</b>	3,342.9	36,887.5	39,716.4	-2.8%
<b>2001</b>	3,171.8	34,800.9	39,318.0	-5.2%
<b>2002</b>	2,935.7	32,562.7	36,788.4	-9.0%
<b>2003</b>	2,782.6	32,375.2	34,107.5	-6.6%
<b>2004</b>	2,772.6	33,632.9	33,632.9	-0.4%
<b>2005</b>	2,364.8	31,600.7		

For data see IFPI (2005), *The Recording Industry In Numbers 2005*, page 14 and IFPI (2006), world sales 2005 retail data.

**Table 3.** *Trade and retail value of total world sales of recordings (physical and digital) for the period 2005-2006.*

\* Values are in current value.

\* Total trade value is calculated as the trade value of total net physical unit shipments added up by the trade value of total digital recording sales.

\* Total retail value is calculated as the retail value of total net physical unit shipments added up by the retail value of total digital recording sales.

	<b>Total Trade Value</b>			<b>Total Retail Value</b>
	<b>US\$ (in millions)</b>	<b>Annual Change</b>	<b>% Digital</b>	<b>US\$ (in millions)</b>
<b>2005</b>	20,795	-3%	5%	33,456
<b>2006</b>	19,587	-5%	11%	31,813

For data see IFPI (2006), Digital formats continue to drive the global music market, page 4 and IFPI (2007), Music Market Data 2006, page 1.

**Table 4.** Total U.S. sales of physical recordings for the period 1990-1999.

(source: RIAA, The Recording Industry Association of America's 1999 Yearend Statistics, <http://www.riaa.com/news/marketingdata/facts.asp>. Accessed at 9-8-2006.)

- \* Values are in current value.
- \* Total value is calculated as the total retail value of net shipments.
- \* Figures are in millions.

	1990	1991	1992	1993	1994	1995	1996	1997	1998	% CHANGE 1997-1998	1999	% CHANGE 1998-1999
(Units Shipped) <sup>1</sup>	289.5	333.3	407.5	495.4	662.1	722.9	778.9	753.1	847.0	12.5%	858.9	10.8%
(Dollar Value)	3,451.6	4,337.7	5,336.5	6,511.4	8,464.5	9,377.4	9,934.7	9,915.1	11,416.0	15.1%	12,816.3	12.3%
CD Single	1.1	5.7	7.3	7.8	9.3	21.5	43.2	66.7	56.0	-16.0%	55.9	-0.1%
	6.0	35.1	45.1	45.8	56.1	110.9	184.1	272.7	213.2	-21.8%	222.4	4.3%
Cassette	442.2	360.1	306.4	339.5	345.4	272.6	225.3	172.6	158.5	-8.2%	123.6	-22.0%
	3,472.4	3,019.6	3,116.3	2,915.8	2,978.4	2,303.6	1,905.3	1,522.7	1,419.9	-6.8%	1,061.6	-25.2%
Cassette Single	67.4	69.0	84.5	85.6	81.1	70.7	59.9	42.2	25.4	-37.4%	14.2	-46.0%
	257.9	230.4	289.8	288.5	274.9	236.3	189.3	133.5	84.4	-28.3%	46.0	-49.2%
LP/EP	11.7	4.8	2.3	1.2	1.9	2.2	2.9	2.7	3.4	25.9%	2.9	-14.0%
	86.5	29.4	13.5	10.6	17.8	25.1	36.8	33.3	34.0	2.1%	31.8	-6.7%
Vinyl Single	27.6	22.0	19.8	15.1	11.7	10.2	10.1	7.5	5.4	-28.0%	5.3	-2.5%
	84.4	63.9	66.4	51.2	47.2	46.7	47.5	35.6	25.7	-27.8%	27.9	8.4%
Music Video	9.2	8.1	7.6	11.0	11.2	12.6	16.9	16.6	27.2	46.2%	19.8	-28.3%
	172.3	118.1	157.4	213.3	231.1	220.3	236.1	323.9	506.0	58.6%	376.7	-27.6%
*DVD	-	-	-	-	-	-	-	-	0.5	+	2.5	405%
	-	-	-	-	-	-	-	-	12.2	*	66.3	442%
Total Units	865.7	801.0	895.5	955.6	1,122.7	1,112.7	1,137.2	1,053.4	1,124.3	5.7%	1,160.6	3.2%
Total Value	7,541.1	7,834.2	9,024.0	10,046.6	12,068.0	12,320.3	12,533.8	12,236.8	13,723.5	12.1%	14,584.5	6.3%
Total Retail Units							833.9	817.5	850.0	4.0%	869.7	2.3%
Total Retail Value							10,768.0	10,785.8	12,165.4	12.8%	13,046.0	7.3%

<sup>1</sup>While broken out for this chart, DVD Audio Product is included in the Music Video totals

**Table 5. (See next page)**

*Total U.S. sales of recordings for the period 1996-2006.*

(source: RIAA, 2006 Year-End Shipment Statistics, <http://www.riaa.com/keystatistics.php>. Accessed at 16-7-2007.)

\* Values are in current value.

\* Total value is calculated as the total retail value of net shipments.

\* Figures are in millions.

Manufacturers' Unit Shipments and Retail Dollar Value  
(In Millions, net after returns)

Physical

	1996	1997	1998	1999	2000	2001	2002	% CHANGE 2001-2002	2003	% CHANGE 2002-2003	2004	% CHANGE 2003-2004	2005	% CHANGE 2004-2005	2006	% CHANGE 2005-2006
(Units Shipped)	775.9	753.1	847.0	938.9	942.5	881.9	803.3	-8.9%	746.0	-7.1%	767.0	2.8%	705.4	-8.0%	614.9	-12.8%
(Dollar Value)	9,934.7	9,915.1	11,416.0	12,816.3	13,214.5	12,909.4	12,044.1	-6.7%	11,232.9	-6.7%	11,446.5	1.9%	10,520.2	-8.1%	9,162.9	-12.8%
Music Video <sup>2</sup>	16.9	18.6	27.2	19.8	18.2	17.7	14.7	-17.2%	19.9	35.2%	32.8	65.0%	33.8	3.2%	23.1	-31.8%
Other (Albums) <sup>3</sup>	228.2	175.3	161.9	126.5	78.2	47.6	33.3	-30.0%	20.5	-38.4%	7.7	-62.3%	4.4	-42.7%	1.7	-61.6%
Other (Singles) <sup>4</sup>	1,942.1	1,556.0	1,453.9	1,093.4	653.7	396.8	238.8	-39.8%	164.2	-31.2%	66.1	-59.8%	48.5	-26.7%	22.1	-54.5%
	113.2	116.4	87.8	75.4	40.3	21.3	8.4	-60.6%	12.1	43.9%	6.6	-45.0%	5.0	-24.4%	2.9	-41.4%
	420.9	441.8	333.3	296.3	173.6	105.5	42.9	-59.3%	57.4	33.9%	34.9	-39.3%	24.2	-30.6%	15.4	-36.3%
Total Units	1137.2	1063.4	1123.9	1160.6	1079.2	968.5	869.7	-11.2%	798.4	-7.1%	814.1	2.0%	748.7	-8.0%	642.6	-14.2%
Total Value	12,533.8	12,236.8	13,711.2	14,584.7	14,323.7	13,740.9	12,614.2	-8.2%	11,854.4	-6.0%	12,154.7	2.8%	11,195.0	-7.9%	9,651.4	-13.8%
Total Retail Units	850.0	869.7	850.0	869.7	788.6	733.1	675.7	-7.8%	658.2	-2.8%	687.0	4.4%	634.8	-7.6%	553.2	-12.8%
Total Retail Value	12,165.4	13,048.0	12,705.0	12,388.8	11,549.0	11,549.0	11,053.4	-6.8%	11,053.4	-4.3%	11,423.0	3.3%	10,477.5	-8.3%	9,052.5	-13.8%

