

# **Emerging business models in the music industry: a descriptive case study of AWAL**

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## **Abstract**

This project is a conceptual, descriptive study of AWAL's business model. AWAL is an online "label services" platform that takes on the role of the record label for independent artists without acquiring these artists' recording rights. The general aim of this study is to uncover the underlying logics of the business model's components based on microeconomic concepts and theories. The relevant sources in this analysis are Towse's *A Handbook of Cultural Economics* and Porter's *Competitive Strategy*. The paper includes a description of the recording industry, a description of the most relevant economic concepts, and a results section where the business model's different components are analyzed in relation to these described concepts. Apart from the study of relevant concepts, the necessary data is derived from AWAL's publicly available service definition. The study's results show AWAL's unique, two-sided position in the music value chain, and a competitive strategy is based on differentiation and cost management. An important finding is that one of its most valuable functions with regards to its long-term survival is the added value it creates for online music retailers.

## **Keywords**

Microeconomics, business models, AWAL, recording industry, competitive strategy, cultural economics

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### **Frequently used terms and their definitions**

- The term ‘traditional record label business model’ refers to the business model of incumbent record labels.
- A ‘standard recording contract’ is a contract between an artist and a record label where the artist hands over its recording rights in return for a royalty fee and additional inputs, such as marketing and distribution.
- ‘Independent artists’ refers to artists who pursue a professional career, but are (currently) not signed to any type of record label and are in full control of their own recording rights.
- The term ‘the recording industry’ is often used as a synonym for the music industry but within the context of this study it is used as the definition of the industry that deals with the creation, marketing and promotion of music recordings, excluding the live music industry.
- ‘Online retailers of music’ refer to music streaming services such as Spotify and Deezer, and online stores, like iTunes and Bandcamp.

## **Introduction**

### **Case description**

The contemporary recording industry is an interesting subject for academic research, due to the increased value prospects of the cultural industries and the very recent developments that are a result of the influence of digitization on the production, distribution and consumption of creative goods. A common critique in this transformational era is that the business model of incumbent intermediary firms, who traditionally deal with the distribution and marketing of recordings, has been lagging behind and currently does not efficiently cater to new market characteristics. Subsequently, institutional alternatives become a topic of discussion. Furthermore, new business formation in a highly insecure and vibrant industry is an interesting subject, as it can tell a lot about how an industry is conventionally structured and which opportunities are missed by incumbent firms.

Recently some attention has been paid to the new industrial arrangements that are built on the 21st century industry principles of independency, transparency and direct connections: “the music industry is undertaking a process of supply chain deconstruction, which will lead to a proliferation in the number of potential actors involved in the supply of music, each of which will have its own unique source of competitive advantage” (Evans and Wurster, 1997) cited in (Graham et al., 2004, p.1095). One of the firms that fits well in this is development is AWAL, a subsidiary of the global Kobalt music publishing company. AWAL was founded in 2003, and acquired by Kobalt in 2011. Before Kobalt’s acquisition of AWAL it represented roughly 5000 independent artists, while it currently represents over 20,000. Kobalt calls AWAL its recordings division. It was “created as an alternative to the traditional record label” (Blom, 2016), and claims to offer “all the services and global expertise an artist needs, plus freedom, control, and a real partner” (Awal.com, 2018). It shows characteristics that are similar to those of a record label, but it is mostly different in that it allows artists to keep their recording rights. This makes its business model unique in an industry that is dominated by the logic of copyright acquisition and protection.

### **Research aim and objectives**

The aim of this research is to theoretically restructure AWAL’s business model and its separate components. The purpose is to uncover these components’ underlying logics in order to form conclusions regarding AWAL’s current and future position in the recording industry, based on microeconomic theory. This should not to be confused with uncovering a firm’s position in the value chain of an industry, but instead it is concerned with a wider definition of the term “firm position”. In this case, this term is related to the description its strategy, when compared with other strategies in the same industry, with a special emphasis on record labels. Also important to stress, is that this research focuses on the recording industry, and not the music industry. This means that it only covers the trade in recorded music, and leaves out other components, such as the live music industry.

The main research question is as follows: ‘*What is AWAL’s business model’s current and prospective position in the recording industry?*’ An accompanying research question can be formulated as: ‘*What is the value of AWAL’s business model for its stakeholders and the industry at large?*’.

### **Motivation**

The decision for this topic primarily came forth out of a genuine interest in this industry and a curiosity for the actual value of new emerging business models. AWAL and similar innovative firms often make bold statements about their ‘revolutionary’ intentions, and are in some cases granted with substantial investments from other companies (an example is Google’s recent 70m investment in label services platform UnitedMasters) (Hu, 2017). Furthermore, it is in itself an interesting objective to find out more about where this industry is going, and what anyone who enters this market should expect to be the structure in the near future. In trying to fulfill this objective, it is essential to not only be aware of these developments, but to really understand them and their environmental influences, in order to make any attempts at predicting future

outcomes. AWAL was chosen specifically in this study because it is believed to show the most unique organizational structure, being somewhat of a hybrid between a distributor, label and service provider. The final motivation for studying this subject is that it fits very well within the frameworks of cultural economics.

### **Academic and societal relevance.**

Because of the recency of the described developments, this study will be a descriptive and conceptual case study. Concepts describe and help to understand complex ideas (e.g. responsibility). Therefore, it does not make any claims in regard to providing empirical results which can be applied to a wider population. The key difference in this approach is that “any propositions identified in a conceptual model are merely logical statements rather than epistemological relationships” (Meredith, 1993, p.4). However, this does not mean that this study lacks an academic relevance. This argument is based on the fact that its description function can generate conclusions which can be explained or tested by empirics in future research projects. The academic field that might benefit of this study include those covering the creative industries, business models and specifically business model innovation (BMI), competitive strategy, transaction costs theory and general microeconomics.

In terms of this study’s societal relevance, the results can provide useful insights not only for AWAL’s stakeholders, but also for other industry players and potential new entrants. This is because the results can show how their position relates to AWAL’s, if there is a need to adapt their business model (or career strategy in the case of independent artists) accordingly, now or in the near future.

## **Theoretical framework**

Scientific papers that are concerned with the topic of business models in the music industry are relatively scarce, and there are no known academic sources that use AWAL or similar firms as a subject or case study. This is common for such a niche subject. However, given this topic’s frequent coverage in prominent music business newspapers, such as Music Business Worldwide and Digital Music News, there seems to be a gap in



academic literature. Because of the recency of these developments, this paper is one of the first sources that attempts to analyze these ‘streaming services’ in microeconomic terms.

