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## **STUDY CONCERNING FAIR COMPENSATION FOR MUSIC CREATORS IN THE DIGITAL AGE**

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## Executive Summary

*This study uses financial and economic data to explore the current structure of the digital streaming market for music, comparing it to other sectors that distribute creative content to determine an appropriate valuation of musical works as well as an equitable split of revenues.*

***The findings reveal that, as they are currently structured, digital streaming services are built on an exploitative value chain that undervalues the musical works which drive their business. Furthermore, regulatory constraints, market imbalances and labels negotiating with services for all types of rights holders has led to the preferential treatment of major record labels at the expense of individual creators and performers.***

*Our study determines that the market rate for use of music by streaming services should be 80% of gross revenue, paid to all rights holders, with a 50/50 split between record labels/performing artists on the one hand and music publishers/songwriters on the other. Currently, services are paying 60-70% of gross revenue to rights holders with an average 94/6 split in favor of record labels.*

*To combat these obstacles to the long-term sustainability of these services and encourage the equitable distribution of revenues, a 'fair trade' approach based on a transparent, easy-to-understand set of ethical business standards that gives consumers a choice at the point of purchase is worth considering.*

Although digital streaming services currently make up less than 15% of the global music market share, they are poised to become the predominant model for distribution of music in the future. By providing access to nearly the entire global repertoire of musical works on multiple devices and platforms, digital streaming is a boon for increasingly mobile consumers and has enormous potential for creators.

Yet so far, the market for streaming is still in a developmental stage where subscription prices and advertising revenues are lower than those that would prevail in a mature market. Furthermore, performers, songwriters and composers have been vocal in their criticism of the low payments they receive from these services for the use of their works. In the US, popular services like Pandora, Spotify and iTunes Radio pay per stream fees to performers of between \$0.001 and \$0.005, with most hovering around \$0.0012. For composers and songwriters, those amounts are even less. In Europe the figures are very similar. Yet even the astonishingly petty amounts doled out don't always make it to the creators and performers due to a number of highly questionable practices during both negotiations of rates and distribution of collected monies, compounding the already inequitable division of revenues.

Without sufficiently supporting the very group of people who provide them with the creative content that drives their business, these streaming services may be undermining their future sustainability. Considering the economic power of the entertainment and cultural industries, we all have a vested interest in seeing these services succeed.

This study, titled “Fair Compensation for Music Creators in the Digital Age,” uses financial and economic data to answer questions that have arisen around music streaming models, including:

- Is the overall amount of compensation to rights holders for the music consumed through these services sufficient?
- Is the share distributed by the services to creators, performers and other rights holders appropriate when compared with other music platforms?
- How is the share distributed to rights holders divided between the songwriters and music publishers vested in the composition of the underlying work, and performers and record producers involved in the master recording?

In addition to bringing the complexities of the current music landscape into focus, our analysis has yielded **four important conclusions:**

**1/ Music is currently undervalued by digital streaming services.**

**Our study finds that the market rate for use of music should be about 80% of gross revenue, distributed to all rights holders. Current levels are 60—70%.**

The current level of streaming services’ revenues paid out for the use of music is between 60 and 70%. The study has demonstrated this level of remuneration undervalues music, and concludes that no less than 80% of gross revenue from all sources would offer compensation at fair market value for the overall use of music by streaming services.

Very low per subscriber revenues complicate the economic picture. “Free” (advertising based) or low subscription rates increase listenership, which in turn drives share prices higher. Shareholders benefit, but performing artists and songwriters essentially subsidize these increases in shareholder value while receiving only a very small fraction of revenue, which are currently quite low.

**2/ The revenue split within the music industry is grossly inequitable and lacks transparency.**

**Our study finds that monies distributed to rights holders by streaming services should be split 50/50 between the two main rights holder groups: record labels/performing artists vs. publishers/songwriters. The current split is closer to 94/6, in favor of labels.**

Currently, major record labels receive up to 97% of revenues that flow to all music rights holders, leaving as little as 3% to be shared among songwriters, music publishers, and other rights holders and administrators. A combination of regulatory constraints, market imbalances and major record labels negotiating with services for all types of rights holders has led to this disparity.

The average 94/6 split skews the relative value of the two principle components in a musical recording: the recorded performance of a song and the underlying composition. This study's analysis of music licensed for use in film, television and commercials provides a fair market metric that supports a 50/50 split in revenue between the songwriter's share (which includes the music publisher's interests), and the artist's performance (which includes the record label's interests).

**3/ A severe lack of transparency makes it difficult for rights holders to evaluate the compensation they receive or take action to change it.**

The story is further muddled by a lack of transparency with regards to the distribution of large non-recoupable advances paid to record labels by music streaming services. According to a report by the Phéline Commission in France, there is no evidence that these advances have been shared with artists, songwriters or other rights holders. This lack of transparency, and the opaqueness of many other aspects of the current value chain, including the conflict of interest that arises when record labels are also shareholders of the streaming services, leaves artists and songwriters in the dark about much of their current situation.

**4/ 'Fair Trade' models may prove more effective in creating a 'virtuous' value chain than government regulation.**

The creative and economic environment is changing rapidly, yet the revision of copyright legislation is inherently lengthy and complex. The regulatory framework seems similarly challenged. (The antiquated Consent Decree in the United States is a prime example.) While global efforts to reform copyright policies are certainly important and should by no means be abandoned, laws and regulations simply cannot and do not keep pace.

Other industries have made notable progress towards a fair value chain without government intervention by adopting ethical rules and practices. The "Fair Trade" movement, for example, effectively communicates a clear choice to the consumer at the point of purchase: she can be the last link in a "virtuous" value chain by choosing a clearly marked "Fair Trade" product, or choose a similar product that is not certified "Fair Trade", and thereby become the final link in an exploitive value chain that largely excludes workers in favor of distributors.

The success of the "Fair Trade" movement has demonstrated consumers' willingness to make ethical choices when given a simple, understandable option to do so. A more equitable future may lie in the application and acceptance by all who inhabit the music landscape – from creators to consumers, and all those in between – of simple ethical practices, the power of which can be seen in the fair trade movement.

## **Study Concerning Fair Compensation for Music Creators In the Digital Age**

### **INTRODUCTION**

With their ability to provide access to almost the entire global catalog of recorded music on multiple platforms and devices, digital streaming services are poised to dominate music distribution well into the future. Considering the cultural industries' role as essential drivers of both national and global economies, we all have a vested interest in seeing these cultural industries succeed. However, major questions have arisen about the sustainability of these services, which are still essentially in their start-up phases. Will these services be able to find a formula that maximizes both subscription and advertising revenues to turn a profit? If so, will it be enough to sustain the health and well being of musical creativity, and those who devote their lives to its pursuit? After all, the entire streaming model depends on the quality and appeal of the creative content to which they provide access, as well as the people who produce it.

While it may be true that most musicians are not drawn to music for the money, they still have bills to pay and cannot dedicate their lives to making music without fair valuation of their works. To date, performers, songwriters and composers have voiced profound disappointment about the extremely low licensing payments made to them for the use of their music by streaming services, despite a general enthusiasm for the technology itself. Yet the services argue that nearly 70% of their overhead expenses go to paying rights holders. As we will demonstrate in this study, both the creators and the services are being honest, so where is the disconnect? The answer, as we shall see, lies partly with the services and partly in how revenues are split within the music industry.

The goal of this study is to determine, based on financial and economic information:

- 1) whether the overall amount of compensation paid to rights holders for the music accessed through digital music services is sufficient, and
- 2) whether the share distributed to all involved in the creative process is appropriate when compared with other comparable platforms. In other words, we propose to determine an appropriate division of revenue between the services (such as Spotify and Pandora), and the blended "bundle" of music rights on the one hand, and, on the other hand, between music creators and right holders vested in the composition of the underlying work, and the performers and right holders involved in the master recording.

Please note that this is an economic study built on a holistic and global worldview. While we certainly acknowledge the complexity of the music "rights universe," in which mechanical rights, performance rights, neighboring rights, synchronization rights, private copy levies and more are collected according to the various legal and regulatory circumstances in territories across the globe, this study focuses principally on the overall revenue received by music rights holders and the division of that revenue between them.