Digital

Download Single	-	-	-	-	-	-	-	-	-	-	139.4	N/A	366.9	163.3%	596.4	59.8%
Download Album	-	-	-	-	-	-	-	-	-	-	136.0	N/A	363.3	163.3%	580.6	59.8%
Kiosk <sup>5</sup>	-	-	-	-	-	-	-	-	-	-	4.6	N/A	13.6	198.5%	27.6	103.3%
Music Video	-	-	-	-	-	-	-	-	-	-	45.5	N/A	135.7	198.5%	275.9	103.3%
	-	-	-	-	-	-	-	-	-	-	-	-	0.7	N/A	1.4	89.5%
	-	-	-	-	-	-	-	-	-	-	-	-	1.0	N/A	1.9	96.2%
	-	-	-	-	-	-	-	-	-	-	-	-	3.7	N/A	9.9	434.3%
	-	-	-	-	-	-	-	-	-	-	-	-	3.7	N/A	19.7	434.2%
Total Units	-	-	-	-	-	-	-	-	-	-	143.9	N/A	383.1	166.2%	625.3	63.2%
Total Value	-	-	-	-	-	-	-	-	-	-	183.4	N/A	503.6	174.5%	878.0	74.4%
Mobile <sup>6</sup>	-	-	-	-	-	-	-	-	-	-	-	-	170.0	N/A	315.3	85.5%
Subscription <sup>7</sup>	-	-	-	-	-	-	-	-	-	-	-	-	421.6	N/A	774.5	83.7%
	-	-	-	-	-	-	-	-	-	-	-	-	1.3	N/A	1.7	27.6%
	-	-	-	-	-	-	-	-	-	-	-	-	149.2	N/A	206.2	38.2%

Total Digital & Physical

Total Units <sup>8</sup>	1,137.2	1,063.4	1,123.9	1,160.6	1,079.2	968.5	869.7	-11.2%	798.4	-7.1%	958.0	20.0%	1,301.8	35.9%	1,593.2	21.6%
Total Value	12,533.8	12,236.8	13,711.2	14,584.7	14,323.7	13,740.9	12,614.2	-8.2%	11,854.4	-6.0%	12,338.1	4.1%	12,269.5	-0.6%	11,510.2	-6.2%

Retail value is value of shipments at recommended or estimated list price

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<sup>1</sup> Includes Dual Disc

<sup>2</sup> Includes DVD Video

<sup>3</sup> Includes Cassette, LP/EP, DVD Audio, and SACD

<sup>4</sup> Includes CD Single, Cassette Single, and Vinyl Single

<sup>5</sup> Includes Singles and Albums

<sup>6</sup> Includes Master Ringtones, Ringbacks, Music Videos, Full Length Downloads, and Other Mobile

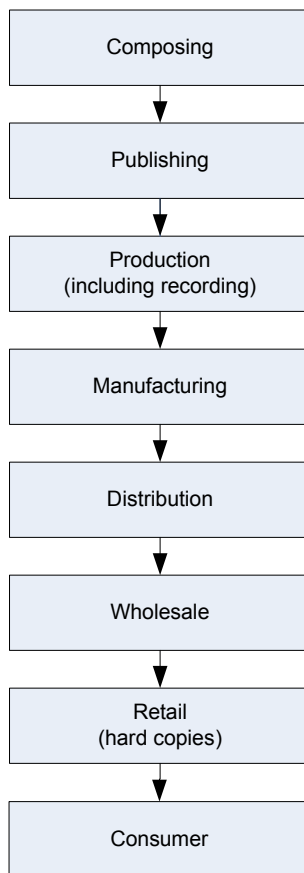
<sup>7</sup> Weighted Annual Average

<sup>8</sup> Units total includes both albums and singles, and does not include subscriptions. If digital singles counted as only 1/10th of an album, units in 2006 were 8.6% greater than 2005

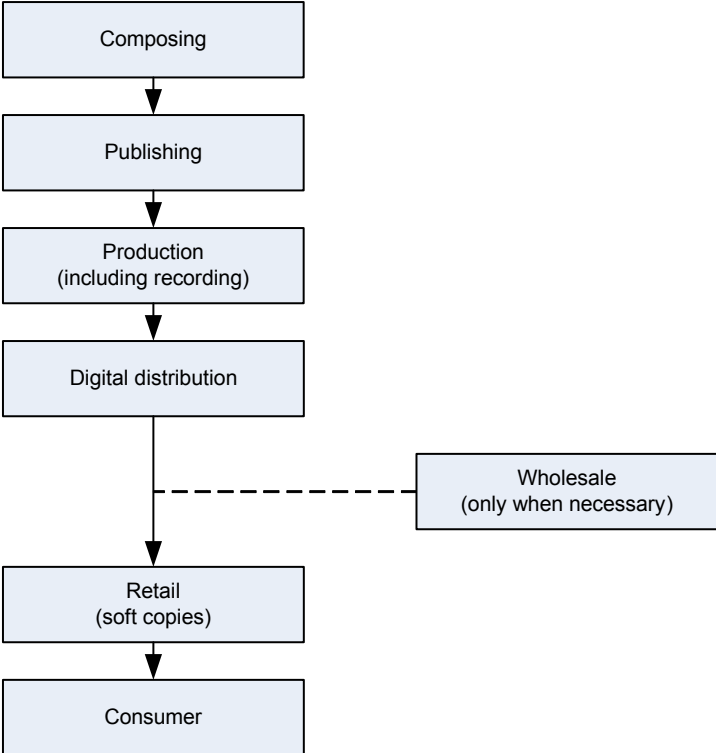
**Table 6.** *The record companies and persons that participated in the research.*

<b>Record Company</b>	<b>Participant/Position</b>	<b>Website</b>
Armada Music	Maykel Piron (Managing Director/Joint Owner)	www.armadamusic.com
Basta	Jeroen van der Schaaf (Managing Director)	www.basta.nl
Challenge Records International	Anne de Jong (Managing Director/Owner)	www.challenge.nl
CoraZong Records	Bert de Ruiter (Managing Director/Joint Owner)	www.corazong.com
Digidance	Cees van der Zwan (Content & Promotion Manager)	www.digidance.cc
Epitaph Records/Epitaph Europe	Hein van der Ree (Managing Director)	www.epitaph.com
Flow Records	Marcel Albers (Managing Director/Joint Owner)	www.flowrecords.nl
Mascot-Provogue	Ed van Zijl (Managing Director)	www.mascot-provogue.com
Music & Words	Liesbeth Puts and Hans Peters (Managing Directors/Joint Owners)	www.musicwords.nl
N.E.W.S/N.E.W.S. Records Nederland	Geert De Blaere (General Manager)	www.news.be
NRGY Music	Tom Peters (Managing Director/Owner)	www.nrgymusic.nl
Pan Records	Bernard Kleikamp (Managing Director/Owner)	
Pentatone Music	Giel Bessels (Managing Director), Dirk van Dijk (General Manager), Job Maarse (Artistic Director)	www.pentatonemusic.com
Play It Again Sam/PIAS Nederland	Daan Reestman (New Media Manager)	www.pias.com, www.pias.nl
Red Bullet Productions	Willem van Kooten (Managing Director/Owner)	www.redbullet.nl
Roadrunner International	Wally van Middendorp (Vice President Marketing and Acquisitions)	www.roadrunnerrecords.com
Skarster Music Investment	Jos Boerland (Managing Director/Owner)	www.skarstermusic.com
VAN Records Company	Henk Willemsen (General Manager)	

**Figure 1.** *An overview of the value chain of a physical recording.*

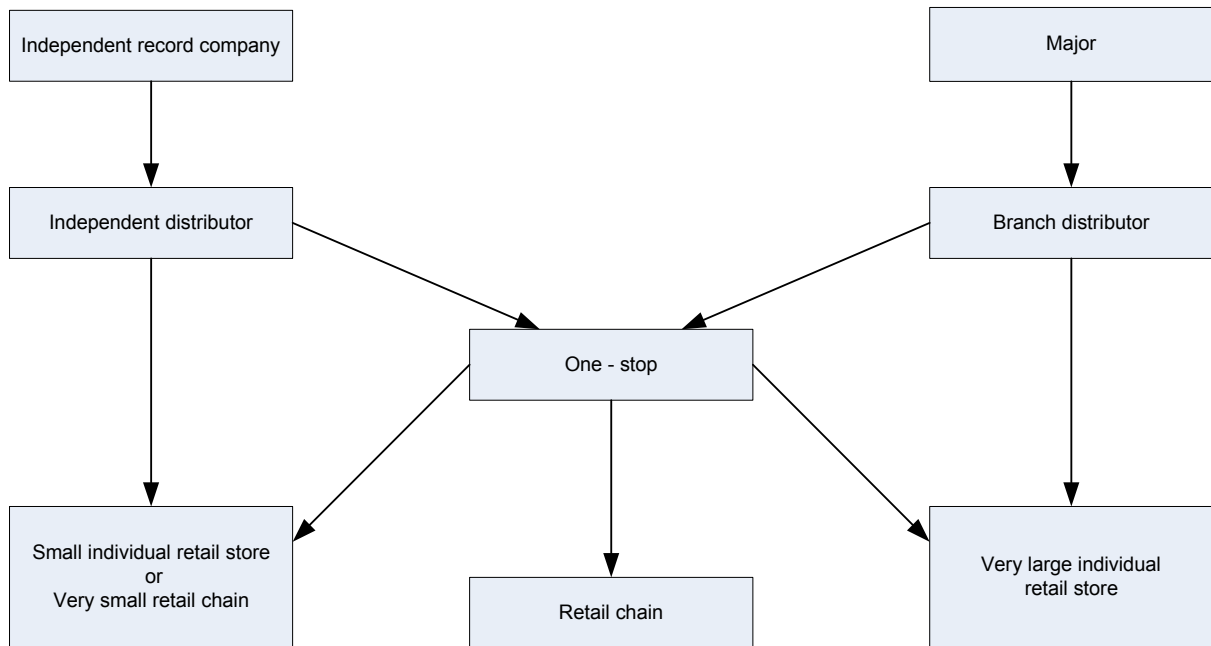


**Figure 2.** *An overview of the value chain of a digital recording.*





**Figure 3.** *An overview of the distribution of hard copies.*



\* An one-stop may also be an in-house one-stop from a retail chain.