The following theoretical framework is split into two sections. The first section includes the description of two of the most used concepts in this study, and the second covers AWAL’s external environment and its relevant characteristics, because “the first step towards formulating a competitive strategy is to define the industry structure within which it is to operate”.

### **Important theories and concepts: business model definition and components**

The business model closely resembles the explanation of a firm’s strategy and the design of its components , which is influenced by microeconomic principles, such as economies of scale and transaction costs. Microeconomics deals in its most basic sense with individual and inter-firm decision making (Black, Hashimzade & Myles, 2013). When analyzing a firm’s value-creation strategy, microeconomic theory is different in relation to the business model concept, because it deals with the explanation of allocation decisions, its influences and results. Business model theory, on the contrary, is more related to the explanation of a firm’s value creation strategy. Therefore, the following paragraph will provide an overview of the business model concept, containing its definitions and components, and a more in-depth description of the relevant features.

Views on definitions of a business model are quite varied. Mikhalkina and Cabantous (2015) for example, define a business model as being a “manipulable device that can be used to help academics or managers understand the linkages between value creation and value capture more clearly”, while Bouwman, Vos and Haaker (2008) describe it as a description of “the organizational and financial arrangements between the involved business actors, including a description of their roles and the division of costs and revenues over the business actors”. The descriptions of a business model’s components also vary between different researchers. Timmers (1998) states that a business model serves as “architecture for the product, service and information flows, including a description of the various business actors and their roles, a description of potential benefits for the various business actors, and a description of the sources of revenues”, while Chesbrough (2002) describes the different components of a business model to be (in random order) the:

- Identification of market segment
- Definition of the value chain
- Description of the firm’s position in the value network
- Estimation of cost structure and profit potential
- Formulation of the competitive strategy
- Articulation of the value proposition

Chesbrough’s description is used as the main source of reference to describing a firm’s components for this study. This decision was made because this framework is found most applicable to understanding AWAL’s industry position. The argument is based on the notion that these components not only incorporate the internal capabilities of a firm, but also its external environment.

It is important to note that the definition of a firm's business model differs from the concept of strategy. This is an important distinction, because these two concepts often cover the same conceptual grounds. Therefore, within the context of this study, the concept of strategy is only described in relation to competitive strategy, which makes it a component of a business model, instead of a separate concept that needs to be discussed separately.

Furthermore relevant in this description of business model theory is what kind of firm is being examined, especially in regard to the concept of business model innovation (BMI). Most studies that cover the concept of BMI focus on the successful innovation of the business model of an incumbent firm in an industry, or in other words the "modification of an existing model". The main motivation for this type of innovation is that firms "are seeking opportunities to create innovations for market segments that are unsatisfied by existing solutions" (Casprini, Pucci and Zanni, 2013).

### **Important theories and concepts: competitive strategy**

Competitive strategy is the most significant business model component in this study, because it is directly related to how AWAL positions itself in an industry, in relation to its competitors. The main source that is used for the description of this concept is Porter's book 'Competitive strategy' (Porter, 1998). According to this source, there are three generic strategies to be specified to "outperforming other firms in an industry", which are: 'overall cost leadership', 'differentiation' and 'focus'. Cost leadership, which seems like the most applicable strategy to this case, entails "the ruthless pursuit of economy and efficiency in all business operations with the aim of providing the product or service to the buyer at the lowest possible price", and includes the "maximizing the cost benefits of new technology" (Porter, 1998). Cost leadership is closely related to the economic concept of transaction costs, which is in its most basic sense a study of barriers from trade. Many online services operate with a business model that is primarily based on lowering these transaction costs between different traders or between traders and buyers. Amazon for example reduces trade barriers between book sellers and consumers, by reducing search costs for consumers with the help of smart algorithms.

Another important concept in Porter's framework is 'differentiation'. This is a concept which will be frequently mentioned in this thesis as it can be applied to many different concepts that are related to AWAL's business model. Differentiation, as its name suggests, involves "developing one significant aspect of a product in order to set it apart from its competitors" Porter (. How AWAL implements this strategy is shown by its service definition, which can be used to better understand its market position and target customer. Furthermore, differentiation can also be applied to economies of scale. Porter (1998) for example states that "in the case of a multi-product or multi-service firm, the notion of average cost is not well defined since the mix of outputs may change with overall size"

## **Contractual structures and the principal-agent relationship**

Critical in determining a business model's market position, is the description of the market itself. Going more into depth of the inner structures of the traditional industry business model, Caves (2000), describes with contract theory the underlying logics of the business relationships between artists and economic agents. He explains that the contracts between artists and record labels are based on the principle of "turning on the problem of allocating decision rights efficiently". Moreover, Caves claims that this contractual structure, which is very common in all creative industries, is a result of two important underlying principles: *arts for art's sake* and *nobody knows*. The former refers to "the utility that the artist gains from doing creative work", while the latter concerns the "fundamental uncertainty that faces the producer of a creative good". This means that the audience perception of the creative good, prior to release, is very hard to determine, resulting in information asymmetries and market failures (Caves, 2000). Within this principle the logic of the transfer of creative and commercial decision rights from the artist to the economic agent is embedded. This is because it reduces the risk of so-called 'sunk costs' of the agent's investment. The music industry is namely characterized by a high level of upfront investment. This happens at the stage of identification and development of talents. It has quite low returns on these investments that are highly concentrated (Seifert & Hadida, 2006). The underlying causes for the contractual structures are based on the limitation of the risk of these sunk costs. Artists, however, can also be risk-averse in the contractual negotiation process: "apparently risk-prone (evidenced by their willingness to enter the riskiest segment of the music industry) creative artists appear highly risk-averse in demanding advances on royalties rather than more generous royalty rates" (Burke, 2003, p. 300).

