

The Changing Nature of the Music Industry

1 April 2006. Apart from being a traditional day for playing practical jokes, this was the day on which another landmark in the rapidly changing world of music was reached. 'Crazy' – a track by Gnarls Barkley – made pop history as the United Kingdom's first song to top the charts based on download sales alone. Commenting on the fact that the song had been downloaded more than 31,000 times but was only released for sale in the shops on 3 April, Gennaro Castaldo, spokesman for retailer HMV, said 'This not only represents a watershed in how the charts are compiled, but shows that legal downloads have come of age ... if physical copies fly off the shelves at the same rate it could vie for a place as the year's biggest seller'.

One of the less visible but highly challenging aspects of the Internet is the impact it has had – and is having – on the entertainment business. This is particularly the case with music. At one level, its impacts could be assumed to be confined to providing new 'e-tailing' channels, such as Amazon or hundreds of other websites. These innovations increased the choice and tailoring of the music purchasing service and demonstrated some of the 'richness/reach' economic shifts of the new Internet game.

But beneath this updating of essentially the same transaction lay a more fundamental shift – in the ways in which music is created and distributed and in the business model on which the whole music industry is currently predicated. In essence, the old model involved a complex network in which songwriters and artists depended on A&R (artists and repertoire) to select a few acts, production staff who would record in complex and expensive studios, other production staff who would oversee the manufacture of physical discs, tapes and CDs, and marketing and distribution staff who would ensure that the product was publicized and disseminated to an increasingly global market.

Several key changes undermined this structure and brought with it significant disruption to the industry. Old competencies were no longer relevant, while acquiring new ones became a matter of urgency. Even well-established names such as Sony found it difficult to stay ahead, while new entrants were able to exploit the economics of the Internet. At the heart of the change was the potential for creating, storing and distributing music in digital format – a problem that many researchers had worked on for some time. One solution, developed by one of the Fraunhofer Institutes in Germany, was a standard based on the Motion Picture Experts Group (MPEG) level 3 protocol (MP3). MP3 offers a powerful algorithm for managing one of the big problems in transmitting music files – that of compression. Normal audio files cover a wide range of frequencies and are thus very large and not suitable for fast transfer across the Internet – especially with a population who may only be using relatively slow modems. With MP3, effective compression is achieved by cutting out those frequencies that the human ear cannot detect – with the result that the files to be transferred are much smaller.

As a result, MP3 files could be moved across the Internet quickly and shared widely. What did this mean for the music business? In the first instance, aspiring musicians no longer needed to depend on being picked up by A&R staff from major companies who could bear the costs of recording and production of a physical CD. Instead, they could use home recording software and either produce a CD themselves or else go straight to MP3 – and then distribute the product globally via newsgroups, chatrooms and so on. In the process, they effectively created a parallel and much more direct music industry, which left existing players and artists on the sidelines.

Such changes were not necessarily threatening. For many people, the lowering of entry barriers opened up the possibility of participating in the music business – for example, by making and sharing music without the complexities and costs of a formal recording contract and the resources of a major record company. There was also scope for innovation around the periphery – for example, in the music

publishing sector where sheet music and lyrics are also susceptible to lowering of barriers through the application of digital technology. Journalism and related activities became increasingly open – music reviews and other forms of commentary become possible via specialist user groups and channels on the Web, whereas before, they were the province of a few magazine titles. Compiling popularity charts – and the related advertising – was also opened up as the medium switched from physical CDs and tapes distributed and sold via established channels to new media such as MP3 distributed via the Internet.

As if this were not enough, the industry was also challenged from another source – the sharing of music between different people connected via the Internet. Although technically illegal, this practice of sharing between people's record collections had always taken place – but not on the scale that the Internet threatened to facilitate. Much of the established music industry was concerned with legal issues – how to protect copyright and how to ensure that royalties were paid in the right proportions to those who participated in production and distribution. But when people could share music in MP3 format and distribute it globally, the potential for policing the system and collecting royalties became extremely difficult to sustain.