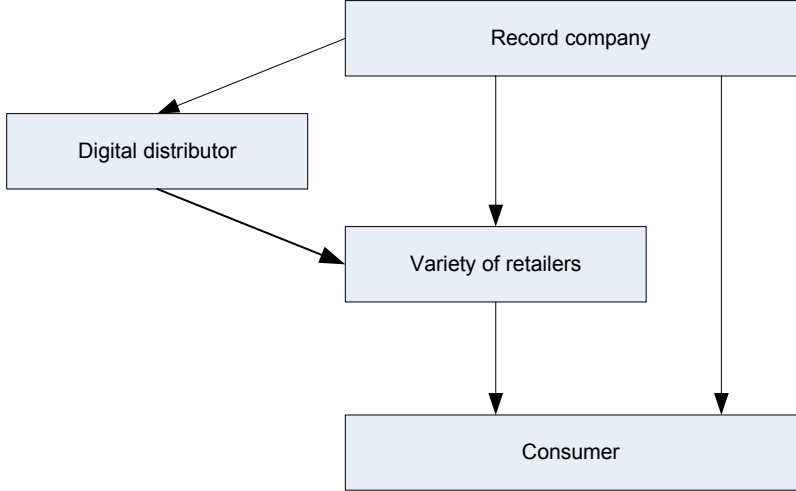
\* An independent distributor may also function as an one-stop.

\* A branch distributor may also distribute products from independents.

\* Some record companies may additionally sell and distribute their physical products directly to the consumer.

\* This outline is derived from the outline as published by G.P. Hull. See Hull (2004), 192.

**Figure 4.** *An overview of the distribution of soft copies.*



## Notes

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<sup>1</sup> The term ‘digitalization’ can be defined in several ways. One is to state that it is the process in which analogue data is turned into digital data. However, within this thesis the term is used to indicate a phenomenon that must be seen in a social/human context. Therefore this thesis is written with the following definition as background: “Digitalization refers to the integration of digital technologies (i.e. information and communication technologies) into the everyday lives of people (...)” This definition is derived from the definition as used on the website of The Berkman Center for Internet & Society at Harvard Law School.

See <http://cyber.law.harvard.edu/readinessguide/glossary.html>, accessed at 17-4-2007.

In addition and in line with the above-mentioned, ‘the digitalization’ can be defined as ‘the widespread use of digital technology.’ This definition of the digitalization will be used within this thesis.

<sup>2</sup> The term ‘downloading’ refers to the transmission of data and files over a network of interconnected computers (such as the Internet) to a user’s appliance (such as a computer or mobile phone) which has access to this network, followed by the storage of these data or files on the appliance (or on a data storage device which is connected with the receiving appliance). The term ‘uploading’ refers to a transfer in the other direction.

<sup>3</sup> The term ‘peer-to-peer network’ refers to a situation where two or more computers are connected and share data or files. Though it is sometimes argued that Napster did not use a ‘true’ peer-to-peer network because it used a central server.

<sup>4</sup> On April 9, 2007 Apple made public that it has sold its 100 millionth iPod since it was introduced in November 2001. This would imply that the iPod is “the fastest selling music player in history”, as the company proudly announced in a statement on Monday the 9<sup>th</sup> of April, 2007.

<sup>5</sup> The Internet can basically be defined as a worldwide network of interconnected computers.

<sup>6</sup> Please note that the term ‘piracy’ (or ‘music piracy’) is rather loaded and disputed, as it is frequently used by various actors within the music industry (such as record companies, branch organizations and artists) in context with criminal activities and theft. Often the statements made by these parties (on purpose) are not as nuanced as they could be (and as many of us think they should be). In addition, a wide variety of scale and commerciality of unauthorised copying is referred to by this single term, which easily may result in a rather over-simplified representation of occurrences. Nonetheless, the term is standard and most commonly used, and therefore it will be used throughout this thesis as well. Piracy can appropriately be defined as a “value-laden label given to activities which involve the unauthorised reproduction of copyrighted material.” As stated by L. Marshall. See Marshall (2005), 190. Thus, physical piracy refers to this act in context with physical products. Internet or online piracy then can be defined as “the act of making available, transmitting or copying someone else’s work over the Internet without permission”. As defined in IFPI (2005), Digital Music Report 2005, 18.

<sup>7</sup> The International Federation of the Phonographic Industry (IFPI) estimates that the value of the worldwide sale of pirated music recordings has increased from approximately US\$2.1 billion in 1995 to over US\$4.2 billion in 2000. Especially in (south-east) Asia and Russia this proves to be a serious and persistent problem. Estimates suggest that in China 90% and in Russia 65% of all sales were pirate recordings. See Hull (2004), 10.

The IFPI states that an estimated 37% of all music CDs purchased in 2005 were pirate, which implies approximately 1.2 billion pirate recordings in total. Furthermore the organization states that in 2005 pirate recording sales outnumbered legitimate sales in 30 markets. See IFPI (2006), The Recording Industry Piracy Report 2006, 4.

Illustrative is the fact that in the first week of April 2007 the United States announced it will take legal action against China in order to make the latter country act against this kind of piracy more intensively. The U.S. claims to lose over US\$2 billion due to the large scale sale of pirated copies of music, films and software originally produced by U.S. companies. For example, see [www.CNN.com](http://www.CNN.com),

<http://www.cnn.com/2007/POLITICS/04/08/china.trade/index.html>, 9-4-2007. Accessed at 16-4-2007.

<sup>8</sup> A record company can broadly be defined as an organization which employs artists in order to make recordings that they hope to market and sell to the public. “They usually sign the artist to a recording contract promising to pay the artist a royalty for recordings sold in return for the artist’s promise to record exclusively for that particular label.” As stated by G.P. Hull. See Hull (2004), 22. For more information on the record company see chapter 4 ‘The record company’.

<sup>9</sup> Within this thesis independent record companies are defined as those record companies who are not owned by one of the majors. For more information on the independent record company and for a discussion of the essential differences between the majors and the independents see chapter 4 ‘The record company’, section 4.6 ‘The independent record company’.

<sup>10</sup> Only one independent record company that was not affiliated with the NVPI participated in the research, namely Roadrunner International. Indirectly the chance was offered to interview a member of the management of this company. Since Roadrunner International for many years had been (and at that time still was in context with the criterion used in this thesis) a prominent independent this opportunity was gladly taken.

<sup>11</sup> These were Challenge Records International, CoraZong Records, VAN Records Company, Armada Music, Music & Words, Pan Records, NRGY Music, Pentatone Music, Flow Records, Skarster Music Investment, Basta, Roadrunner International, Epitaph Europe (this a branch of Epitaph Records) and Digidence.

<sup>12</sup> As stated by B. Byrne. See Byrne (2004), 182.

<sup>13</sup> Examples of these are (un)authorized downloading, digital distribution, production, the Internet as marketing tool, retailing, record sales, type of niche market etc.

<sup>14</sup> These were N.E.W.S. Records Nederland (this is a branch of N.E.W.S.), Mascot-Provogue and Red Bullet Productions.

<sup>15</sup> This interview was with Willem van Kooten, who is the director and owner of Red Bullet Productions.

<sup>16</sup> This was Play It Again Sam.

<sup>17</sup> See Seale (2004), 314.

<sup>18</sup> Towse (2003), 170.