## **General principles of cultural organizations**

The music market is characterized by certain features that are applicable to the art market in general. These include the heterogeneity of goods, imperfect competition, lack of transparency, and trading of credence goods with uncertain (preliminary) value, which creates the important role of gatekeepers. Very common for organizations in the creative industries is that they serve a double function, acting both as suppliers for demand as well as gatekeepers. This is also applicable to organizations in the recording industry. For example, one of the main functions of a record label is to enhance the artist's artistic and commercial credibility in the eyes of the public and other industry players, such as radio stations and concert promoters. Through this function, the organizations reduce search costs for other economic agents in the market, which is one of its value definitions. Furthermore, it is the task of the cultural organization in the creative industries for reproducible goods to add 'humdrum' inputs to the creative good (Caves, 2000). Humdrum inputs are additional inputs that enhance the economic value of a creative good, including distribution and marketing.

## **The recording industry and its competitive characteristics**

To describe the creative industries from an economic perspective, 'A Handbook of Cultural Economics' (Towse & Hjorth-Andersen, 2011) provides an overview of how the cultural and creative industries differ economically from other sectors. In the chapter that covers the recording industry, Burke describes a market characterized by high levels of entry and exit which is subjected to "ongoing technological innovation in audio software and hardware" (Burke, 2003). However, the author also acknowledges the industry's more static attributes, such as "highly concentrated markets and low levels of change in firm ranking (in terms of market share)" (Burke, 2003). The music industry is essentially an oligopoly with three major firms (Sony, Universal and Warner) accounting for roughly 60% of global revenue. This is said to be a result of economies of scale and scope in manufacturing, distribution, marketing, finance costs and speed to market, causing a high minimum efficient scale for music industry organizations:

*"Their products are risky and subject to radically uncertain reception by consumers, which results in a very high failure rate (ratio of financial successes to flops) that adds to firms' fixed costs and exacerbates barriers to entry due to high initial capital requirements for production and global marketing"* (Burke, 2003).

Two relevant concepts when describing the music industry's market structure are economies of scale and scope. Economies of scope is related to diversification of output, and exists when the costs of producing two or more products together is lower when producing and selling those separately (Gandy, 2012). Economies of scale, on the other hand, presumes that the cost of inputs per unit of production is lower when the level of production is greater (Gandy, 2012). Economies of scale are mainly about production costs and product efficiency, and therefore relate to the aspirations for cost leadership.

When discussing rates of returns for investment, large incumbent firms in the music industry have a competitive advantage, because of vertical integration of production. That allows large firms to generate more income from a single production. At the same time they use their size and networks to penetrate the market better and faster. But most importantly, large firms can spread their sunk costs of un-recouped advances (about 94% of total advances) over a larger amount of investments.

When discussing competition, it can be said that because of the heterogeneousness of a record label's output, due to artists being 'imperfect substitutes' of each other, the supply side of this market is relatively non-competitive. Record labels and other similar firms on the other hand do compete for resources (mainly potentially successful artists). It seems that for new entrants, effectively competing with incumbents, while operating with a business model that is subjected to the previously described economies of scale, is difficult, if not impossible. However, there are certain internal elements of large incumbents in this market that allow for the existence and survival of smaller players, and are the cause of the roughly 40% market share of independent record labels. One example are cannibalization effects, which are also called 'business stealing effects'. These effects happen when a record label signs a new artist and it can either multiply the net gain for the label, or in some cases it can drive attention and income away from an artist that is already under the label's roster. This concept, as Burke (2003) highlights, could potentially be beneficial for new entrants and smaller firms, as it provides the opportunity to sign potentially successful artists that are rejected by larger labels. Thus, it can be said that the competitive strategy of the traditional independent record label is based

on signing artists that are either overlooked or rejected by larger firms, due to some degree of substitution of output. However, this then leaves out the important concept of product differentiation. Porter (1998) states that larger firms with greater access to resources usually take advantage of cost-based strategies, while smaller firms compete in a niche market with highly differentiated products. New entrants can therefore compete by focussing on a market that is neglected by the incumbent record labels, which explains why independents record labels usually sign artists that operate within a certain niche.

### **Market failures in the traditional music industry**

Market failure is a topic that is closely related to government intervention and welfare economics, making it a central issue in the analysis of the cultural economics. Within the context of this study, market failure is related to moral hazard and the previously mentioned principal-agent theory. This theory describes the problem which occurs when one person's (the agent) decisions impact another person or when he takes actions on behalf of the other. It is furthermore related to the problem of risk-aversion in the music industry. Central in this issue is that in some cases, agents can act out of their own interest, which is contrary to the principal's interests. Artists can for example act out of art for art's sake interests, which causes moral hazard, because it conflicts with the commercial interests of pursuing the pecuniary value of the recording by the record label. According to Caves (2000), this is exactly the reason why artists usually are obligated to hand over their decision rights in a standard artist-label contract.

On the other hand, record labels can make decisions that are contrary to the artist's creative and commercial interests. This is related to the obtainment of copyright by the record label which includes issues of inefficiency in the supply of the artist labour market. Caves (2000) argues that this is a result of the 'high stiff ratio' of projects that fail to recoup the label investment and cause sunk costs. Record labels have an incentive to promote the artist's career, because it increases the pecuniary value of future obtained copyrights, but risk-averse behavior in some cases implies that the agent could diverge its resources to a different artists because this artist suddenly shows an increase in popularity.

Another common type of market failure in the cultural industries is that of moral hazards and information asymmetries. Moral hazards come forth out of the previously described issue that the value of cultural goods is uncertain to the consumer until after consumption. This causes an asymmetry of information problem where demand is not efficiently supplied.

*"Information costs lead consumers to choose what other people have already selected, according to a mimetic process. Market forces alone do not select naturally the most talented: selected performers may be untalented, and the inertia of consumers' behaviour leads them to dominate an increasing share of the market"* (Benhamou, 2003)

### **Digitization's organizational-level influence**

The impact of digitization, which is a subject that has been covered quite extensively by academic research, is claimed to help new entrants to compete by making it possible to avoid traditional barriers to entry with

the help of technological innovation. Pitt (2015), for example points out that companies such as TuneCore and CD Baby, who have quite similar business models as AWAL, have used new software technology to differentiate themselves from incumbent PRO's (Performance Rights Organizations). PRO's generate value, based on the Coase (1960) theorem that transaction costs are associated with the allocation of property rights, causing inefficiencies. Collection societies economize on the reduction of these costs and inefficiencies through the centralization and bundled allocation of mechanical rights. Companies like TuneCore are able to compete with their monopolies "by offering independent musicians several income-revenue streams, weekly royalty payments, and instant access to sales and performance data, giving musicians control over their music" (pitt, 2015). In this case the natural monopolies of PRO's such as the PRS and NCPS are disrupted. In this specific case, the disruption is made possible by TuneCore and CD Baby being able to provide the same lowered transaction costs upon which PRO's business model was built:

*"Prior to the digital age, the rationale behind the natural monopoly regulation of PROs, instead of a competitive system, was that a single collective agency reduced the transaction costs of publicly performing copyrighted musical compositions for both individual music users and copyright holders" (Pitt, 2015)*

It is not uncommon in the case of investigating alternative institutional arrangements, to look at the barriers that prevent transactors from securing their potential gain from trade. In the music industry, these barriers usually prevent competition, but are now subject to technological innovation. Similar to the PRO example, there is currently a debate about the necessity of the record label's position in the music supply value chain. A frequent critique is that the major record labels artificially uphold their market share based on anti-competitive measures such as the extension of the copyright duration and the advocacy of anti-piracy laws: "between 1998 and 2003, the record industry was unable to imagine innovative value-creation logics because of cognitive lock-in. Therefore, the record industry tried to reinforce the traditional logic in order to capture profits more efficiently" (Moyon, 2014). However, this notion of disintermediation is contested based on the fact that, according to IFPI (2018), most artists today still aspire a record deal.

In economic terms, true independence of artists from economic agents would mean the integration of formerly outsourced functions. However, outsourcing these functions is built on the logic that the involved transaction costs are lower than the potential costs of integration. Based on this principle, artists can only be truly independent once the costs of integration fall below the transaction costs of outsourcing these functions. It is true that the internet has somewhat reduced these costs, but not enough. The notion that the music industry is currently undergoing a "shift away from the 'traditional' business model where sales and marketing strategies were driven by record labels, to today's digital environment where artists have a variety of channels for self promotion" (Tschmuck, Pearce & Campbell, 2013), is therefore regarded to be an oversimplified view that still has to be proven. The industry now has come to a where that digitization is slowly seeming to alternate certain industry structures. It is no longer an industry that is aversive to change.

*"As entry barriers are removed, new specialist companies are entering the market, and there will be a greater variety of potential partners; new combinations of customers, suppliers, and business partners are emerging to replace the dominance of the major record labels. Hence, the traditional, static music industry*

*supply chain is becoming increasingly dynamic as new combinations of organizations come together” (Graham et al., 2004))*

As Porter (1998) mentions, industry evolution is of critical importance for the formulation of a firm’s strategy. It has many related concepts, such as the product life cycle, product change and product innovation. Also does Porter mention the possible changes in buyer segments served. Overall does industry evolution have a significant impact on strategy and, given the circumstances described above, this concept should not be neglected in the analysis of AWAL’s competitive strategy. Porter (1998) states that reduction of uncertainty is a great indicator of changing industry structure. Uncertainty in this case leads to experimentation, “with many different strategies adopted representing different bets about the future” (Porter, 1998). However, Porter also highlights that over time, when uncertainties are resolved, new strategies may be disproved and the industry will continue to evolve and become more stable. Uncertainty therefore is not a solid base for any strategy. Uncertainty is also often met with preliminary adaptations of business strategies. A good industry example of strategy adjustment is the way record labels adapted their business model to include data collection methods and increasingly use the benefits of streaming services.

## **Conclusion**

In conclusion, the recording industry is subject to a number of different microeconomic and cultural-economic concepts. It is traditionally an industry that can be classified as an oligopoly, with a high stiff ratio and skewed distribution of income. This is mainly caused by a high medium efficient scale (MES). Furthermore, incumbent firms as well as artists are risk-averse and economic agents are subjected to sunk costs. These inputs have created the traditional industry structure, which raises the question which aspects of the industry are subjected to disruption by digitization, and subsequently, how this is related to the formation of AWAL’s business model.

## **Methodology**

### **Unit of analysis**

AWAL is this study’s unit of analysis. However, the following table shows a summarized overview of which components of this case are actually being studied. The decision to analyze these specific components is a result of a thorough literature review, and decisions were made based on an evaluation of what theories would best help in accomplishing the research aim.

<b>Concept</b>	<b>Studied components</b>
Architecture of the product	- Service definition

Identification of the market segment	- Two-sidedness
Cost structure and profit potential	Definition of the value chain Market segment Transaction costs
Formulation of the competitive strategy	Barriers to entry, and cost structure Differentiation Direct and indirect network effects

## Research approach

The design is different from traditional empirical research in the sense that it does not try to identify or describe a causal relationship between two variables. This means that the approach is more focussed on understanding a single case. This explains the application of the descriptive case study design, as this design aims to provide an organized and cohere presentation of the case and it allows to see the case through the theory.

Being a conceptual study, obtaining primary empirical data was not found to be a necessity. This assumption was made based on the fact that in the effort to make accurate practical assumptions and predictions about this case, providing a strong theoretical framework was deemed much more important. This is because the thesis is a study of a business model, of which the components are easily obtained and do not require any kind of research tools such as surveys or interviewing. Instead, accurate assumptions and results are based on the formulation of theory and applying this theory to the business model. Therefore, AWAL's (publicly available) service definition is the most relevant data source. However, more in-depth data such as AWAL's market share percentage would also have been helpful. Although I asked for these data, they were unfortunately not provided by AWAL, due to the competitive sensitivity of these numbers.

## Validity, reliability and generalizability

Being a conceptual study, the concepts of validity, reliability and generalizability have different applications than in a traditional qualitative research. With respect to validity, or the appropriateness of the research processes, "choice of methodology must enable detection of findings/phenomena in the appropriate context for it to be valid, with due regard to culturally and contextually variable" (Leung, 2015). The use of publicly available data to form value-based conclusions and predictions about the business model in traditional research methods is not regarded as sufficient. However, given the research objective, the detection of findings was considered to be done properly by providing strong theory. This research's validity is therefore grounded in the accurate decision-making when it comes to choosing the relevant economic concepts. The chosen concepts were based on applications of research on firm performance, especially applied to intermediary firms, which was found most suitable given the aim of understanding a firm's value inside a certain market environment.



The concept of reliability lies in the accurate description of the used theoretical concepts in relation to the case. In other words, if someone else would conduct the same study using the same concepts, he would probably have similar results.

In terms of generalizability, the findings of this research can be very well applied to future business models. It is also important to say that findings from this research are merely assumptions. Furthermore, these assumptions are not based on performance data of AWAL or on data of similar firms.