Furthermore, the scope of this study does not extend to audiovisual (A/V) portals such as YouTube and Netflix, which nevertheless factor strongly in the valuation of music in the digital environment. While much of what is discussed below is certainly relevant to these services, further research is needed. It is our intention to do so in a companion study in the near future.

## **METHODOLOGY**

The methodology used in this report is based on a comparative analysis of markets that exhibit similarities to contemporary streaming services. This method is already in use by different specialized boards and tribunals (notably the Copyright Royalty Board in the United States, as well as the Copyright Board of Canada for example) to determine a reasonable remuneration for the use of copyrighted material.

In music, a truly free and competitive market, in the economic sense, does not exist. This market exhibits a number of characteristics that prevent “owners” from getting a “competitive” price for their product. For example, every song/composition is a distinct product competing with every other song/composition, so the supply keeps growing while demand has a limit.

Pass-through licensing (where labels license all rights to third parties including rights they may not own) and vertical integration cloud the picture further. In both of these instances, multinational record labels negotiate with users for a large repertory or catalog of rights, while their music publisher subsidiaries exercise little or no apparent independent authority to negotiate on behalf of songwriters and composers.

Finally, it has proven all but impossible to quickly diminish the share of unpaid consumption, such as file sharing and other forms of “piracy” using tools such as harsh enforcement (‘suing the fans’) or so-called graduated response systems such as HADOPI in France, which have yet to show convincingly that they can directly induce major revenue increases or behavioral changes among consumers.

Below, we will compare streaming services with commercial broadcasting and specialty and pay television services. We will show the percentage of revenue expended on programming and production for different services. This approach is very similar to the method employed by the much-discussed Jeffrey Eisenach study, “Understanding Webcaster Royalties”<sup>1</sup>.

We will examine the nature of commercial broadcasting, and specialty and pay television services and describe the similarities and differences between these services and how they might affect the comparison. This method will give us a range within which we can establish a value for music.

## **THE CURRENT PICTURE**

The determination of a theoretically “fair” or equitable price may seem to lie in the realm of social justice. In economics, a price is assumed to be fair when based on a functioning competitive market. If the price of a good or service lies below the cost of producing it, then resources are better used producing something else, and that good or service will no longer be commercially produced.

Many characteristics of the music market make it impossible for the market to yield a truly competitive price. One must therefore use other means to arrive at a fair price. These can include negotiated rates, or third party arbitration. An arbiter seeks information from both parties to determine a fair and transparent solution. In a direct negotiation between the parties, an exchange of information is generally required.

In the case of music streaming, the main negotiation takes place between the services and major multinational record labels (and an association representing the independents). As mentioned above, in some cases, representatives of major labels effectively negotiate on behalf of all the interests involved (performing artists, publishers and songwriters). In other cases, songwriters and publishers are excluded from negotiations because their rights are limited by the government using a compulsory license or competition law (both tools are used in the United States in relation to rights in musical compositions, but not in relation to interactive streaming of sound recordings, which are subject to a full exclusive right, thus creating a clear imbalance).

There have also been reports of major labels receiving large non-recoupable advances and in some cases, equity in the music service itself. If it is accurate that these labels indeed have an equity position in some of these services, they have the option of sacrificing short-term revenue in order to maximize the promise of capital gains derived from their equity position. As negotiators, they are sacrificing the interests of music creators and other rights holders who are not offered participation in capital gains equity participants will enjoy. This will be discussed further later in this report.

To illustrate, this practice is analogous to your stockbroker selling your portfolio at a discounted price to a buyer while, at the same time, the stockbroker owns shares of the buyer’s company. In most countries this would be actionable in court. This practice raises a serious ethical issue.

The concept of “fairness” in this conversation might be best demonstrated by looking at others who have faced, and found solutions to similar challenges.

Historically, coffee growers were not benefiting from a “fair” price, principally because they were too numerous while buyers were relatively few, creating a significant imbalance in bargaining power between the companies and the growers. Thanks to the widespread implementation of ethical practices, the consumer pays roughly the same price for a cup of coffee, but the farmers are better compensated because intermediaries now abide by an accepted code of conduct. Adherence to this code by all in the value chain is made clear to consumers at their point of purchase. What further relevance such a code of ethics might have for music will also be examined later in this study.



## **MODELS AND CONCEPTS**

The growth of streaming is seen as a model that may increasingly replace both broadcasting and sales of music, through downloading. Research has shown that the younger generation is slowly but surely turning away from conventional commercial radio. The “Napster” (peer-to-peer) generation, now in their mid-to-late twenties, will hopefully adopt legal music services (online music stores and streaming) in lieu of illegitimate consumption. IFPI reports that in 2012, one third of Internet users still accessed unlicensed music services regularly<sup>2</sup>.

Performing rights collected on behalf of songwriters and publishers remained almost flat in the US (BMI and ASCAP only) at \$1,885 million in 2012, while in Canada they decreased 5% to \$252.1 million in 2012. Over the long term, if streaming replaces commercial radio, revenues from performing rights will decrease and negatively impact songwriters’ and composers’ revenues.

SOCAN revenues have been on an upward trend. A 2012 Supreme Court of Canada decision reversing the right to collect performing rights on permanent downloads cancelled five years worth of collections. This explains the drop in revenue for 2012. IFPI data confirms that SOCAN’s performing rights revenues are once again growing in 2013.

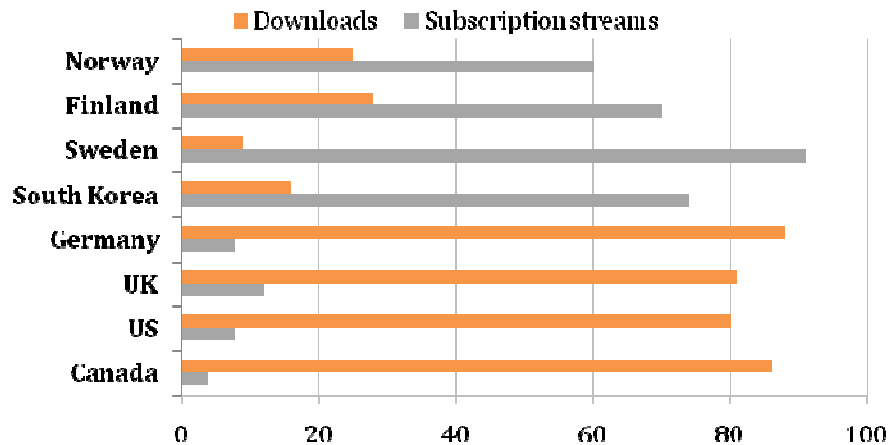
Sales of physical recorded music fell from 814.1 million to 225.8 million units between 2004 and 2012 in the US, while they fell from 60.5 million units to 25.4 million in Canada. Assuming an album is equal to 10 tracks, sales reached 251.3 million album downloads in the US, and 21.9 million in Canada in 2012<sup>3</sup>. The table below illustrates the development of the digital market in different countries<sup>4</sup>.

As we can see, the streaming market is particularly developed in Scandinavian countries while the download model still dominates in North America and most major European markets (Italy, France, UK and Germany).

As we transition from analog to digital environments, one of the potential problems for songwriters and composers is that they have become hostages of the myriad of current copyright laws and regulations around the globe that collectively have failed to keep up with the new distribution methods. While these may have been effective for the traditional models of music consumption, they have not adapted to the rapidly changing global digital models. So, while rapid growth of streaming services may become the new “Gold Rush” for the music industry, it will not be for all who participate in the creation of music, unless a new model for sharing this potential wealth is developed.

## Streaming versus downloads

% of digital revenues 2012



(Source: IFPI)

In addition, current revenues from advertising and subscriptions must increase, and as we will demonstrate, the distribution of revenues between the production side (label and performing artist) and the publishing side (publisher and composer/songwriter) must be re-balanced in order for streaming models to be sustainable for creators.

## THE FUTURE OF STREAMING

### 1. An expanding market

Based on the growth of active users as well as the growth in revenues, it is clear that the music streaming business is far from mature. An ABI Research forecast puts the number of paying subscribers at 191 million by 2019 and premium services revenue at \$46 billion<sup>5</sup>. Such rapid growth is possible, but given that IFPI estimates the global market to be at \$16.5 billion in 2012 with approximately 35% being digital sales, it is hard to believe the market will grow that rapidly (see endnote 3). That said, in 1999 the market reached a peak of \$27.6 billion and few believed it would fall as low as it has today.