<sup>19</sup> For example see Caves (2000).

<sup>20</sup> Illustrative is that in 2000, 4892 singles were released in the UK, but only 926 of them featured in the weekly Top 100 charts, which is a percentage of 19%. See Burke (2003), 323.

<sup>21</sup> Estimates suggest that about 80% of albums and 85% of singles do not cover the costs that were made to produce them. See Caves (2000), 61. However, these estimates seem to be more accurately in context with the majors, than is the case in context with the independents.

<sup>22</sup> Often stated is a generalizing success-failure rate of 20%-80% (meaning that 20% of a record company's productions breaks even and 80% does not). However, this division is much more applicable to the majors than it is to the independents, which productions in general prove to break even more often. It is illustrative that this fact has frequently been emphasized by the interviewees that participated in the research for this thesis. See also chapter 5.

<sup>23</sup> For example see Towse (2003), 172.

<sup>24</sup> For instance see Caves (2000), Towse (2003).

<sup>25</sup> Towse (2003), 172.

<sup>26</sup> Doyle (2002), 13.

<sup>27</sup> Burke (2003), 323.

<sup>28</sup> Doyle (2002), 5. Stretton (2000), 370-375.

<sup>29</sup> Illustrative is the fact that the by far most of the interviewed managers/managing directors/owners of independent record companies were (enthusiastic) fan of the genre in which their record company is specialised. Besides this, because of the independents' typical (sometimes very) flat organizational structure there is relatively equal and personal contact with the artists who are signed. At the same time this flat organizational structure makes philanthropically orientated behavior (although never completely philanthropic) more possible than the relatively large, slow and bureaucratic organizations of the majors do.

<sup>30</sup> For example see Doyle (2002) and Stretton (2000).

<sup>31</sup> A record company's catalogue is the total collection of sound recordings in which it owns the copyrights or in which it has exclusive licenses.

<sup>32</sup> For insights on the subject of cultural value see Zolberg (1990), Klamer (ed) (1996), Klamer (2002) and Abbing (2002), for instance.

<sup>33</sup> Several interviewees explicitly mentioned cases where a choice for a production and release was made because the product was valued greatly by the management (and because it was seen as a welcome supplement/addition to the company's catalogue), even though at the same time either the commercial success of such a production was highly doubtful or it was even quite sure that the break-even point would never be reached.

<sup>34</sup> As stated by N. van Lingen. Own translation. See Van Lingen (2002), 15. It should be noted that even though the copyright is initially granted to the original author, it can (partially) be assigned to another party.

<sup>35</sup> Frith / Marshall (2004), 6.

<sup>36</sup> Van Lingen (2002), 25, 49.

<sup>37</sup> Van Lingen (2002), 75.

<sup>38</sup> Frith / Marshall (2004), 9.

<sup>39</sup> Please note that in copyright terms 'producer' refers to the company or individual responsible for the production of the recording and not to the individual who basically manages the recording process of a record.

<sup>40</sup> The master recording is the original recording that has been made in the studio. This is the recording from which the copies are made that are sold to the consumer.

<sup>41</sup> Performance rights “relate to the rights of the songwriter and the record producer to gain a fee whenever their composition or sound recording is played in public (...)”. As stated by L. Marshall. See Marshall (2005), 113.

<sup>42</sup> For example see Australian Copyright Council (2005), Intellectual Property and Information Technology Update, <http://www.ipit-update.com/perform.htm>, accessed at 7-6-2007 and Frith / Marshall (2004), 9.

<sup>43</sup> As stated by Shapiro / Varian. See Shapiro / Varian (1999), 83.

<sup>44</sup> Two distinct ‘main business models’ making use of soft copies can basically be distinguished, namely: 1) Pay-per-download services. These popular download services enable the consumer to own a copy of a certain recording (whether a single track or an album) by downloading it. 2) Subscription services. These services make use of interactive streaming, implying that for a monthly fee subscribers have access to a very large collection of music and when desired they often also can download the recordings offered to them as music streaming. However, on their turn these two main models can be divided into various business models as well, as they make use of different products (such as single tracks, digital albums and music videos), different ways of digital distribution (via the Internet to a computer or wireless transmission to a mobile phone) and different distribution channels (for instance use can be made of a digital distributor and /or a download store or a record company can deliver its content directly to the consumer).

<sup>45</sup> For example, R.G. Picard points out that of the total costs for a ‘normally’ (as stated by R.G. Picard) priced physical CD recording (it appears that he actually refers to a CD album) 8% is said to be manufacturing costs and 20% is said to be distribution costs. See Picard (2002), 58.

<sup>46</sup> Hull (2004), 259.

<sup>47</sup> Hull (2004), 177-178.

<sup>48</sup> Please note that the possibilities of cost reductions in this example are in context with the production and distribution of musical recordings in digital format, and not with the aforementioned digital recording equipment.

<sup>49</sup> Picard (2002), 58. Fisher (2004), 19.

<sup>50</sup> An IFPI/M-Lab survey shows that 42% of the respondents named the lower retail price of soft copies compared to hard copies as a reason for them to start buying music online. A Nielsen/Net Ratings survey in the UK shows that 39% of the respondents named the price of soft copies as a reason for them to purchase music online. See IFPI (2007), Digital Music Report 2007, 14, 15.

<sup>51</sup> In this context the term ‘youth’ should be seen in line with the way it is commonly used, namely referring to the period in a person’s life that is roughly in between childhood and adulthood.

<sup>52</sup> In context with popular music, which is the primary content produced by the record companies, it can be said that “the heaviest consumers have traditionally been fifteen to twenty-four years old”. As stated in Hull (2004), 18-19.

<sup>53</sup> For example, the OECD states that the youth often prefers to spend its money on computer games instead of records. See ‘Downloaden niet oorzaak’, Het Parool, 14-6-2005.

Based upon information provided by a consumer survey conducted by Jupiter Research/IPSOS, the IFPI claims that one in three P2P-network users buys less music. In addition the organization states that the heaviest impact is in the 15-34 year age group. See IFPI (2006), Digital Music Report 2006, 21.

See Hull (2004), 8-10.

<sup>54</sup> In this context (and in the context in which the term is used throughout this thesis) the term ‘streaming’ refers to “the transmission over the Internet of a digital copy of an audio or video recording, which is then played but not stored.” As defined by W.W. Fisher, in Fisher (2004), 17. In addition, ‘interactive streaming’ and ‘noninteractive’ streaming can be distinguished. The former refers to a situation where the transmission takes place at the request of the recipient (as for example is the case with the music subscription services), whereas the latter refers to a situation where the recipient cannot choose what file is to be transmitted. See Fisher (2004), 17.

<sup>55</sup> For instance see IFPI (2004), Online Music Report 2004, 7, 9. IFPI (2005), Digital Music Report 2005, 8-9. IFPI (2006), Digital Music Report 2006, 7, 10-12. IFPI (2007), Digital Music Report 2007, 9-10, 15.

<sup>56</sup> For example, research from the Canadian Recording Industry Association (CRIA) shows that approximately 75% of the interviewees said to now and then purchase a CD/DVD in pursuance of a download. See Doorn, ‘P2P-gebruikers kopen meer cd’s’, <http://www.webwereld.nl/articles>, 20-3-2006. Accessed at 18-10-2006.

See Fisher (2004), 33. Here the artist Janis Ian is cited as she gives some illustrative commentary on the way peer-to-peer networks have the potential to promote artists and their music. See Fisher (2004), 114-115. See Garofalo (2003), 98-99.

Even though the surveys which the IFPI refers to consistently show that most respondents say to buy/have bought less recordings as the result of their unauthorized downloading, there always is a group of respondents that says to actually buy/have bought more recordings because of it. See IFPI (2004), Online Music Report 2004, 11. IFPI (2005), Digital Music Report 2005, 18-19. IFPI (2006), Digital Music Report 2006, 15, 17.

<sup>57</sup> For instance, research done by Intomart/Gfk, by order of Planet Internet, showed that the Dutch have little moral objections against the free downloading of music, software and movies from the Internet. Only 40% of the

interviewees thought of it as theft, and of this group almost 75% said not to have any conscientious objection. See NieuwsNieuws, 'Weinig bezwaar tegen gratis downloaden', [http://www.nieuwnieuws.nl/archives/2006/04/weinig\\_bezwaar\\_tegen\\_gratis\\_do.html](http://www.nieuwnieuws.nl/archives/2006/04/weinig_bezwaar_tegen_gratis_do.html), 24-04-2006. Accessed at 18-10-2006. Please note that whereas in most countries this form of downloading is illegal, up until now in the Netherlands it is not, as it is only the uploading without permission that is illegal in this country.