## **Results**

In order to show the results in a clear way without getting lost in the different concepts and subjects, the results section of this paper is separated into separate sub-sections. The categories of subjects upon which these sections are divided are based on the different business model components which were described in the theoretical framework.

### **AWAL's service definition**

According to Throsby (2016), "the first requirement in any economic analysis of an industry is to define the product". Subsequently, providing AWAL's service definition seems like the most logical starting point of the results and analysis section. A service definition is defined as the "architecture of the product" to which the

theoretical concepts that were described in the theoretical framework can be related. Relevant in this description are AWAL's service components and their related costs. These are graphically represented in relation to the components and costs of its most direct competitors, including digital distributors, streaming services and collecting societies, to provide a more clear overview of it's originality (see table 1). Traditional record label business models have not not been included, but are discussed separately.

AWAL's service definition and cost structure

Value creation	AWAL	Digital distributor (examples used: CD Baby, Tunecore)	Collecting society (example used: PRS)	Streaming service (example used: Spotify for Artists)
Services	Digital music distribution, playlist promotion, collection of user generated content. After initial success: added label-related services, including funding	Digital music distribution, publishing administration, analytics, and artist services that "enable" artist to promote themselves. Automated advances based on anticipated streaming earnings (in the case of TuneCore)	Licence music and collect royalties when a work is "performed, broadcast, streamed, downloaded, reproduced, played in public or used in film and TV" (in case of PRS), offers support for the industry (indirect funding)	Enable social media promotion, basic performance and geographical analytics
Function	Intermediary, lowers transaction costs between online retailers and creators of music	Intermediary, lowers transaction costs between online retailers and creators of music	Intermediary, lowers transaction costs between digital distributors and recording rights holders	Intermediary, lowers transaction costs between end users and creators of music
Cost structure	AWAL	Digital distributor (examples used: CD Baby, Tunecore)	Streaming service (example used: Spotify for Artists)	Collecting society (example used: PRS)
Certification / curator function	Selection based on: "creative quality" "positive fan engagement" "positive media engagement" "business relationships" and "professionalism"	Minimal audio quality requirements	Only accepts music supplied via a DSP, curation function for end- users via both manual as well as algorithms-based suggestions	Has no certification function,
Measurement	Relatively high due to the measurement of "creative quality" and "professionalism"	Relatively low, funding applied based on performance numbers, not on perceived quality	Low, quality measurement task is outsourced to the distributor or DSP	Has no measurement function
Licencing	Standardized, non-exclusive	Standardized, non-exclusive	Standardized, non-exclusive	Standardized, exclusive

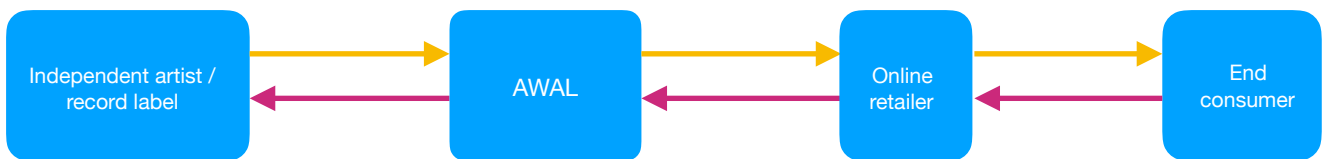
Enforcement	High due to high amount of transactions, but lowered by active screening	High due to high amount of transactions	High due to high amount of transactions	High due to high amount of transactions
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What is shown in this graph, is that AWAL’s service definition differs most significantly from its competitors by incorporating a more extensive gatekeeper function. Other than TuneCore, artists are screened based on a number of different variables, which are valued by a non-automated valuation process. This closely resembles the traditional record label’s A&R function which is very costly but also increases the pecuniary value of signed artists and thereby reduces sunk costs. AWAL most closely resembles its competitors by centralizing and distributing content as well as market information (with the exemption of collecting societies, who do not distribute content but the rights to use content). Next to this important similarity, this graph shows that all market players operate with standardized, non-exclusive contracts. Artists who sign up to these services retain full control of the mechanical rights of their recordings. This is also where AWAL and its competitors differ most significantly from a record label, whose business model is primarily based on the obtainment and trade of recording rights. Furthermore, just like many online-based intermediary firms, one of the organization’s most important functions is lowering the transaction costs between two parties. AWAL centralizes both market information as well as content, making it less costly for artists to trade with digital retailers. It is important to note that AWAL also provides its services to independent record labels, but this is not included in the analysis, for the sake of demarcation of the research.

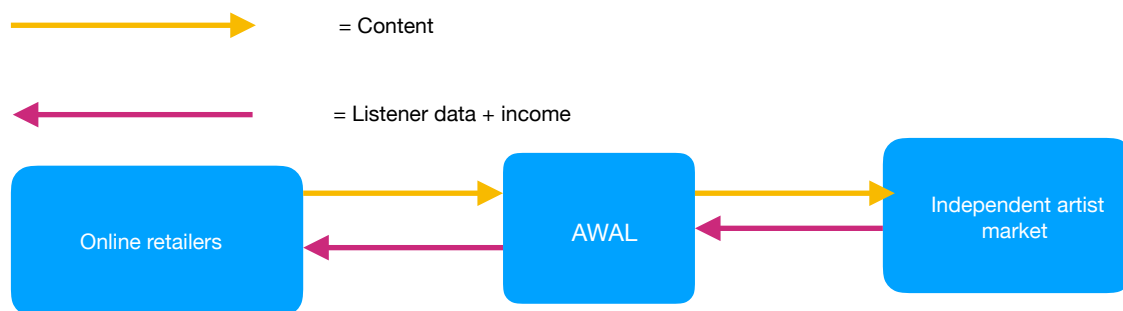
### **AWAL’s position in the value network**

As figure 1 shows, AWAL can be seen as a business-to-business, two-sided firm, which supplies music recordings to online music outlets and at the same time provides certain services for artists. Central in this issue is the concept of demand and whether or not this is two-sided for AWAL. According to Rysman (2009), a two-sided market is a market where “two sets of agents interact through an intermediary or platform, and the decisions of each set of agents affects the outcomes of the other set of agents, typically through an externality” (p. 125). In a two-sided market the intermediary firm centralizes the transaction and market information of the two sides of the market, which also allows the firm to exploit indirect network effects. Indirect network effects occur when the intermediary allows trade with the other side of a market. Given the fact that Spotify only allows content that is uploaded via an intermediary firm, it can be said that just by this notion one of AWAL’s functions is that of a facilitator. The notion that they bring several agents together is more debatable, as AWAL can not be considered a “marketplace” platform such as Spotify.