As clearly noted, there are different types of digital music services: the “traditional” download, like iTunes, where the consumer purchases the music which is downloaded to a device permanently; models where the consumer creates his own selection of music (playlists, etc.) and “owns” the music as long as he is a client of the service, and models where the streaming service algorithmically creates playlists for the consumer based on his tastes. The first two are referred to as “interactive” because the consumer has freedom to choose, and the last is usually considered non-interactive.

There are a variety of pricing models. The two most popular are:

1) A free to the user ad-based service, generally non-interactive where the music is streamed; and

2) A premium model where the user pays for the service, with a low monthly fee if the service is only Internet-based and, a higher fee if the service is available through both Internet and mobile services.

“Active” users are those who **actually listen** to music from the streaming service. “Inactive” users are those who have access to the music service because it is included in their Internet, cable or mobile telephony package, but don’t listen to it. Those who sign up for a free trial but stop listening before the end of the trial period are considered inactive as well. Active users are most important to ad-based streaming services because they generate advertising revenue.

Most services offer a free trial period in the hope of turning the user into a paying subscriber or an active user for ad-based streaming service.

Current prices for premium services are in the \$4.99 to \$9.99 per month range with the low end for web access only and the high end for web and mobile access. Strangely enough, the same prices are generally charged in local currency whether in Euros, US dollars or Canadian dollars, regardless of the exchange rate<sup>6</sup>. Below are short descriptions of the recent financial statistics of some major services available in Canada, the United States and Europe.

**Pandora** is considered a non-interactive ad-based streaming service. Its revenues tripled from \$137.8 million in 2011 to \$427.1 million in 2013 while active users rose from 29 to 66 million (financial year end of January 2013). By end of December 2013, the number was 76.2 million<sup>7</sup>. Approximately 87% of Pandora’s revenue is from advertising. Net losses exploded from \$1.8 to \$38.1 million<sup>8</sup>. Meanwhile, share prices more than doubled from \$17.42 on June 15, 2011 to \$35.05 on January 15, 2014<sup>9</sup>. Even though share prices fluctuate, the overall trend is up so it seems clear that investors expect a turnaround from the loss to a profit.

For **Spotify** (fiscal year end is December 31) revenues grew from \$97.5 million in 2010 to \$573.1 million in 2012. At the same time, losses rose from \$37.6 to \$77.4 million<sup>10</sup>. On its web site, Spotify boasts over 24 million active users in 55 markets with 6 million paying subscribers (01/28/2014). Here again, the growth rate seems indicative of a market that has not achieved maturity.

“The financial results of Spotify and Pandora pose two key questions about their business models: whether they're sustainable for music creators, and whether they're sustainable for the companies themselves.

Spotify has been clear about the fact that it pays around 70% of its revenues to music rights holders, who are then responsible for passing this money on to artists and songwriters according to the terms of their contracts which – this is the music industry, remember – vary considerably in transparency and fairness.”<sup>11</sup>

**iTunes Radio** recently launched a streaming service in the US and reports say their subscriber base is growing rapidly while **Beats Music** launched its own service in January 2014 (N.B. Beats Music has been acquired by iTunes).

**Deezer**, is available in Europe and Canada and is reported to be looking for an established American partner before launching in the US. According to *The Guardian* it has 12 million active users and 5 million paying subscribers, although mostly as part of paid mobile telephone services, which could be active or inactive subscribers. It was available in 180 countries at the end of 2013<sup>12</sup>. In an interview with *Journal du Net*, Simon Baldeyrou, Deezer's Directeur General in France, reported 30 million "members", presumably both active and inactive users. He also said revenue had risen from €47 million in 2011 to over €60 million in 2012, mainly from the French market, with only €10 million from advertising<sup>13</sup>.

**Rdio** has not released subscriber numbers in some time but it says it is available in 50 countries. It recently closed its Canadian office but is still active in the Canadian market.

The above information illustrates that, while most if not all of the currently available streaming services are suffering losses, commentators feel that the business model will survive and is probably poised to thrive. Investors and the financial markets confirm this as equity values continue to rise. As to the second question posed in the quote above, namely whether the business models are viable for the streaming services, the answer is most likely "yes".

In our view, viability lies not only in acquiring subscribers and moving users from the free ad-based model to the premium paid subscription model, but also in increasing revenue generated per active user, whether it is advertising revenue, subscription revenue, or both.

Whether the model is currently viable for music creators, judging from the outcry from the artistic community the answer is a definite "no". We will look at that issue in another section to see if that answer is factually derived.

Let's now turn to the pricing models.

## **2. Pricing Models**

For a business to be sustainable, it has to be able to eventually turn a profit or have its equity grow faster than the accumulated debt. When shareholders have no hope of recouping their investment, they usually cut their losses by forcing a bankruptcy. Most professional sports teams incur losses every year with player salaries exceeding gate revenues. However, ancillary revenues from broadcasting rights and merchandising are usually sufficient to keep these businesses going. Additionally, the value of the franchise often grows faster than the accumulated debt. So the expected future value of the asset is what eventually compensates the current losses.

The same logic can be applied to music streaming. Pandora's and Spotify's capitalization value keeps rising even though they have yet to turn a profit. The same has been observed in other notable cases, such as Amazon.com. It is legitimate to question their pricing strategy. As mentioned earlier, subscription pricing is around \$10 a month for a premium service that provides full web and mobile access. Most services also offer limited-time free trial offers and free ad-based, non-interactive streaming. Rdio has recently added a free ad-supported web-based service and Spotify also extended free streaming to tablets, and limited streaming to mobile services.

The reasoning that supports this type of model may be described as the "addiction" model. Once the subscriber is "hooked" on streaming, the service tries to move him from ad-supported to the paid premium service. This is nothing new. Movie channels feature free weekends to get viewers interested in subscribing to their channels, magazines offer drastic rebates on subscriptions to readers in hope of keeping them longer than the length of the rebate year. In fact with the rebates and gifts they offer, they need to keep the subscriber 30 to 36 months to break even. The logic is, grow the readership and the advertising revenue will follow.

Revenue will be maximized by finding the right balance between ad revenue and subscriber revenue - not an easy task. Changing the subscription price will impact the number of subscribers which, in turn, will impact the ad revenue. On the other hand, too many ads might drive consumers away, negatively impacting subscription revenue and revenue per ad.

In economic terms, the services need to maximize revenue per subscriber, whether this revenue is from subscriptions, ads, or both. Streaming services seem to be operating in an "experimental" phase at this point.

In terms of annual revenue per subscriber, let us now look at the data.

**Table 1 Annual Revenue per Active User<sup>14</sup>**

(in millions)	Pandora		Spotify	
	2011	2012	2011	2012
Revenue	\$275	\$427	\$245	\$573
Active users	47	66	20	24
<b>Revenue per active user</b>	<b>5.85</b>	<b>6.46</b>	<b>12.25</b>	<b>23.88</b>

Spotify, with 32% of its active users being paying subscribers, seems to be faring better than its competitors in terms of revenue per subscriber. With a premium subscription fee of \$9.99 a month, however, or \$120 a year, revenue per subscriber still is not very impressive. Only 3% of Pandora's active users are subscribers, the vast majority are ad-based. Clearly, Pandora's main challenge is to generate more advertising revenue while growing its base of paid users.

Alvarez & Marsall, a firm specializing in corporate restructuring and performance improvement, recently looked at the pricing of streaming services in the UK and Germany<sup>15</sup>. They concluded that if subscription prices were around £5/month in the UK, paid subscribers would rise from 17% to 40% of total users. In Germany a price around €5/month would translate into 40% of paying users instead of the current 9%. They argue that taking into account the exchange rate and the disposable income in each country, their proposed prices would be close to the \$9.99 price in the US where, the study says, the conversion rate of consumers from non-paying to paying tiers is much higher than in the UK and Germany.