W.W. Fisher points out that polls conducted in the U.S. in 2000 indicated that between 40% and 56% of all respondents, and higher percentages of Internet users, believed that it was not immoral to download music from the Internet. See Fisher (2004), 3.

<sup>58</sup> See IFPI (2006), Digital Music Report 2006, 4, 7. IFPI (2007), Digital Music Report 2007, 4-5. In the first nine months of 2006 digital album sales in the U.S. increased with 114.2% to approximately 22.6 million units, as compared to the approximately 10.6 million units that were sold in the first nine months of 2005. As stated by E. Christman. See Christman, 'Sales up, tracks leveling', Billboard, 14-10-2006. Derived from the LexisNexis database.

<sup>59</sup> For instance, in context with the possibilities the first version of MP3.com as a legal music-sharing service had to offer, Roger McGuinn (a founder member of the famous rock group the Byrds) stated: "They offered an unheard of, non-exclusive recording contract with a royalty rate of 50% of the gross sales (...) MP3.com not only allowed me to place these songs on their server, but also offered to make CDs of these songs for sale. They absorbed all the packaging and distribution costs. So far I have made thousands of dollars from the sale of these folk recordings on MP3.com, and I feel privileged to be able to use MP3s and the Internet as a vehicle for my artistic expression. MP3.com has offered me more artistic freedom than any of my previous relationships with mainstream recording companies. I think this avenue of digital music delivery is of great value to young artists, because it's so difficult for bands to acquire a recording contract. When young bands ask me how to get their music heard, I always recommend MP3.com." See Garofalo (2003), 94-95.

<sup>60</sup> For example, the OECD points out that the Internet should enable the independents to reach an audience tuned in to the specific genres these companies are specialized in more easily. See 'Downloaden niet oorzaak', Het Parool, 14-6-2005.

<sup>61</sup> Gronow (1983), 126.

<sup>62</sup> Cowen (1998), 145.

<sup>63</sup> Hull (2004), 2.

<sup>64</sup> Hull (2004), 45.

<sup>65</sup> Cowen (1998), 145.

<sup>66</sup> IFPI data suggest that in 2005 the retail value of the recording industry's total world sales was US\$31.600,7 million. For that year the reported net unit shipment figures are: 1.968,9 million CDs / 188,2 million MCs / 162,1 million singles / 3,5 million LPs / 142,7 million DVDs and 7,5 million VHS videotapes. Unfortunately digital sales are not mentioned. See IFPI (2006), world sales 2005 retail data.

In an other table IFPI data suggest that in 2005 the retail value of the recording industry's total physical world sales added up by the recording industry's total digital music sales was approximately US\$33.456 million. In this case digital sales are mentioned explicitly, as they are said to have accounted for 5% of the total retail value. See IFPI (2006), Digital formats continue to drive the global music market, 4.

<sup>67</sup> For more information on criticism on the cultural industries see Cowen (1998), Negus / Pickering (2004), Marshall (2005) and Zolberg (1990) among others.

<sup>68</sup> See Negus (1992), 91-92, 141-145, 149-150. Barrow / Newby (1995), 20, 30. For more general information on the tension between the artistic and business side in context with production within the cultural industries see Caves (2000), in particular the section 'Creative workers care about their product' on page 3-5.

<sup>69</sup> Such a division is generally build up around a certain genre and often performs the all-important A&R and marketing functions relatively independent from the record company to which it belongs. When the term label refers to a trademark used by a record company for marketing purposes only, meaning that there is no business structure attached to the label, it also is called an imprint.

<sup>70</sup> Hull (2004), 69-70 and 97-99.

<sup>71</sup> Hull (2004), 97- 99.

<sup>72</sup> Hull (2004), 71 and 98-99.

<sup>73</sup> Passman (1994), 219.

<sup>74</sup> Administration rights basically consist of the right to find people/companies that are interested in using a song, the right to issue licenses for this use, the right to collect royalties and the right (as well as the obligation) to pay the writer of a song. See Passman (1994), 215.

<sup>75</sup> Passman (1994), 132, 219, 264. Hull (2004), 71-75. Wallis / Malm (1984), 78-81.

<sup>76</sup> The three largest music publishers are EMI Music Publishing, Warner/Chappell Music, Inc. and Universal Music Publishing Group. Which are owned by EMI Group, Warner Music Group and Universal Music Group. In September 2006 Universal Music Group bought BMG Music Publishing. If the E.U. allows the deal it will imply

that Universal Music Group also will own the worlds largest publishing company in addition to the worlds largest record company.

<sup>77</sup> Please note that the difference between a record company and a music conglomerate is somewhat arbitrary in this context. At one hand there are record companies who have established publishing interests, at the other hand there are four major music conglomerates (of which all except EMI actually are owned by other companies as well) who are big enough to represent a very large record company (one of the majors), publishing company, record manufacturer and distribution company. However, the point is that both the smaller record companies and the big conglomerates have started to participate in music publishing activities for the same reasons.

<sup>78</sup> Mechanical royalties are the royalties paid to the owner of the copyright of a song as compensation for the use of this song on recordings. Hence, the owner of the copyrights in a (sound) recording pays mechanical royalties to the owner of the copyrights in the recorded songs for each recording sold.

<sup>79</sup> The royalties of a song are traditionally divided in a writer's share and a publisher's share. Most common is that each of these shares is 50% of the total songwriter's royalties, but any division is possible in theory. The publisher's share on its turn can be divided between several parties as well. When a record company earns income by means of the possession of copyrights in a song it (in principle) receives the royalties it is entitled to connected to the publishers share, as it is unethical to also try and take a part of the royalties connected to the writer's share. See Schwartz (2003), 106-107.

<sup>80</sup> In fact, popular music records are by far the most important factor behind the collection of royalties. It can be estimated that more than 75% of music publishing royalties are the (both direct and indirect) result of the marketing and sale of popular music recordings. See Hull (2004), 69-70.

<sup>81</sup> Passman (1994), 218. Hull (2004), 73. Even though this phenomenon may be dominant within the music industry since the 1990s, it should be pointed out that the shift basically started with the advent of rock music and coherent with this the emergence of rock aesthetic, within which the idea of a musician that performs his own songs is valued greatly. See Negus (1992), 44.

<sup>82</sup> Negus (1992), 43.

<sup>83</sup> Please note that some of them, under pressure of diminishing record sales, actually do.

<sup>84</sup> Negus (1992), 130. Hull (2004), 116.

<sup>85</sup> Negus (1992), 38.

<sup>86</sup> G.P. Hull suggests that a (large) record company/record label may consist of the following departments and divisions: the 'label president', business affairs, accounting, 'international division', marketing and A&R. The marketing department may consist of the following subdivisions: sales, promotion, advertising, publicity and artist relations. Finally, the A&R department may consist of the subdivisions A&R administration and 'producers'. See Hull (2004), 130-135.

However, even though this overview is useful to illustrate the organizational structure of a record company, it certainly is not case that all of these companies are organized in this strict manner. But to the contrary, as this overview is best suitable for relatively large record companies, the organization of an independent (thus in particular of the relatively small indies) predominantly and typically consists of (much) less departments and subdivisions. It is even the case that many independents are run by just a few persons, which obviously implies that, even though the relevant activities must be carried out in one way or another, such companies' organizations show a picture that is essentially different from what the here given overview suggests. In context with the foregoing G.P. Hull states that "although the two basic functions of any label" (meaning a record company and also often a label as a division of a larger record company) "are A&R and marketing, any given label may perform those functions in depth, spread across a number of departments and personnel, or simply either not do them or hire an outside organization to provide the service (outsourcing)". See Hull (2004), 130.

<sup>87</sup> Hull (2004), 155.

<sup>88</sup> Foxall (2003), 120.

<sup>89</sup> Dibb (e.a.) (2006), 7.

<sup>90</sup> Bennett (ed) (1995), 166.

<sup>91</sup> Baker (2003), 9-10.

<sup>92</sup> Hull (2004), 185.

<sup>93</sup> Catalogue and deep catalogue products have been defined as those records that have been on the market for longer than 18 months (catalogue) and longer than 36 months (deep catalogue). As defined by Nielsen SoundScan, "Market Watch", Billboard, 2 August 2003, 67. See Hull (2004), 178.

<sup>94</sup> Hull (2004), 179, 182.

<sup>95</sup> Hull (2004), 177.