Some clarification might be provided by looking at the organization’s playlist promotion service. It is important because it seems to be the main promotion-related service AWAL offers. If one considers streaming service’s curated playlists as one side of the market, and independent artists the other, a more convincing case for AWAL’s two-sidedness can be made. This is because within this framework, the demand of the two market sides definitely influences each other. When more AWAL recordings are incorporated by these playlists, and/or if these playlists increase in popularity, potentially successful artists will most likely increase their willingness to choose AWAL over other similar services or record labels contracts. Simultaneously, if more independent artists deliver commercially successful recordings through AWAL’s service, playlist curators will become more willing to add AWAL’s repertoire to their playlists. AWAL can subsequently benefit from these indirect network effects, and facilitates this transaction between the two parties. Overall does AWAL’s two-sidedness seem to depend on the perspective from which its market segment is viewed. The following figure represents the value chain and its description represents the two different views:



(AWAL’s market value chain when the recordings are the product, artists are economic agents and music consumers are regarded as the end-consumer)



(AWAL’s market value chain when the service bundle is the product and independent artists are regarded as end-consumers)

What can be seen in this figure is that the two intermediary firms in this value chain basically intermediate in the transaction of two goods, end consumer data and end consumer royalty income. AWAL does not facilitate a transaction, but instead adds curation to uploaded content and at the same time adds commercial potential for content that is uploaded via independent artists. In the second form, AWAL takes the role of an intermediary service provider, extracting, as well as providing resources to two interdependent economic partners: streaming services and independent artists.

### **AWAL's market segment**

The following paragraph is aimed at defining AWAL's targeted market segment within the recording industry, and to compare this with other industry players. According to Towse, (2003), "a market is a group of consumers expressing desires and needs for products, services or ideas". A firm's market as a concept is closely related to a firm's position in the value chain, but is different on the principle that it aims to describe the unique characteristics of the targeted consumer group, instead of just identifying them. A case could be made for the existence of an 'independent artist market', in which intermediary platforms economize on otherwise possible unexploited income from commercial talent. This is not a case of market segmentation, but instead a division between an artist labour market, who aspires a recording contract from a record label, and the before-mentioned independent artist market, which is seen as a market of producers of creative goods that require humdrum inputs (resources of intermediary firms), but at the same time operate as independent entities for several reasons. These two markets presumably often overlap and share very similar characteristics. Within this framework, for the sake of clarification, artists who are signed to record label-type contracts are seen as employees, and their relationship with the label is that of an employer-employee.

However, the concept of the 'independent artist market' has not been covered by academic research. This makes it unclear what the characteristics of the demand-side of this market are, and it is beyond the scope of this research to provide an in-depth overview. Nevertheless, a study by Burke (1997) shows the determinants for artists to choose to release their music independently opposed to via a record company, which is found to be the most helpful source in this analysis. Burke for example mentions the following determinant:

*"Composers who generate net multiplier effects for particular record companies are highly likely to accept a record contract as it is possible for a record company to offer a royalty and advance deal which also rewards composers for these positive externalities. It is difficult to imagine new small firms being in a similar position to capture the positive externalities generated by multiplier effects"* (Burke, 1997).

Other inter-firm determinants include capital constraints, first mover/economies of scale advantages and profits. Therefore, artists formerly could choose the path based on the profit potential that a record deal

offers, based on the firm's scale and network benefits. It is important to note that within this quote, Burke compares the independent artist decision with accepting a recording contract only with the option of creating their own start-up firm, which in his description is the only viable commercial alternative for artists. This different view is probably related to the time in which this study was done, which makes its results less applicable. Nevertheless can the assumption be made that (without taking AWAL's added value into account) artists who chose to be a part of the independent artist market, probably deemed their profit potential of signing a standard recording deal not high enough.

### **Differentiated service bundling**

What is also evident from these firm's service definition, is that its business contains not one, but a multitude or 'bundle' of services. This carries with it an important economic logic, which should not be left out in this description. Service bundling, as Stremersch and Tellis (2002) point out, like business model theory does not have a definition that is universally agreed upon, but basically means 'selling goods in packages', and is called a long-term differentiation strategy. Of the economic logics embedded in the strategy the most important one is related to diversification in relation to competitive strategy. Here "the central idea is that bundling enables competing firms to differentiate their products and thus reduce price competition in their primary market" (Chen, 1997). This quotation falls in line with Porter's description of the competitive purpose of differentiation, as he states that this strategy leads to buyers being less price-sensitive, allowing the firm to be less reliant on a low-cost based strategy.

Another economic logic of service bundling is related to the lowered (transaction) costs of outputs compared to providing or producing services separately. This is also related to the economies of scope, and significantly increases AWAL's output value. However, it differs from the theory of economies of scope in the sense that bundling is about service output and customer valuation, while economies of scope is about the reduction of the costs of production. Based on the separation of these two concepts, it can be said that the strategy is both innovative as well as traditional. It is innovative because AWAL uses digital retailers not only for distribution, but also for marketing, which reduces the costs of both functions. It is a traditional strategy in the recording industry, because record labels traditionally "bundle" distribution with marketing and their costs are simultaneously incurred in the artist royalty rate.

Differentiation also obligates the need for a low cost function according to Porter. Porter also states that it is best for a firm adopting this strategy to differentiate themselves along several dimensions. Looking at AWAL's service definition, it clearly differentiates itself from digital distributors such as TuneCore by incorporating a more active gatekeeper function. This is called technological differentiation, and allows AWAL to create a defensible position for coping with competitive forces. It explains why AWAL can take a relatively high royalty income percentage compared to its most direct competitors. Their differentiated strategy mitigates the buyer power of artists and makes them less price sensitive.

### **AWAL's cost structure**

In business model theory, a firm's cost structure is related to the description of its profit potential. Furthermore, the concept is named as one of the three generic competitive strategies by Porter. In terms of competitive strategy, a firm's cost structure can be used to outperform its competitors by keeping its operational costs as low as possible. Based on the results obtained from the description of AWAL's service definition, it is assumed that this concept is AWAL's most significant tool in their competitive efforts with incumbent record labels.