The price comparison is certainly in line with the findings of an APRA AMCOS (Australasia's collective society) whitepaper analyzing Spotify's monthly subscription price as a percentage of disposable household income in OECD countries. The results indicate that the US has the lowest ratio at 0.30%, less than half the UK ratio of 0.68% and about two-thirds of the German ratio of 0.50%. The US ratio is also half of the average ratio of 0.59% and almost one-third of the top ratio of 0.81%, making it arguably low<sup>16</sup>, unless the strategy is to expand the subscriber base with no immediate return. While this strategy may have long-term benefits for shareholders in terms of future value extraction, there is no mistaking the fact that it is achieved largely at the expense of music creators.

### **3. Is the Cost of Music Too High?**

Many commentators argue that the cost of content acquisition is a major factor in streaming services' inability to turn a profit<sup>17</sup>. This issue is considered in Jeffrey A. Eisenach's report<sup>18</sup> where he concludes the following:

“Financial data from other retail firms, who, like Pandora, must purchase the content and products they eventually resell, demonstrate that Pandora's content acquisition costs are in line with (and in many cases lower than) those of similarly situated commercial firms. Moreover, the argument that high royalties have prevented Pandora from achieving profitability is specious.”

Some clarification is required. To be attractive to the average consumer, streaming services must acquire a variety of catalogs to satisfy the musical tastes of the prospective active user and possibly turn him into a paying subscriber. In the start-up phase, if services pay advances<sup>19</sup> to acquire these catalogs in addition to the percentage of revenue they negotiate with the major labels, the cost of sales is higher in the early years than in subsequent years.

Access to music is the only product being sold to the subscriber. Let us look at the share of revenue invested in programming in a few key markets. We will compare streaming with commercial radio and television as well as with specialty television, pay television services, pay-per-view and video-on-demand.

As mentioned above, streaming services generally offer the consumer a few options; a “free” to the consumer ad-based service, and an ad-free paid subscription service. Some services also offer a hybrid low-priced subscription service with fewer ads. This is similar to various fee structures in commercial radio and in specialty and pay television.

When comparing music streaming services to commercial radio and television, it is important to include all creative expenditures to compare apples to apples. In the case of the latter, these include on air talent as well as all the entertainment/information programming which is what the listeners are expecting. They want news, sports, traffic, weather, commentary *and* music. Limiting the comparison to music only would underestimate the importance of the investment in content broadcasters make to attract listeners.

“Specialty” television generally means television channels that specialize in sports, arts, news, movie or TV reruns, etc. “Pay” generally refers to channels that offer movies or first-run series that are not available on specialty or commercial television (e.g. HBO). “Pay-Per-View”: (PPV) and “Video-On-Demand” (VOD) refer to services that offer programming on demand for a fee per program; these include movies, special sports offerings, etc.

The table below sets out the total gross revenue these services generate in Canada, the expenditures they made in programming and production, and what percentage of gross revenue this represents. We also indicate the subscription-to-advertising revenue for each type of service.

**Table 2 Revenues and Expenditures in Radio and Television, summaries of 2008-2012<sup>20</sup>**

	Total Revenue (TR) (in millions)	Ratio of Subscription to Advertising Revenue	Programming and Production Expenditures (PPE) (in millions)	Ratio of PPE to TR
<b>Pull</b>				
<b>PPV/VOD</b>	<b>\$380</b>	<b>2.03</b>	<b>\$265</b>	<b>70%</b>
Pay Television (restricted)	\$458	0.45	\$278	61%
<b>Push</b>				
Specialty Television	\$3,130	1.44	\$1,711	55%
Commercial Television	\$2,038	n/a	\$1,388	68%
Commercial Radio	\$1,314	n/a	\$369	28%

In the case in PPV/VOD, the subscriber has the ability to choose what he wants to view from a defined repertoire, and when he wants to view it. This is very similar to the “pull” music streaming services. One of the features the consumer buys is the ability to choose what he will be listening to and when, not what someone has chosen for him. One major difference for music streaming is the consumer’s access to virtually the entire catalog of music available. This can only add to the value the consumer places on the service.

Pay television is somewhat like PPV/VOD, however the consumer is restricted to a pre-set schedule. Certainly he can pick what he wants to watch but not entirely when he wants to watch it. The lack of choice, both for programming and timing, make the comparison with streaming less attractive.

For commercial radio, commercial television and specialty services, the consumer does not choose the programming. He consumes what the provider has compiled for the entertainment of a broad audience, not a narrowly focused one. These are remotely comparable to the push-type (ad-based) streaming services. There are major differences between the two delivery mechanisms.

In streaming:

- 1) the consumer gets music only programming and
- 2) an algorithm selects music tailored specifically to each consumer's taste giving the programming a much higher value, particularly in comparison to commercial radio.

From the perspective of the viewer/listener, the characteristics of PPV/VOD, in terms of choice, are very similar to those of streaming services, and therefore the better choice for comparison in terms of programming value. How does this translate into numbers with regard to streaming music service costs? We would argue that a starting point around 70% of total gross revenue from **all sources** is not unreasonable. This could be increased given the consumer has access to the entire catalog of the world's music, not just a selection, and complete freedom as to what, where and when he will be listening. Such unlimited and unfettered access can only be seen as dramatically increasing value to the consumer.

So if the programming costs are not excessive as alleged by Pandora, or as high a percentage of revenue as hinted by some industry observers, it must be that revenue per active user is too low.

If Spotify and Pandora choose to sacrifice short-term revenue for expansion of client base and advertising, and an increase in equity and share value, that is their business decision. That should not occur at the expense of their suppliers. The shareholders take the risks and share in the windfall, not the suppliers. In the case of major record labels, who are both suppliers and shareholders, this is profoundly problematic.

“There's no altruism in this business, at least not beyond your loving mother. So stop streaming Kumbaya: Spotify has its own financial interests and goals that may be completely misaligned with yours. Ask yourself: **if Spotify goes public on Wall Street and mints billions, will you see any of that?**”<sup>21</sup>  
(Emphasis added)

It is up to the shareholders to cover the losses in the “startup” years, not the suppliers.

It is our view given all of the factors discussed above, that the share of gross revenue received by those who create and provide music should be in excess of the 70 to 80% range for the foreseeable future. The division of revenue to each participant in the supply chain is discussed later in this study.



#### **4. The Value of Music**

As discussed above, the intermediaries may be charging too low a price to the consumer and the advertiser. Therefore, gross revenue may be well below what it should be. Charging a percentage of gross revenue, as is customary, may still yield too low a payment. But why would the streaming service sell at a lower than optimal price? This may be explained by the fact that the services are still in a startup phase and want to attract a maximum number of subscribers.

In fact, the Alvarez & Marsall study referred to earlier (see endnote 16) suggests that lowering the subscription price in the UK and Germany would increase total revenue through higher conversion rate of non-paying to paying customers. So the increase in the number of paying subscribers would more than compensate for the decrease in price. As seen earlier, the optimal prices would be £5 and €5 for the UK and Germany. Their market research findings also indicate that the optimal price in the US would be \$10, which is basically where prices are in both the US and Canada. Please keep in mind, this research was conducted recently so the results may well differ if it is conducted again in a few years. The optimal price is likely to rise as consumers become more familiar with the streaming services and better assess their value.

Economists differentiate between value and price. The “price” of the streaming service is determined by what the market will bear. It is determined by competition for subscribers as well as the consumer’s ability to pay and the importance of music for that individual. The main problem streaming services have is that for some of the users, they are competing with illegitimate service providers. The “value” is the amount each user would be willing to pay. For all those who love music, \$9.99 is certainly more than reasonable. Over time, willingness to pay will likely increase as more consumers experience music streaming services, as will the subscriber base and eventually the price.

### **ARE THE CURRENT BUSINESS MODELS SUSTAINABLE FOR MUSIC CREATORS?**

#### **1. How much are the streaming services paying out?**

The amounts paid out by streaming services for use of the master recordings to major record labels are negotiated between the services and the labels that own the master recordings. Other rights holders are paid a per-stream rate, usually based on a percentage of gross revenue. The revenue split between labels and other rights owners is being called into question by many artists and observers.

The table below shows the amounts paid to artists, musicians and content owners per stream.

Unfortunately, it isn't clear whose remuneration is included in these amounts. The first three providers are mainly non-interactive services so the amounts are likely only for performing artists and musicians, with the composer/songwriter's shares governed by the performing rights tariff set by the Copyright Royalty Board of the United States. A non-regulated royalty for mechanicals is paid only for interactive services. Spotify is a hybrid model - therefore the range - with the high amount probably for subscription streaming and the low for ad-based streaming. The last two are mainly subscription based, thus the higher per-stream rates.