<sup>96</sup> The term 'wholesaler' can be defined as: "A merchant establishment operated by a concern that is primarily engaged in buying, taking title to, usually storing and physically handling goods in large quantities, and reselling the goods (usually in smaller quantities) to retailers or to industrial or business users." See Bennett (ed) (1995), 305.

<sup>97</sup> Illustrative is that the Dutch entertainment industry association NVPI (Nederlandse Vereniging van Producenten en Importeurs van beeld- en geluidsdragers) helps its member independent record companies with this issue even by negotiating collective agreements with these wholesale distributors. For instance, due to these negotiations in the beginning of 2006 a collective agreement with OD2/Loudeye was signed. The relevant independents could then participate in this agreement. See NVPI (2006), *De entertainmentbranche in 2005/2006*.

<sup>98</sup> As the IFPI has rightfully referred to this new type of wholesale distributors. See IFPI (2006), *Digital Music Report 2006*, 9.

<sup>99</sup> See section 4.6 'The independent record company' for more information on this matter.

<sup>100</sup> Retailing can be defined as: "A set of business activities carried on to accomplishing the exchange of goods and services for purposes of personal, family, or household use, whether performed in a store or by some form of nonstore selling." See Bennett (ed) (1995), 245.

<sup>101</sup> As mentioned, hard copies are the traditional physical products such as CD albums. Soft copies are digital downloads.

<sup>102</sup> Case / Fair (2004), 290.

<sup>103</sup> Hull (2004), 121.

<sup>104</sup> The majors Universal Music, EMI Music and Warner Music are part of the music conglomerates Universal Music Group, EMI Group and Warner Music Group. These music conglomerates include the publishing divisions Universal Music Publishing Group, EMI Music Publishing and Warner/Chappel Music, Inc. Sony BMG Music Entertainment is a joint venture between the two music conglomerates Sony Music Entertainment and BMG Entertainment, however the publishing divisions Sony/ATV Music Publishing and BMG Music Publishing were excluded from the merger.

<sup>105</sup> As stated by L. Cendrowicz. See Cendrowicz, 'Sony, BMG pursue merger on two fronts', *Billboard*, 28-10-2006. Derived from the LexisNexis database.

<sup>106</sup> As part of the big four, in 2005 Universal Music was the largest record company with a market share of 31.71%, second came Sony BMG Music Entertainment with a market share of 25.61% (13.83% Sony and 11.78% BMG), third came Warner Music with a market share of 15% and fourth came EMI Music with a market share of 9.55%. See Cashmere, 'Universal Is The Biggest Music Company of 2005', [www.undercover.com](http://www.undercover.com), 5-1-2006. Accessed at 13-12-2006. Original data from Nielsen SoundScan.

Please note that there is disagreement on how to measure the market share of the majors and the independents exactly. For example, both the majors, the American Association of Independent Music and Billboard/Nielsen SoundScan choose a different approach in context with the distribution of a record. However, the data provided by Nielsen SoundScan is widely used and excepted in the field. See *Billboard*, 'What is fair market share?', 18-3-2006. Derived from the LexisNexis database.

<sup>107</sup> Despite of the different opinions in this matter, within this thesis independent record companies are defined as those record companies who are not owned by one of the majors (as mentioned earlier in note 9). Not only is this approach the most usable and arguably the most dominant, it also provides the necessary clarity on the term 'independent record company' in a way that is in line with the division between the big four and the other companies, hence with the oligopolistic state of the market on which record companies operate.

<sup>108</sup> Please note that most of the big 'independent' distributors (meaning the non-branch distributors) are actually owned by the four big music conglomerates. See Passman (2006), 65. This implies that even though these distribution companies may still be tuned in to the needs of independent record companies, they cannot be considered truly independent because of this construction.

<sup>109</sup> In his book *Producing Pop* (published in 1992) Keith Negus uses the term 'minor' in stead of the term 'independent', which is a smart choice when the question that is mentioned here is considered, as the term 'minor' makes this question superfluous and at the same time the choice for it is obvious, since it refers to those relatively small record companies that are not part of the huge majors. Still, as the term independent is dominant within the field and is used throughout this thesis as well, some attention to the question 'what then these record companies are independent from' is given here.

<sup>110</sup> Illustrative is that of the more than 35.000 releases in the year 2000, over 29.000 of these titles were released by independents. See Hull (2004), 136.

Though at the same time, that year the majors had a market share of 76.5% (Universal Music 22.5%, Sony Music 16%, EMI Music 13.3%, Warner Music 12.7%, BMG 12%). See *The Globe and Mail*, Report on business: *The Wallstreet journal*; *What's News*, Pg. B10, 26-7-2001. Derived from the LexisNexis database.

<sup>111</sup> Hull (2004), 20.

<sup>112</sup> Even though operating at a professional level many independent record companies are home based or have got a relatively small office and are run by a handful of people, a situation which obviously reduces overhead costs and personnel costs drastically.

<sup>113</sup> Hesmondhalgh (1996), 46.

<sup>114</sup> Barrow / Newby (1995), 70.



<sup>115</sup> See Hesmondhalgh (1996), 47-50 for some additional information.

<sup>116</sup> Hull (2004), 137.

<sup>117</sup> For additional information see Barrow / Newby (1995), 30. Here some attention is given to the sometimes problematic relationship between the major record company at one hand and its labels/artists at the other, in context with labels as part of a huge record company.

<sup>118</sup> For more information on these so called mega deals see Passman (1994), 122-125.

<sup>119</sup> Passman (1994), 123.

<sup>120</sup> For new artists, costs between US\$50.000 and US\$100.000 per music video are no exception at all. See Hull (2004), 148. For well known artists and especially for stars the costs for just one music video may easily be a multitude of these amounts.

<sup>121</sup> A plugger is someone “whose sole job is to supply radio stations with records and then to persuade radio producers and DJs to play them”. As defined in Barrow / Newby (1995), 118. Note that pluggers may also focus on television and especially on MTV-like music television stations. Besides, pluggers may focus on club DJs as well, especially those of independent record companies specialized in dance music, since they are connected to a music scene in which the DJs in the clubs and on the festivals play an important and central role. See Barrow / Newby (1995), 121-122.

<sup>122</sup> “Payola in the recording industry is paying a bribe to someone to perform or play a certain song or recording in order to increase exposure for that song or recording in the hope that the exposure will lead to increased sales.” As defined by G.P. Hull. See Hull (2004), 186.

In practice this means that an undisclosed payment to a certain broadcaster in exchange for a certain type and amount of airplay is interpreted as payola and is prohibited by law. But at the same time this implies that if the broadcaster discloses a payment there is no violation, even if the description connected to this payment is rather vague. Obviously this situation leaves enough possibilities for record companies to pay broadcasters in exchange for airplay without violating the law, meaning that they may not participate in the practice of payola in terms of law, but still make use of practically the same method and obtain the same results.

<sup>123</sup> See Barrow / Newby (1995), 118 and Hull (2004), 185 for some background information.

<sup>124</sup> Hull (2004), 178.

<sup>125</sup> As mentioned, especially for the independents efficient and effective worldwide distribution proves to be a lot less complex undertaking when soft copies are concerned.

<sup>126</sup> As stated by W.W. Fisher. See Fisher (2004), 13-14.

<sup>127</sup> See Internet World Stats, Top 35 countries with the highest Internet penetration rate, <http://www.internetworldstats.com/top25.htm>, accessed at 19-6-2007.

<sup>128</sup> See Internet World Stats, Top 35 countries with the highest Internet penetration rate, <http://www.internetworldstats.com/top25.htm>, accessed at 19-6-2007.

<sup>129</sup> See Internet World Stats, Internet usage statistics: the big picture, <http://www.internetworldstats.com/stats.htm>, accessed at 19-6-2007.

<sup>130</sup> For example, in 2004 the Netherlands had the tenth biggest market for recorded music. See IFPI (2005), The Recording Industry In Numbers 2005, 14. In 2005, the Netherlands had the tenth biggest digital music market. See IFPI (2006), Digital formats continue to drive the global music market, 4.

<sup>131</sup> See OECD Broadband Statistics to June 2006, <http://www.oecd.org/sti/ict/broadband>, 13-10-2006, accessed at 19-6-2007.

<sup>132</sup> A survey carried out by the IFPI and M-Lab shows that 49% of the respondents named the possession of a broadband connection as a reason for them to start buying music online. See IFPI (2007), Digital Music Report 2007, 14.

<sup>133</sup> Fisher (2004), 15.