It was made much more so by another technological development – that of person-to-person networking. Shawn Parker and Sean Fanning, teenage students (Fanning had the nickname 'The Napster'), were intrigued by the challenge of being able to enable their friends to 'see' and share between their own personal record collections. They argued that if they held these in MP3 format, then it should be possible to set up some kind of central exchange program that facilitated their sharing.

The result – the Napster.com site – offered sophisticated software that enabled peer-to-peer (P2P) transactions. The Napster server did not actually hold any music on its files – but every day, millions of swaps were made by people around the world exchanging their music collections. Needless to say, this posed a huge threat to the established music business since it involved no payment of royalties. A number of high-profile lawsuits followed, but while Napster's activities were curbed, the problem did not go away. Many other sites began emulating and extending what Napster started – sites such as Gnutella, Kazaa and Limewire took the P2P idea further and enabled exchange of many different file formats – text, video and so on. In Napster's own case, the phenomenally successful site concluded a deal with the entertainment giant Bertelsmann, which paved the way for subscription-based services that provide some revenue stream to deal with the royalty issue.

Expectations that legal protection would limit the impact of this revolution were dampened by a US Court of Appeal ruling, which rejected claims that P2P violated copyright law. Their judgement said, 'History has shown that time and market forces often provide equilibrium in balancing interests, whether the new technology be a player piano, a copier, a tape recorder, a video recorder, a PC, a karaoke machine or an MP3 player' (Personal Computer World, November 2004, p. 32).

Significantly, the new opportunities opened up by this were seized not by music industry firms but by computer companies, especially Apple. In parallel with the launch of their successful iPod personal MP3 player, they opened a site called iTunes, which offered users a choice of thousands of tracks for download at 99c each. In its first weeks of operation, it recorded 1 million hits; in February 2006, the billionth song, 'Speed of Sound', was purchased as part of Coldplay's 'X&Y' album by Alex Ostrovsky from West Bloomfield, Michigan. 'I hope that every customer, artist, and music company executive takes a moment today to reflect on what we've achieved together during the past three years', said Steve Jobs, Apple's CEO, 'Over one billion songs have now been legally purchased and downloaded around the globe, representing a major force against music piracy and the future of music distribution as we move from CDs to the Internet'.

This technological change to digital music was a dramatic shift, reaching the point where more singles were bought as downloads in 2005 than as CDs and where new players began to dominate the game. And the changes didn't stop there. In February 2006, the Arctic Monkeys topped the UK album charts and walked off with a fistful of awards from the music business – yet their rise to prominence had been entirely via 'viral marketing' across the Internet rather than by conventional advertising and promotion. Playing gigs around the northern English town of Sheffield, the band simply gave away CDs of their early songs to their fans, who then obligingly spread them around on the Internet. 'They came to the attention of the public via the Internet, and you had chat rooms, everyone talking about them', says a slightly worried Gennaro Castaldo of HMV Records. David Sinclair, a rock journalist, suggests that 'It's a big wakeup call to all the record companies, the establishment, if you like ... This lot caught them all napping ... We are living in a completely different era, which the Arctic Monkeys have done an awful lot to bring about'.

Subsequent developments have shown an acceleration in the pace of change and an explosion in the variety of new business models better adapted to create and capture value from the industry. For example, the US music download business became dominated by Apple and Amazon (with 70% and 10%, respectively, of the market) – two companies with roots in very different worlds. While the volume of downloads increased significantly, competition emerged from other new business models, notably those built around streaming services. In 2008 the Swedish company Spotify AB launched the Spotify service with a different assumption – that people did not necessarily wish to own the music they wanted but would be prepared to rent access to it on a subscription basis. Its catalogue now runs to over 30 million items and the company currently has 271 million users spread across 79 countries; of these 124 million pay a subscription for the premium service while the rest access the service for free with the costs being picked up in advertising streamed alongside the music.

SOURCE: Tidd & Bessant (2021). Textbook 7th edition