**Table 3 Summary of the amounts paid to artists, musicians and content owners per stream, 2013**

<b>Streaming Service (USA)</b>	<b>Amount in US\$ per Stream</b>
Slacker	\$0.0012
Pandora	\$0.0012
iTunes Radio	\$0.0013
Spotify	\$0.001-\$0.005
Deezer	\$0.0081
Rdio	Less than \$0.01

Source: Data compiled by Gryffin Media<sup>22</sup>

Payouts are based on the number of times a song is streamed, usually in any given month. This means that if a song becomes a mega-hit in a particular month, all other songs streamed suffer because in a short time frame the services' revenues won't increase, so each individual stream is worth less, impacting on every other song's cumulative value. Some services and aggregators also have a policy of not paying out if aggregate royalty amounts are below a certain threshold. This means that an artist, and/or music creator with many popular songs in his catalog, would be penalized if none, or few, achieve the per-month minimum level of streams. Where does the money from these unpaid streams go?

Given the extremely low per-stream rates in place, many artists and music creators are affected. Here, increasing overall share to music creators and letting them decide how to split the revenues would "spread the wealth" among more who currently fall below thresholds. In this context it would be interesting to develop models that look at how monthly payouts, compared to quarterly or annual payouts, might impact the total amount paid to artists, composers and songwriters. Longer calculation periods may allow more works to surpass the threshold.

## 2. Internal splits – Who gets what?

To determine how much revenue each group of rights owners receive, we must look at the regulatory situation, i.e. is there any compensation split that is provided through various country's copyright legislation or regulation, and if so what is it? Then we must also look at privately negotiated rights and determine what they generate for the different rights groups.

For example, in Canada the Copyright Board sets tariffs for mechanical rights under an arbitration regime in situations where the negotiating parties ask the Copyright Board to do so. This exercise isn't mandatory, and technically the mechanical rights collectives SODRAC and CMRRA (who together formed CSI for the purpose) could decide not to revert to the arbitration. Of course if they don't, potential users could file a complaint with the Commissioner of Competition under the conspiracy provisions (a criminal matter), or abuse of dominant position (then a civil matter decided by the Competition Tribunal) under the Competition act.

In the current context, the Board was asked to arbitrate the tariffs and did so. In short, mechanical tariffs apply to permanent downloads (iTunes et al), limited downloads (Rdio), in cases where the music is accessible only for the duration of the subscription, as well as to non-interactive streaming (Pandora). The Supreme Court of Canada has ruled that a "communication to the public" only happens in the case of "non-interactive streaming" of the Pandora type. Pandora is not available in Canada, but there are similar services available. In those cases a SOCAN (the Canadian performing rights society) "public performance tariff" applies. The rates approved by the Copyright Board are:

**Table 4 Rates approved by the Copyright Board for the CSI and the SOCAN**

	<b>Royalties to be paid to CSI (2008-2010)</b>	<b>Royalties to be paid to SOCAN (2007-2010)</b>
<b>Permanent Downloads</b> (like iTunes)	9.9% of the amount paid by the consumer  <u>Minimum fee</u> -6.86¢ per file -3.92¢ per file in a bundle of 13 tracks or more	
<b>Limited Downloads</b> (like Rdio, where you no longer have access if you cancel your subscription)	9.9% of the amount paid by the subscriber  <u>Minimum fee</u> -99¢ per month, per subscriber if portable limited downloads are allowed -66¢ if not	
<b>On-Demand Streams</b> (interactive or non-interactive, like Pandora)	5.18% of the amount paid by subscribers  <u>Minimum fee</u> -Free streaming: 0.99¢ per file streamed per visitor, up to a maximum of 34.53¢ per visitor per month -Otherwise 34.53¢ per subscriber per month	7.6% of the amount paid by subscribers  <u>Minimum fee</u> -Free streaming: 0.13¢ per file per visitor, up to a maximum of 50.67¢ per visitor per month  -Otherwise, 50.67¢ per subscriber per month.

Source<sup>23</sup>

Strangely, most of the evidence in this case is classified as “confidential.” Consequently, the public does not have access to most of the information used by the Board to arrive at these amounts. We do not know, for example, whether it had knowledge of advances that might have been paid to the major labels, or if they were considered when arriving at the final amounts. As well, it is impossible to know whether the Board had knowledge of the fact that the majors are also shareholders of some of these streaming services, or if that knowledge had impact on the decision.

In Europe the Phéline Report<sup>24</sup> states that on average the retail price of a download is 0.83€ (taxes excluded). Major labels receive 70% of the retail price with a minimum of 0.70€ for each download. Independent labels receive 60% of retail and no minimum. SACEM, the French performing rights society, receives 8% of retail with a minimum of 0.07€ per title.

In the United States, the Copyright Royalty Board (CRB) sets performing rights tariffs for non-interactive services. Mechanicals are not paid for non-interactive streaming. For interactive services such as iTunes, the payments are not regulated and must be negotiated with rights holders. Unfortunately, the owners of the master recording (the major labels in most cases) collect all rights, including those of songwriters and composers.

From the table below, we can see that the rates Pandora pays to the digital collecting society SoundExchange are lower than the Copyright Royalty Board rates. Congress has allowed negotiation ostensibly because it felt the CRB rates were too high or otherwise impracticable. The Webcaster Settlement Acts of 2008 and 2009 allowed webcasters to negotiate alternative royalty rates directly with SoundExchange. Thus, Pandora has applied the so-called “Pureplay” rate – because of the Pureplay Settlement – since 2009. So in the case at hand, the regulated rate acted as a ceiling instead of a floor. Therefore, a regulated solution may not be in the composers’ and songwriters’ best interest.

A recent decision of the United States District Court, Southern District of New York (the Rate Court) reveals that 55.9% of Pandora’s revenues were used to pay labels for the use of their recordings. Judge Denise Cote imposed a rate of 1.85% for the publishing rights accruing to ASCAP.<sup>25</sup> As explained above, Pandora being a non-interactive streaming service, pays no mechanical rights. If we include an estimate of the BMI and SESAC rights paid by Pandora, the result is that between 91.5 and 93% of the money paid for music by Pandora goes to labels and 7% to 8.5% goes to publishers, composers and songwriters. As stated above we feel that a more reasonable price for music in streaming services would be in the range of 70% to 80% of revenues. However, even if Pandora paid out the 80% of its revenues to all music rights holders we argue for, publishers, songwriters and composers would still only receive between 4% and 5% of Pandora’s gross revenues, given current splits. The above decision illustrates how current regulation in the US is out of step with the reality of today’s music market.

**Table 5 - The royalty structure applicable for Pandora Media, Inc.** <sup>26</sup>

	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
CRB Rate	0,0021	0,0021	0,0023	0,0023
Pureplay Rate (subscription)	0,0020	0,0022	0,0023	0,0025
Pureplay Rate (non-subscription)*	0,0011	0,0012	0,0013	0,0014

\* The rate applicable to Pandora’s non-subscription service is the greater of the per-performance rates in this row or 25% of Pandora’s US gross revenue

Interactive streaming of sound recordings, unlike broadcasting of music, is subject to an “exclusive” right. This means that the use of a master recording needs to be licensed by the service. In the United States and Canada, the major labels negotiate the overall payment for all rights and the split with the different rights holders. This of course leads to a distribution that largely favors the labels.

One could suggest that, owing to the dominant position of the three majors in the market, failure to make their catalog available could lead to antitrust inquiries and litigation. After all, there are three Performing Rights Organizations (PROs) in the United States (ASCAP, BMI and SESAC) as there are three major labels. Two PROs (ASCAP and BMI) operate under consent decrees that never sunset, and antitrust proceedings may be pending against the third. If this is true, labels in fact have to negotiate with users and come to an agreement.

Conversely, for streaming services to survive, they must be able to offer these major catalogs to their users. In France, 11 different services have either filed for bankruptcy or failed in the last few years<sup>27</sup>.