<sup>134</sup> In Japan 96% of all digital music revenues came from mobile music sales in the first nine months of 2005. By September 2005, in Japan 70% of all mobile phone sales were 3G phones. Digital download sales in the UK and U.S. saw a large spike the week after Christmas 2005. The IFPI argues that “both spikes are directly related to consumers receiving portable players as Christmas gifts” See IFPI (2006), Digital Music Report 2006, 10, 15.

Nokia has sold approximately 40 million music phones in 2005 and approximately 80 million in 2006. Research done by Jupiter Research in September 2006 in the UK, Germany, France, Italy, Sweden and Spain shows that “16% of Internet users that own an iPod (...) download music legally on a monthly basis, compared to 5% of Internet users that do not own a portable player.” An IFPI/M-Lab survey shows that 50% of the respondents named the possession of a portable player as a reason for them to start buying music online. See IFPI (2007), Digital Music Report 2007, 10, 14.

As mentioned in note 4, Apple has sold its 100<sup>th</sup> millionth iPod in between 2001 and April 2007. At the same time Apple's iTunes Store is and has been the online music market leader.

<sup>135</sup> Research done in 2005 by Jupiter Research by making use of a random sample of Internet users shows that 45% of all file-sharers transfer music to portable players on a monthly basis, compared to 29% of all purchasers of authorized downloads. See IFPI (2006), *Digital Music Report 2006*, 15.

<sup>136</sup> As stated by G.P. Hull. See Hull (2004), viii.

<sup>137</sup> For more information on bootleg recordings and the phenomenon of bootlegging see Marshall (2005).

<sup>138</sup> See IFPI (2006), *Digital Music Report 2006*, 16.

<sup>139</sup> Garofalo (2003), 89.

<sup>140</sup> Garofalo (2003), 89. Marshall (2004), 193.

<sup>141</sup> Fisher (2004), 4.

<sup>142</sup> As quoted in Fisher (2004), 113.

<sup>143</sup> First quotation: as quoted in Marshall (2004), 201.

Second quotation: as stated by L. Marshall. See Marshall (2004), 201.

<sup>144</sup> As quoted in Marshall (2004), 201.

<sup>145</sup> As quoted in Marshall (2004), 201.

<sup>146</sup> For additional information see Fisher (2004), 113-114.

<sup>147</sup> As stated by W.W. Fisher. See Fisher (2004), 4.

<sup>148</sup> For example, "In September 2005 the Federal court of Australia held that KaZaA was guilty of copyright infringement and ordered it to shut down or implement copyright filters." "November 2005 saw the Grokster P2P network agree to shut down operations in light of the U.S. Supreme Court's ruling." "In June 2006 the Dutch Court of Appeals ruled against zoekmp3.com, effectively declaring that deep linking to infringing mp3 files is illegal in the Netherlands." "With help from IFPI's anti-piracy teams, national enforcement authorities around the globe seized a record amount of discs in 2005 –some 80 million in all." See IFPI (2006), *The Recording Industry Piracy Report 2006*, 4, 7.

<sup>149</sup> For instance, research performed by Forrester in August 2004 shows that in that year "36 million of the 40 million people downloading (nine in ten) in Europe" did not pay for the music they have downloaded. See IFPI (2005), *Digital Music Report 2005*, 19.

Research done by Jupiter Research in the UK, France, Germany, Italy, Spain and Sweden shows that while the average broadband household penetration in these countries rose from 7% in 2002 to 40% in 2006, the average percentage of Internet users regularly involved in file-sharing in these countries decreased from 18% in 2002 to 14% in 2006. See IFPI (2007), *Digital Music Report 2007*, 18. This appears to be good news for the recording industry and to some extent it is, certainly because the fact that broadband usage increased strongly within these years. But in the period 2000-2007 the Internet usage in these countries has grown respectively 144.2%, 262.8%, 110.3%, 133.1%, 266.8% and 70.2%. For Europe in total this was 203.6%. See Internet World Stats, Internet usage in Europe, <http://www.internetworldstats.com/stats4.htm>, accessed at 19-6-2007. This implies that whereas the percentage of Internet users regularly involved in file-sharing has decreased in the period 2002-2006, at the same time it is highly probable that the total amount of file-sharing Internet users has risen because Internet usage itself has increased heavily in this period.

With reference to physical piracy, in 2000 the IFPI claimed that "one in three recordings worldwide is pirate". In 2006 the IFPI still stated that "physical piracy shows no sign of abating", that "more than one in three of all music discs is thought to be an illegal copy" and that in 2005 "pirate CD sales outnumbered legitimate sales in a total of 30 markets". See IFPI (2000), *IFPI Music Piracy Report 2000* and IFPI (2006), *The Recording Industry Piracy Report 2006*, 4.

<sup>150</sup> In IFPI (2007), *Digital Music Report 2007*, 22.

<sup>151</sup> As stated by John Kennedy, the chairman and CEO of the International Federation of the Phonographic Industry. See IFPI (2005), *The Recording Industry Commercial Piracy Report 2005*, 3.

<sup>152</sup> For example, the IFPI states that "global music sales have fallen 16% in five years -from \$US 39.7 billion in 2000 to \$US 33.6 billion in 2004- to a large extent because of the proliferation of free unauthorised music". See IFPI (2006), *Digital Music Report 2006*, 16.

In addition, the organization argues that "Internet piracy and the ubiquity of unlicensed music have caused enormous problems for the recording industry as it evolves into the digital age. The music industry was the first of the modern creative, intellectual property-based industries to feel the impact of the mass availability of its core product for free", that "record companies' sales and investment in music has been severely hit by Internet piracy in recent years" and that because of piracy "global CD sales fell by 23 per cent in value between 2000 and 2005". See IFPI (2007), *Digital Music Report 2007*, 18.

<sup>153</sup> For these estimated values current prices are used.

<sup>154</sup> The IFPI's estimates and statements can be found in: IFPI (2000), *IFPI Music Piracy Report 2000*. IFPI (2002), *IFPI Music Piracy Report 2002*, 2. IFPI (2003), *The Recording Industry Commercial Piracy Report 2003*, 2. IFPI (2004), *The Recording Industry Commercial Piracy Report 2004*, 3. IFPI (2005), *The Recording Industry Commercial Piracy Report 2005*, 4. IFPI (2006), *The Recording Industry Piracy Report 2006*, 4.

<sup>155</sup> Note that in the case of a bootleg the pirate recording is not a substitute for an authorized recording at all.

<sup>156</sup> As suggested by Ruth Towse. See Towse (2004), 20.

<sup>157</sup> See table 1-5 in the appendix.

<sup>158</sup> With reference to world sales figures the IFPI calculates the amount of total units as the so called 'total album equivalent', meaning that three singles are counted as one album.

<sup>159</sup> See IFPI (2001), *The Recording Industry In Numbers 2001*, 17 and IFPI (2005), *The Recording Industry In Numbers 2005*, 14. See table 1 and 2 in the appendix.

<sup>160</sup> See RIAA, 2006 Year-End Shipment Statistics, <http://www.riaa.com/keystatistics.php>, accessed at 16-7-2007 and RIAA, *The Recording Industry Association of America's 1999 Yearend Statistics*, <http://www.riaa.com/news/marketingdata/facts.asp>, accessed at 9-8-2006. See table 4 and 5 in the appendix.

<sup>161</sup> For example, with respect to these arguments see Hull (2004), 4. Towse (2004), 20. Fisher (2004), 34.

<sup>162</sup> For instance, see 'Downloaden niet oorzaak', *Het Parool*, 14-6-2005.

<sup>163</sup> Though in all fairness, in this period for some relatively less well-developed countries (representing only minor music markets) and regions (such as in this context predominantly Latin America) the state of the economy probably has been an important reason for a strong decline of recording sales. For instance, this seems to be the case with regard to Argentina, which was struck by an economic crisis between 2000-2002. Unit sales in this country declined with 29.8% in 2000 and with 30.7% in 2001, and in these years the Argentinean music market declined in retail value with respectively 36.7% and 36.5%. But, as this country recovered from the economic crises during 2003-2004, it saw its music market grow again with 33.5% in retail value in 2004, as unit sales grew with 18% as well in that year. See IFPI (2001), *The Recording Industry World Sales 2000*. IFPI (2002), *The Recording Industry World Sales 2001*. IFPI (2005), *The Recording Industry World Sales 2005*, 3.