The most obvious example that illustrates this statement is AWAL's investment function. AWAL, similarly to digital distributors such as TuneCore, offers funding to aspiring independent artists, which they can use for recording and promotional purposes. Investment however, is only provided to artists who surpass a fixed steaming success threshold. This differs significantly from the traditional record label business model, which is based on high fixed costs in upfront investment in return for copyright ownership of the end-product. When discussing AWAL's competitive strategy, this can be related to overcoming economies of scale-related barriers to entry. Large firms traditionally have an advantage in this sense as they are able to spread their risk over a larger amount of artists. AWAL's lack of preliminary investment thus greatly decreases sunk costs. However, this does not mean that AWAL's business model eliminates the risk of sunk costs. There are still certain costs present such as promotion and measurement costs. Also, as previously mentioned, funding is provided to a specific selection of artists who have been under the artists roster for a certain period of time and have proven their commercial appeal by reaching a high amount of streams or sales on online platforms. Measurement costs within this process are kept relatively low due to the previously named fixed success threshold that needs to be reached prior to investment, and more importantly the fixed amount of funding per artist who actually reach this threshold. This function also significantly lowers contracting costs that are traditionally a large percentage of the recording's sunk investments.

Furthermore, AWAL in its core service (without counting its investment function), outsources the most cost-intensive spectrum of the music value chain, which is its production process. This is in fact quite similar to the independent label model, which in most cases only initially trades in finished products due to a lack of available investment funds. As stated in the theoretical framework, involvement in the production process can increase the pecuniary value of a recording. AWAL therefore has increased monitoring costs, which are caused by the need to compensate for this loss over the control of the commercial value of produced recordings. This is quite a common principle for firms in general: "The production of inputs outside the firm requires additional costs associated with the management as well as quality control of the input production lines carried by the subcontractors" (Shy and Stenbacka, 2005). This is not an uncommon model in the music industry. For example, independent distributors of physical records also showed risk-averse behavior in the sense that they show a gatekeeper function: in order to maximize fees they conduct their own cycle of product profiling and assessment to ascertain which products would be prioritized and where to spend sales and promotions budgets.

However, internalization is not only related to cost benefits, but also as a cause of transactional failures for markets for intermediate goods. This is applicable, because the choice to completely outsource the production process can also be a result of AWAL's efficient, low-cost transactional structures with artists, of which its fixed contracts are a good example. Furthermore are transactions with artists based on flexible grounds: "the AWAL deal is a simple digital distribution license with a 30 day rolling term which means that you can terminate your agreement with us at any time on 30 days' notice" (<https://wildmusic.es/ewam/faq>).

This contractual flexibility of course works both ways, meaning that any unsuccessful act can be dropped from the roster if the additional revenue income is deemed to be outweighed by the service costs in the long run.

### **The mitigation of market failures**

As was described in the introduction, AWAL is (presumably) built on the idea that the traditional music industry business model fails to serve the changing needs of music artists. This, in basic economic terms would constitute as an example of market failure. Vertical integration leads to anti-competitive effects. If you consider the competition in the independent artist market, there is indeed a case of market failure through integration, as firms that perhaps might provide a better suited product for artists were traditionally competed away. Also, the theoretical framework of this paper described other market failures in the recording industry, including the principal-agent issue and information asymmetries, which the organization possibly mitigates, or perhaps induces. For this failure to be mitigated, AWAL's interests should align better with those of artists compared with record labels.

The principal-agent problem could be reduced by the low-cost position of AWAL in regard to its distribution and promotion functions. This, combined with a fact that AWAL only generates sales from the percentage they take of streaming income, could create more of an incentive for AWAL to act out of the artist's interest. As is stated on the website of AWAL: "we only make money when you do". However, not owning the copyright to these recordings might give AWAL less of an incentive to increase its value. Similarly, not signing long-term deals with artists might make AWAL less interested in enhancing the artists career.

The second mentioned form of market failure in the cultural industries, asymmetrical information, and supply's inability to efficiently reach its target consumer, also to some extent might be mitigated by the business model. As Caves (2000) puts it, "asymmetrical information, usually involves a situation in which the seller knows key characteristics of the product not known to the buyer. However, in creative industries nobody knows, and the core problem is one of symmetrical ignorance". Whether or not AWAL helps to solve this problem depends on if it helps niches of the independent artist market to better reach its target consumer, and that they implement a more effective strategy than (independent) record labels. However, this is a very complex and difficult question to answer because it involves many unknown variables. Nevertheless, it is assumed, based on the fact that AWAL does not select artists based on genre, and again because of its low-cost structure, might provide an incentive to further work with artists who operate in a niche.

### **Future threats**

Probably the most significant threat to AWAL's future success is the vertical integration of streaming services. This threat is highlighted in an article by Mulligan (2018), where it is stated that:

*"Spotify does have a number of different switches it can flick that will each contribute percentages to net margin and that collectively can help Spotify become commercially viable and in turn enable it to invest in*



*the product and experience innovation that the streaming sector so crucially lacks” and “To say that Spotify will become a label is too narrow a definition of what Spotify would become. Instead it would be a next generation music company, encompassing master rights, publishing, A+R, discovery, promotion, fan engagement and data, lots of data”.*

Furthermore does Spotify have the financial means to acquire Kobalt or other data-driven services if they find this to be a profitable investment in the long-run. The probability of this scenario depends on the economic concepts of a streaming service’s cost structure and a firm’s optimal scale. To make adequate prediction of this scenario, it is first important to look at what function AWAL provides that reduces certain costs for Spotify. Given AWAL’s previously described gatekeeper and curator functions, which they share with record labels, streaming services are provided with content that does not or to a lesser extent have to be pre-screened in order to be added to one of their curated playlists. This makes AWAL act as a filter for Spotify. Therefore, as soon as the transaction costs of outsourcing this function fall above the cost of integrating it streaming services will most likely either add their own services and cut AWAL off from their vitally needed data, or acquire AWAL as a subsidiary firm.