“A case by case analysis would be needed to determine exactly to what extent among other factors, the failures would be attributable to the dominance of certain competitors or the “uneconomical” conditions imposed by the most powerful suppliers of catalogue”.  
(Translation is ours)

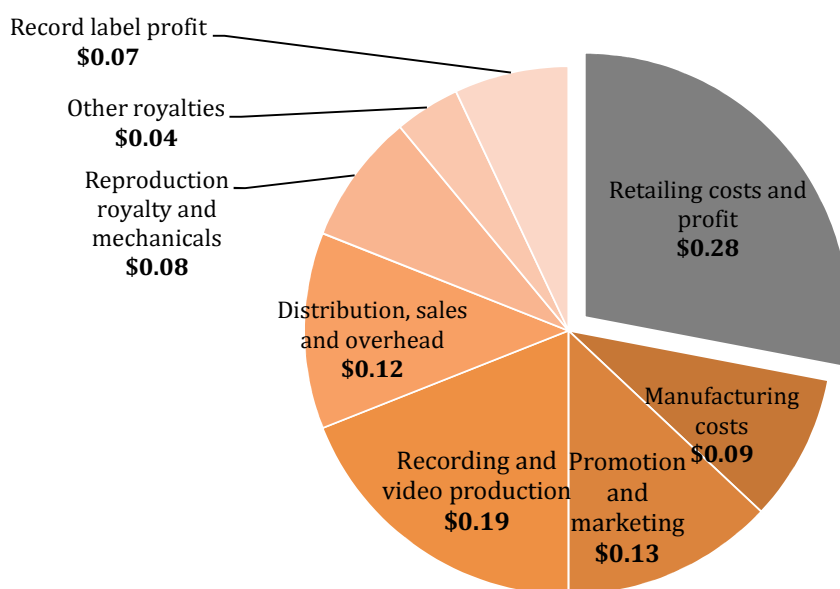
If all rights holders took part in a direct negotiation, the result would likely be much different.

### **3. A better proxy**

A comparison to the revenue distribution from the sale of a CD would give us a useful starting point for a comparison of how much should accrue to each participant in the value chain. We wouldn’t go so far as to say all steps of the production and distribution processes happen in perfectly competitive markets, however the ultimate price of the CD is indicative of what the market will bear.

Leaving aside the retailing costs and profit to which an online retailer would be entitled (It might not be as high as \$0.28 but we assume it would be below that), the \$0.53 total for: manufacturing costs, promotion and marketing, recording and video production and distribution, sales and overhead, may be justified in the physical world, but one might well question how such costs would apply to the online world. Of course when an artist's new CD is released, an investment in manufacturing, marketing, shipping, etc. is warranted as well as an allocation for free promotional product and returns. However, in the online world none of these should be included. There are no returns, and manufacturing and shipping have a marginal cost of zero. Marketing costs would largely be the responsibility of the streaming service and as such be included in the retailing cost and profit (\$0.28).

### **Distribution per \$1 of revenues from CD sales**



Source: S. Liebowitz<sup>28</sup>

Eric Nicoli, then Chairman of EMI confirms this in the 2005 EMI Annual Report;

“certain costs borne in the physical world such as manufacturing, returns and pick-pack-ship are not relevant for digital products. For physical products, these costs are in the range of 15% to 18% of sales.”<sup>29</sup>

In its decision on the Sony/BMG merger, the Commission of the European Communities made the following comment on the cost differential between the physical and the online markets in relation to the prices the record labels are charging to online music services;

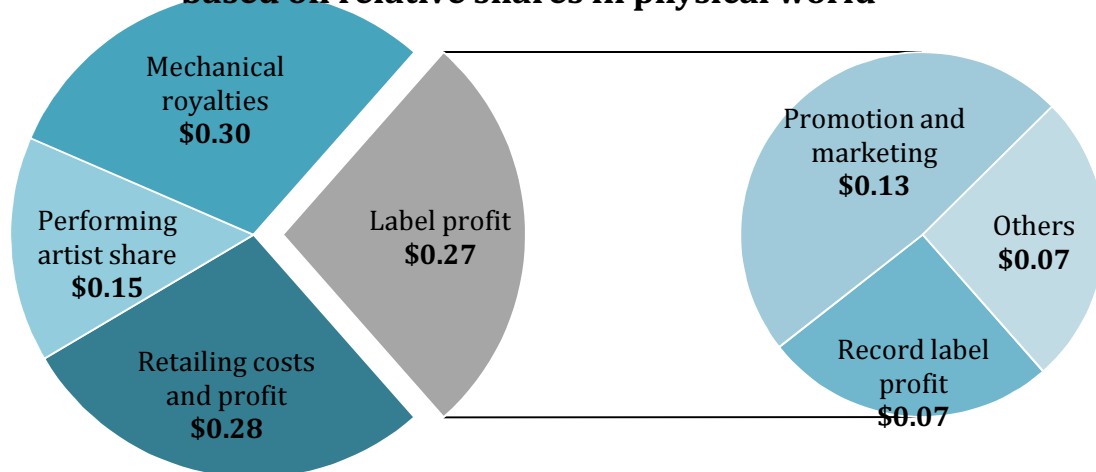
“prices charged to online music providers are quite high given the fact that in the case of the sale of an online licence no costs for the production and distribution of the physical carrier and the booklet and no obsolescence costs are incurred. The prices charged for albums to the online music providers do not at all seem to reflect these cost savings when compared with the net prices charged to traditional retailers for the sale of CDs. In this respect, it also has to be taken into account that for the sale of online music no returns appear, **no cooperative marketing costs are reimbursed (the marketing costs are contractually borne by the online provider) and no discounts are granted.**”<sup>30</sup>

(emphasis added)

Additionally, the attraction to consumers of the streaming services is the breadth of catalog. A place where you can find anything you could possibly want, not just the new releases where the marketing budget is usually focused. Thus the \$0.72 of revenues for all items except retail costs and profit should accrue to the three items left: label profit, performing artist share and mechanical royalties shared by songwriters, composers and publishers.

Based on their relative shares in the physical world, in the online world (excluding the retail costs and profit), the labels would get \$0.27 or a share of 37%, the artists would get \$0.15, a share of 21% and the publishers/songwriters \$0.30, a share of 42%.<sup>31</sup> Even if one were to argue that labels still need to invest in promotion and marketing, their share of the pie is sufficient to do so. We seriously question how much they would need to invest given the online retailer likely covers a large portion of these costs.

### **Distribution per \$1 of revenues in online world based on relative shares in physical world**



In the online world, if the labels are receiving non-recoupable advances and a share of equity, these should further lower their share in the percentage of sales, thereby increasing others' shares.

Other markets that are appropriate proxies are the film production market, the television production market, and the television commercials market. In those markets, the buyer acting on behalf of the producer of the audio-visual product negotiates what is called the synchronization right with both the owner of the master recording and the music publisher. This is similar to streaming since the buyer is the streaming service and, as in the audio-visual market, there are no other expenses incurred related to music. Manufacturing costs, promotion and marketing, recording and video production and distribution, sales and overhead are related to the physical world much more than the online world as demonstrated above. The other costs incurred by the streaming services are related to the promotion and marketing of the service itself, not the songs.

In those markets, the sync rights for the music are generally split 50/50 between the producer of the master/recording artist and the music publisher/songwriter/composer.

This is the case in Canada, the US, the UK and France: the standard split for the synchronization right is 50/50. The half that accrues to the producer of the master (label)/performer group is then divided based on their mutual contractual arrangement. The same is true of the half accruing to the publisher/songwriter/composer group.<sup>32</sup>

In Canada, when the Copyright Board was mandated to establish a value for neighboring rights for broadcasting, it set the rate at the same level as the performing rights. The neighboring rights of course accrue to the producer/performer group while the performing rights accrue to the publisher/songwriter/composer group. And here is why the Board concluded that they were of equal value:

“ In the end, it was probably Mr. Reynolds, president of Universal Music Canada, who best stated the conundrum, when he expressed the view that establishing **the relative value of the authors’ and performers’ contribution in a successful recording “is the classic chicken and egg situation. I don’t think you can extricate the two and say, this is more important than that.”**

The Board goes on to say:

**“The Board prefers deciding on the basis that there is no reason to believe that the use of sound recordings on radio stations has any greater value than the use of the underlying works.** Several reasons point to this solution. First, nothing requires the Board to look to the market (and especially a different market) for guidance; it is within its discretion to decide that this approach is reasonable. Second, these are similar uses of the same recordings by the same broadcasters. Third, **it can be readily argued that a pre-recorded performance is worth no more to broadcasters than a pre-recorded work: in both cases, one is dealing with something that has already been fixed.**”<sup>33</sup>  
(emphasis added)

The Board set the tariff at the same level as the performing rights with an adjustment because about 45% of the music played on Canadian radio is subject to neighboring rights, unlike the US repertoire, which is widely broadcast in Canada, and is not.