<sup>164</sup> Note that the U.S. has the by far largest music market in the world and that global music sales are significantly influenced by the sales in this country. For instance, in 2001 music sales in the U.S. took account for 39.8% of the world total (in terms of retail value), followed by Japan (15.6%), the UK (8.3%) and Germany (6.3%). In 2004 the U.S. music market was 36% of the world market (in terms of retail value), followed by Japan (15%), the UK (10%) and France and Germany (both 6%). See IFPI (2002), *The Recording Industry World Sales 2001* and IFPI (2005), *The Recording Industry World Sales 2005*, 2.

<sup>165</sup> Calculated as the total album equivalent.

<sup>166</sup> See IFPI (2005), *The Recording Industry In Numbers 2005*, 14. IFPI (2006), world sales 2005 retail data. IFPI (2006), *Digital formats continue to drive the global music market*, 4. IFPI (2007), *Music Market Data 2006*, 1. See table 2 and 3 in the appendix.

<sup>167</sup> See RIAA, 2006 Year-End Shipment Statistics, <http://www.riaa.com/keystatistics.php>, accessed at 16-7-2007. See table 5 in the appendix.

<sup>168</sup> See IFPI (2001), *The Recording Industry In Numbers 2001*, 17. IFPI (2005), *The Recording Industry In Numbers 2005*, 14. IFPI (2006), world sales 2005 retail data. IFPI (2006), *Digital formats continue to drive the global music market*, 4. IFPI (2007), *Music Market Data 2006*, 1. See table 1-3 in the appendix.

<sup>169</sup> See RIAA, *The Recording Industry Association of America's 1999 Yearend Statistics*, <http://www.riaa.com/news/marketingdata/facts.asp>, accessed at 9-8-2006 and RIAA, 2006 Year-End Shipment Statistics, <http://www.riaa.com/keystatistics.php>, accessed at 16-7-2007. See table 4 and 5 in the appendix.

<sup>170</sup> As stated by W.W. Fisher. See Fisher (2004), 34. Unfortunately he does not mention which study he exactly refers to.

<sup>171</sup> With reference to the mentioned best selling albums/artists see IFPI (2001), *The Recording Industry In Numbers 2001*, 16. IFPI (2005), *The Recording Industry World Sales 2005*, 5. IFPI (2006), *Digital formats continue to drive the global music market*, 4. Ellis, 'U.S. album sales drop year-to-year', *Billboard*, 12-1-2002. Derived from the LexisNexis database.

<sup>172</sup> As quoted in Hull (2004), 4.

<sup>173</sup> See IFPI (2001), *The Recording Industry In Numbers 2001*, 17. IFPI (2005), *The Recording Industry In Numbers 2005*, 14. RIAA, 2006 Year-End Shipment Statistics, <http://www.riaa.com/keystatistics.php>, accessed at 16-7-2007. With reference to U.S. sales of physical singles in the here mentioned years see table 5 in the appendix.

<sup>174</sup> For example, Nielsen SoundScan only started with the tracking of the U.S. music download sales since July 2003. Therefore it is reported that in the second half of this year 19.2 million single track downloads were sold in the U.S. When this amount is compared to the 798.4 million physical recordings sold in the U.S during all of 2003 (of which 746 million units were C.D. albums, generally containing round about 10 to 14 songs), the insignificance of the amount of legitimate download sales in 2003 becomes plain to see. This comparison is equally relevant when the total amount of downloaded tracks in the U.S. in this year is estimated to be twice the reported amount. Though this amount will clearly be estimated to high, as for example Apple's iTunes Store (back then still called the iTunes Music Store) only was launched on April 28, 2003.

For the mentioned figures see IFPI (2004), *Online Music Report 2004*, 3. RIAA, 2006 Year-End Shipment Statistics, <http://www.riaa.com/keystatistics.php>, accessed at 16-7-2007. See table 5 in the appendix.

<sup>175</sup> See Ellis, 'U.S. album sales drop year-to-year', *Billboard*, 12-1-2002. Derived from the LexisNexis database.

<sup>176</sup> See Hiatt / Serpick, 'Music biz laments "worst year ever"',

[http://www.rollingstone.com/news/story/9147118/music\\_biz\\_laments\\_worst\\_year\\_ever](http://www.rollingstone.com/news/story/9147118/music_biz_laments_worst_year_ever), 13-1-2006, accessed at 26-7-'07.

<sup>177</sup> See RIAA, *The Recording Industry Association of America's 1998 Consumer Profile*. RIAA, *The Recording Industry Association of America 2002 Consumer Profile*. RIAA, *The Recording Industry Association of America 2006 Consumer Profile*. These publications are accessible via

[http://www.riaa.com/keystatistics.php?content\\_selector=consumertrends](http://www.riaa.com/keystatistics.php?content_selector=consumertrends), accessed at 1-8-2007.

<sup>178</sup> See RIAA, *The Recording Industry Association of America 2006 Consumer Profile*,

[http://www.riaa.com/keystatistics.php?content\\_selector=consumertrends](http://www.riaa.com/keystatistics.php?content_selector=consumertrends), accessed at 1-8-2007.

<sup>179</sup> For example, the NVPI reports that the total retail value of Dutch recording sales fell from 494 million Euro in 2000 to 307 million Euro in 2006, while at the same time the Dutch market for computer games increased in retail value from 83.23 million Euro in 2000 to 214.4 million Euro in 2006. See NVPI (2006), NVPI *Marktinformatie Audio 2006*, 2. NVPI (2006), NVPI *Marktinformatie Interactief 2006*, 1.

<sup>180</sup> For instance, portable digital music player penetration increased between 2003 and 2004 from 5% to 11% in the U.S., from 5% to 9% in the Netherlands, from 4% to 9% in the U.K., from 3% to 7% in France, from 3% to 6% in Germany and from 2% to 6% in Japan. See IFPI (2005), *Digital Music Report 2005*, 13.

In 2005 one in ten European Internet users is reported to have bought a portable digital music player (equating an approximate 23 million people). See IFPI (2006), *Digital Music Report 2006*, 15.

Portable digital music player sales are reported to have totalled an approximate 120 million in 2006. This is said to be an increase of 43% compared to 2005. See IFPI (2007), *Digital Music Report 2007-Key Facts*,

[http://www.ifpi.org/content/section\\_resources/digital-music-reportb.html](http://www.ifpi.org/content/section_resources/digital-music-reportb.html), accessed at 3-8-2007.

<sup>181</sup> For example, (as pointed out in note 53) a consumer survey conducted by Jupiter Research/IPSOS in November 2005 suggests that even though on average an approximate one in three persons engaged in unauthorized file-sharing buys less recordings because of this, the heaviest negative impact on recording sales as the result of this activity is in the 15-34 year age group. See IFPI (2006), *Digital Music Report 2006*, 21.

<sup>182</sup> As stated by G.P. Hull. See Hull (2004), 8.

<sup>183</sup> For example, with reference to those who argue that Internet piracy results in decreasing recording sales see Liebowitz (2004), Liebowitz (2006) and Michel (2006). IFPI (2005), *Digital Music Report 2005*, 18-19.

IFPI (2006), *The Recording Industry Piracy Report 2006*, 5. IFPI (2006), *Digital Music Report 2006*, 15.

For instance, with reference to those who argue that Internet piracy does not result in decreasing recording sales (or even state that it stimulates recording sales) see 'Downloaden niet oorzaak', *Het Parool*, 14-6-2005. Doorn,

'P2P-gebruikers kopen meer cd's', <http://www.webwereld.nl/articles>, 20-3-2006, accessed at 18-10-2006.

Garofalo (2003), in particular page 97-98.

<sup>184</sup> See IFPI (2005), *Digital Music Report 2005*, 18-19.

<sup>185</sup> See IFPI (2006), *The Recording Industry Piracy Report 2006*, 5.

<sup>186</sup> See Garofalo (2003), 97-98.

<sup>187</sup> See Michel (2006), 1 and Liebowitz (2004), 3-4. On these pages they give a fairly extensive overview of papers in which recently conducted research (performed by the authors of these papers) is published, of which only one (that of Oberholzer and Strumpf) did not find that recording sales are harmed by unauthorized downloading.

<sup>188</sup> See Michel (2006), the introductory abstract and page 1.

<sup>189</sup> See Liebowitz (2004), 32.

<sup>190</sup> See Liebowitz (2006), abstract from the article 'File Sharing: Creative Destruction or Just Plain Destruction?', accessible via <http://www.journals.uchicago.edu/JLE/journal/contents/v49n1.html>, accessed at 10-7-'07.

<sup>191</sup> All sentences and words in quotation marks in this chapter are quotations from the interviewees. Please note that these quotes are translated from Dutch to English.