Another relevant threat may come from competition of similar business models. If the model is found to be a highly commercially viable entry to the market for new firms due to its scale efficiencies and cost structure, and if the streaming market continues to grow, it is very likely that new entrants will arrive until a market equilibrium is reached and the entire independent artist sector is served. However, there are still barriers to entry for new firms that aim to operate with a similar business model. The digital distribution function alone requires significant investment into IT-related systems. Furthermore does AWAL rely heavily on beneficial agreements with streaming services when it comes to data analysis and playlist promotion, which are very hard for new entrants to establish due to scale inefficiencies. This may cause the market to be dominated by subsidiaries of incumbent firms, which is now already the case, due to their recourse benefits and network effects. For example, the major labels develop their own label-services companies, which are for example Caroline (Universal), Red (Sony) and ADA (Warner Music).

Being heavily dependent on the success of online music retailers, and especially streaming services for both royalty income as well as streaming consumer data, AWAL might benefit from the further increase of their market share, but at the same time can considerably decline as a result of a decline in market share. It is highly unlikely that physical distribution will regain the upper hand in the future, but further technological development might bring about a new way of music distribution and consumption that calls for new intermediary business models, which are more adequately mitigating certain market failures. Technological change however, is part of the macro-environment of the firm and is therefore not controllable.

Another threat which should be mentioned is restrictions on data usage. According to Becker (2014) “Competitive advantage for businesses is now to be found in the use of data to understand customers. In this new data age, however, the individual is gaining a new power to demand a fairer share of the economic value of personal information”. This goes both ways. Who actually controls the artists data might in the near future be a relevant question. It questions who controls the artists per-stream royalty income. Consumers also might be more inclined to protect its consumer data: “a new economic actor, the individual consumer, is rising to compete alongside industry giants for the control and monetization of data, more specifically of their own personal data” (Becker, 2018). Both parties however still highly benefit from the intermediary’s services,

making these scenarios unlikely. As personal information becomes a currency, it will become as precious as other limited resources and managed as such, since it is the gateway to the individual's attention and time.

## **Discussion**

Because of this study's exploratory nature, its findings are quite wide-ranging and are in some cases interconnected. Who AWAL competes with seems like one of the most relevant questions. Firstly, regarding AWAL's service definition, it is clear that it produces a bundled service which caters to a specific market, namely the independent label market. The recency of the development of this market, and on the overlap with the artist labour market, makes it's comparison with the traditional record label business model more complex. Certain aspects of competition and firm performance in the recording industry subsequently apply to AWAL, but others are found to be less relevant. Arts for arts sake and nobody knows inputs and their associated uncertainty risk-averse behavior are still applicable, and are found in AWAL's A&R related

functions and the provision of funding only after a fixed success threshold is reached. AWAL also has an important gatekeeper function, and uses this to create value by reducing search costs for online retailers, as stated by the company itself: we aim for curative, scalable quality over quantity” One of AWAL’s greatest strengths is it’s ability to surpass conventional barriers to entry by establishing itself as a label service provider, which offers a unique product to an undersupplied market. This is allowed by it’s low-cost structure. AWAL position itself as an alternative to a record label, but in fact occupies a very different spot in the value chain, and even caters to a different market. Furthermore can it be seen as a two-sided intermediary, which trades in data as well as creative content and lowers transaction costs in the process. A record label on the other hand, is a supplier of creative content who sees artists and as important resources, but not as the end product. Therefore, if AWAL can truly be seen as an alternative to the record label for artists, it must somehow show that the value of it’s added inputs to the creative content is at least equal or higher than that of a record label, which is unclear at this point.

## **Conclusion**

Going back to the aim of this research, it’s research question has been answered to some extend, but not fully. Based on the found economic logics underlying its business model components, AWAL’s position in the music industry is that of a two-sided intermediary between an independent artist market and online music retailers. Its value is generated from enhancing each agent’s value, and lowering transaction costs between the two parties at the same time. The artist’s product’s gain in pecuniary value though the implementation of low-cost, but presumably effective humdrum inputs. The digital music retailers benefit from outsourcing it’s curator function. AWAL’s business model has quite a strong position in the music industry, due to it’s low

cost and differentiation-based competitive strategy. Therefore, in terms of its value for the industry at large the assumption can be made that it will continue to thrive, and even grow its influence in the near future, hereby mitigating certain market failures which are beneficial for artists but not for incumbent record labels. Oversupply on the artist labour market due to intrinsic motivation can be seen as market failure in the case some or all of the unserved entrants have some kind of potential commercial value that is unexploited by the current amount of intermediary firms. By keeping transaction costs as low as possible, new firms try to economize on this unsatisfied portion of the market. However, AWAL does not seem to pose a competitive threat to incumbent firms (yet), because it presumably competes in a different market segment.

### **Recommendations for AWAL**

Based on AWAL's strong cost structure and differentiation-based strategies, AWAL is likely to continue its organization successfully at least in the near future without the threat of competition from new entrants. More significant threats may come from the vertical integration of parts of AWAL's service by larger firms such as Spotify. It is therefore deemed to be vitally important for AWAL to understand its two-sided characteristics and not to neglect the value it creates for these firms. Therefore, unbalanced allocation of resources towards the independent artist market could potentially have significant negative implications for the future of the business firm.

### **Recommendations for the industry**

AWAL can only increase the market share of the independent artist market, and only its own market share in the label services market. This could increase the overall music industry's competitiveness in which case both artists as well as music consumers would be better off: "the economic challenge of the twenty-first century is transition from the managed to the entrepreneurial society, the purpose being to take full advantage of the knowledge-based society brought about by the diffusion of information and communication technologies" (Santarelli, 2006). For smaller firms, in case AWAL and similar organizations increase in size and influence, it is recommended to focus increasingly on serving a local networks and niche markets. This recommendation is based on the notion that the described new business model is more beneficial to "rejected" artists and therefore might it become harder and harder to compete with AWAL's scale-efficient service offerings.

### **Recommendations for future research**

The most important recommendation for future academic research that came out of the results of this research is to help to better understand the independent artist market and its characteristics. In other words, a study might be conducted which shows how artists who are part of AWAL or other similar firms share the same traits and background, which differ from artists who aspire to or are signed to a standard recording

contract. In the long term, when if more data about this firm's performance will become available, a more in-depth empirical research can be conducted which could potentially use the results of this study as part of its theoretical framework, and subsequently compare it's empirical results with this study's conceptual results. Overall does it seem that exciting times are ahead for the recording industry, and academic researchers in this field will be continuously supplied with new and interesting developments.

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