We draw the reader's attention in particular to the last bolded section. In the case above, as in the case of streaming services, the relevant rights are those in a recorded performance of a musical work. The only difference between the situation analyzed by the Board and streaming is that, in the case of streaming, the labels freely negotiate and can exercise market power to obtain a better deal solely for themselves.

The above leads us to conclude that the only reasonable revenue split in the streaming market between music creators and right holders vested in the composition, and performers and right holders involved in the master recording, should be 50/50.

## **MODELS AND CRITERIA FOR FAIR COMPENSATION**

While fairness as a principle lies outside the realm of economics, in general where price is a function of supply and demand in a competitive market, price will be determined to be fair when supply and demand are in balance. This is, of course, theoretical because in the real world one rarely finds a perfectly competitive market. Situations happen where some producers do not receive adequate compensation for their products, and cannot make a decent living. One only has to think of coffee as a good case in point. While the market price to the consumer may be "competitive", historically some of the intermediaries in the value chain made a handsome profit while coffee growers barely made enough to survive. Other examples include poor employment conditions for garment workers in different countries (recent issues in India, Pakistan, Thailand, etc.) and show that a significant number of consumers care about "ethical" production, worker remuneration, and safety, even if it means paying a little more for the products they consume.

When provided with a direct connection from the goods they use, to the inequitable reality often faced by the people who produce these goods, consumers have demonstrated they will opt for "fair", as the "Fair Trade" movement has clearly shown. In the case of music services, a symbol or logo displayed on websites and apps could be used to indicate that that particular service operates according to established criteria such as sustainable compensation to all rights holders, and transparency. The development of these criteria would best be put into the hands of an independent body that would include performers and music creators, as well as other rights holder and stakeholder representatives.

The comparative analysis in the above sections will allow us to develop these essential criteria for models that could qualify as fair compensation models for creators of music.

Along with these, we will identify requirements to ensure these models generate a fair result; we will identify what information digital services must provide to creator groups or the negotiating party, and what information music creators or their negotiator must provide to the services so that they can arrive at a fair price.

As described above, currently the multinational record labels negotiate directly with streaming services, while music publishers, songwriters and composers are, for the most part, left out of the discussion.

In August 2013 the Minister of Culture in France, mandated Christian Phéline to investigate the apparent “tensions” between different music industry parties with respect to the remuneration for the use of music through streaming and downloading services<sup>34</sup>. The report provides a summary of the views of all the actors in the French market. The authors question the fairness of granting large advances, (none of which is typically distributed to creators) and minimum payments to the major labels, as well as labels taking an equity participation in some of the services. In short, the report concludes that a mechanism must be put in place that allows the services and the different rights owners to negotiate equitable remuneration. The parties should have total access to any and all pertinent information that could impact remuneration. It suggests that if such an open and transparent negotiation involving all the parties fails, the government should consider a regulatory solution.

We have established that the overall increased valuation of music in new models can be supported. Fair Trade offers a sustainable private industry model that could generate fair payment to creators and other rights holders, but crucially, full disclosure of all revenue and expenses would be required.

Given current trends on how music is accessed by consumers, a system that allowed for equitable remuneration to all rights holders might well look very different from “legacy” models, where those who controlled physical distribution have traditionally had the upper hand, particularly in terms of internal revenue splits.

## **THE WAY FORWARD**

### **1. Market power**

With the purchase of some of the assets of EMI by UMG and Sony, it is clear that the three multinational record labels and publishers have tremendous market power, power they can exercise in negotiations with streaming services, while composers and publishers don't, for various reasons – including vertical ownership. This is problematic for those services, as well as for other parties not involved in the negotiation. Ownership stakes in one or more services by the labels muddies the water even further.

Market power of any party needs to be counterbalanced. This can be achieved by inclusion: all parties subjected to the outcome of the negotiations need to be fully involved in the process. Representatives of record labels, performing artists, music publishers and songwriters and composers must be at the bargaining table.

### **2. Transparency**

**In setting the overall remuneration for music:** Labels negotiate ownership positions in the services they are bargaining with, receiving large advances from these services, as well as minimum payments often under non-disclosure agreements.

Any conflicts of interest need to be declared at the outset of the negotiation. This way, all parties on all sides of the table know what information they need to get a “fair” deal.

**In deciding how to redistribute the payments to the rights holders:** Having third parties decide the formula used to calculate the individual payments to songwriters is problematic. A more equitable scheme would be to calculate the overall payment accruing to songwriters and publishers and let them decide on the method of disbursement.

### **3. Commonality of Objective**

This is an important issue. As we said at the outset, the streaming distribution model is still in the early stages of its development. It is the most promising model, but only if all the actors can agree on the ultimate goal. The Phéline report suggests that in order to succeed, the streaming model has to provide “equitable” compensation. We would add that fair compensation for all is essential if streaming is to be sustainable for the services, as well as for those who provide the content, the performing artist, the songwriters, the composers, the music publishers and, yes, the labels.

All must agree that growing revenue streams from both advertising and subscribers is a shared goal. Institutional and individual greed cannot get in the way of the common objective.

“Fair Trade” may be powerful because it not only conveys an “anti-greed” message to consumers regarding labels and services, it may in fact achieve the reality of equitable remuneration for creators.

## **CONCLUSIONS**

Music streaming services offer huge potential to both creators and consumers by providing instant and near-ubiquitous access to the world’s repertoire of music, new and old, popular and obscure. Yet, as we have uncovered in this study, “Fair Compensation for Music Creators in the Digital Age,” worrying practices that undervalue the contribution of those who write and perform the songs and all but excluding them from sharing in the financial rewards, undermines these services’ future sustainability. Even if revenues increase dramatically in coming years – as they are predicted to do – financial inequality will only increase if measures are not instituted to rebalance the current situation.

By examining the overall amount of compensation paid by music streaming services for the use of music and comparing this to other sectors that use creative content, we have provided a practical metric in determining the appropriate valuation of music used by streaming services.

In addition, by analyzing the split of those revenues flowing to each participant in the creative process, including record labels, performing artists, songwriters and music publishers, we have been able to bring the current digital music ecosystem into focus. We can conclude that:

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**Music is currently undervalued by streaming services. Our study finds that the market rate for use of music should be about 80% of gross revenue, distributed to all rights holders. Current levels are 60—70%**

Using the methodology described above, this study has demonstrated that this level of remuneration undervalues music, and concludes that no less than 80% of gross revenue from all sources would offer compensation at fair market value for the overall use of music by streaming services. The current level of revenues paid out by streaming services to all rights holders for the use of music is between 60 and 70%.

Very low per-subscriber revenues complicate the economic picture. “Free” (advertising based) or low subscription rates increase listenership, which in turn drive share prices higher. Shareholders benefit but performing artists and songwriters essentially subsidize these increases in shareholder value while receiving only a very small fraction of profits, which are currently quite low.

**The revenue split within the music industry is grossly inequitable. Our study finds that monies distributed to rights holders by streaming services should be split 50/50 between the two main rights holder groups: record labels/performing artists vs. publishers/songwriters/composers. The current split is closer to 94/6, in favor of labels.**

A discussion of fair compensation for music creators in the digital age must examine how overall revenues received from digital music streaming services are divided among various parties involved in the creative process.

Currently, major record labels receive up to 97% of revenues that flow to all music rights holders, leaving as little as 3% to be shared among songwriters, music publishers, and other rights holders and administrators. One reason for this is that streaming services often only negotiate with the major record labels, which are supposed to represent all rights holders. In some cases, record labels are also shareholders in the streaming services, which clearly places their interests in conflict with the artists, songwriters and other rights holders they claim to represent.

The average 94/6 split skews the relative value of the two principle components in a musical recording: the recorded performance of a song, and the song itself. This study’s analysis of music licensed for use in film, television and commercials provides a fair market metric that supports a 50/50 split in revenue between the songwriter’s share (which includes the music publisher’s interests), and the artist’s performance (which includes the record label’s interests).

The findings of regulatory bodies such as the Copyright Board of Canada also support the intrinsically equal value of the song and the recorded performance. In testimony before the Board, the former president of Universal Records, Ross Reynolds, called the relative value of the song and the performance “the classic chicken and egg situation. I don’t think you can extricate the two and say, this is more important than that.”

**A severe lack of transparency makes it difficult for rights holders to evaluate the compensation they receive or take action to change it.**

No discussion of how revenue is shared in the music industry can ignore the music industry's major problems with transparency. To illustrate, the Phéline Commission in France reported that major record labels have received large non-recoupable advances from music streaming services. There is no evidence that these advances have been shared with artists, songwriters or other rights holders in Europe, the United States, or elsewhere. This lack of transparency, and the opaqueness of many other aspects of the current value chain, leaves artists and songwriters in the dark about much of their immediate situation. Likewise, consumers have no way of knowing what portion of their subscription fees make it into the pockets of their favorite musicians and songwriters.

**'Fair Trade' models may prove more effective in creating a 'virtuous' value chain than government regulation.**

The creative and economic environment is changing rapidly, yet the revision of copyright legislation is inherently lengthy and complex. The regulatory framework seems similarly challenged (the antiquated Consent Decree in the United States is a prime example). While global efforts to reform copyright policies are certainly important and should by no means be abandoned, laws and regulations simply cannot and do not keep pace.

Other industries have made notable progress towards a fair value chain without government intervention by adopting ethical rules and practices. The "Fair Trade" movement, for example, effectively communicates a clear choice to the consumer at the point of purchase: she can be the last link in a "virtuous" value chain by choosing a clearly marked "Fair Trade" product, or she can choose a similar product that is not certified "Fair Trade", and thereby become the final link in an exploitive value chain that largely excludes workers in favor of distributors.

Although not without controversy, the success of the "Fair Trade" movement has demonstrated consumers' willingness to make ethical choices when given a simple, understandable option to do so. Whether there are lessons here that could be applied to the music value chain is beyond the scope of this study to determine, but this does suggest non-governmental approaches are worthy of exploration.

While most musicians and songwriters don't dedicate themselves to music for money, the simple truth is they can't make music without it. The sustainability of creativity depends on the recognition of the intrinsic **financial** value that musical works bring to so many businesses. This can only be achieved through fair compensation to the songwriters and performers. After all, these services wouldn't exist without the music itself and need a steady stream of good music to keep listeners coming back. A more equitable future may lie in the application and acceptance by all who inhabit the music landscape – from creators to consumers, and all those in between – of simple ethical practices, the power of which we have clearly seen in the "Fair Trade" movement.

## ENDNOTES

<sup>1</sup> Jeffrey A. Eisenach, Understanding Webcaster Royalties, June 2013, Navigant Research.

<sup>2</sup> IFPI, Recording Industry in Numbers, The Recorded Music Market in 2012, p.5.

<sup>3</sup> IFPI, Recording Industry in Numbers, The Recorded Music Market in 2012

<sup>4</sup> IFPI, Recording Industry in Numbers, The Recorded Music Market in 2012

<sup>5</sup> Retrieved on 2014/01/27 from <http://www.digitalmusicnews.com/permalink/2013/08/05/abi>

<sup>6</sup> APRA AMCOS Policy Department Whitepaper, November 2013, retrieved from <http://www.apra-amcos.com.au/broadcast/downloads/APRA-policy-whitepaper-music-streaming-Nov2013%5B1%5D.pdf>

<sup>7</sup> Retrieved on 2014/01/07 from <http://www.digitalmusicnews.com/permalink/2014/01/07/pandora-3>

<sup>8</sup> Retrieved on 2014/01/27 from

<http://musicbusinessresearch.wordpress.com/2013/06/17/is-streaming-the-next-big-thing-the-business-models-of-music-streaming-services/>

<sup>9</sup> Retrieved on 2014/01/28 from

<http://finance.yahoo.com/q/hp?s=P>

<sup>10</sup> Data for 2013 retrieved on 2014/01/28 from <http://www.theguardian.com/technology/2013/aug/01/spotify-pandora-streaming-music-profits>, source of data for 2010 refer to footnote 9.

<sup>11</sup> Data for 2013 retrieved on 2014/01/28 from <http://www.theguardian.com/technology/2013/aug/01/spotify-pandora-streaming-music-profits>, source of data for 2010 refer to footnote 9.

<sup>12</sup> Retrieved on 2014/01/28 from <http://www.theguardian.com/technology/2013/nov/06/deezer-streaming-music-spotify-discovery>

<sup>13</sup> Retrieved on 2014/01/30 from

<http://www.journaldunet.com/web-tech/start-up/simon-baldeyrou-deezer-simon-baldeyrou.shtml>

<sup>14</sup> Most of the data was retrieved on 2014/01/27 from <http://musicbusinessresearch.wordpress.com/2013/06/17/is-streaming-the-next-big-thing-the-business-models-of-music-streaming-services/>

Spotify's subscriber data was retrieved on 2014/01/29 from <http://www.digitalmusicnews.com/permalink/2014/01/09/downloadspotify>

The calculation for revenue per active user is ours. Pandora's fiscal year end is end of January but we have identified 2011-2012 as 2011 and 2012-2013 as 2012 to make it comparable to Spotify whose year end is 31 December.

<sup>15</sup> Alvarez & Marsall, Music Streaming In Tune With Consumers – Can the UK and Germany Support a Profitable Model. Retrieved from <http://www.alvarezandmarsal.com>

<sup>16</sup> APRA AMCOS Policy Department White Paper, November 2013

<sup>17</sup> <http://musicbusinessresearch.wordpress.com/2013/06/17/is-streaming-the-next-big-thing-the-business-models-of-music-streaming-services/>

<sup>18</sup> Jeffrey A. Eisenach, Understanding Webcaster Royalties, June 2013, Navigant Research.

<sup>19</sup> Christian Phéline, Musique en ligne et partage de la valeur - État des lieux, Voies de négociation et rôles de la Loi, Rapport à Madame la Ministre de la Culture et de la Communication, Novembre 2013. p. 35

<sup>20</sup> The data above is compiled from CRTC publications: Pay, Pay-Per-View, Video-on-Demand and Specialty Services Statistical and Financial Summaries, 2008 – 2012 and Commercial Radio Statistical and Financial Summaries (National Statistics, Canadian Broadcasting Corporation, Radio Markets), 2008 – 2012 and CRTC Communications Monitoring Report, September 2013, CRTC.

<sup>21</sup> Source : Digital Music News, Daily Snapshot, December 17, 2013, What Beyoncé Just Thought Every Single Artist in the World.....

<sup>22</sup> Retrieved on 2013/12/13 from <http://www.digitalmusicnews.com/permalink/2013/12/13/quicksummarystreaming>

<sup>23</sup> Copyright Board of Canada, Fact sheet, **Online Music Services, SOCAN Tariff 22.A (2007-2010) and CSI Tariff (2008-2010)**, October 5, 2012.

<sup>24</sup> Christian Phéline, Musique en ligne et partage de la valeur - État des lieux, Voies de négociation et rôles de la Loi, Rapport à Madame la Ministre de la Culture et de la Communication, Novembre 2013. pp. 22-24.

<sup>25</sup> United States District Court, Southern District of New York, In a petition of Pandora Media Inc., United States of America v. American Society of Composers, Authors and Publishers, March 14, 2014, Denise Cote, United States District Judge. The ASCAP tariff was set at 1.85% of Pandora's gross revenue. The BMI tariff was not yet known at the time of writing so we used the radio rate as an estimate. The SESAC tariff is not public but given that the song repertoire is about 10% of those of ASCAP and BMI, we used the BMI rate of 1.7 as a proxy for the maximum and 0.5% as a minimum. This brings the total rate for performing rights within a range of 4 to 5.25% of gross revenue. Given that the labels get 55.9% of gross revenue, the PROs/labels split for music revenue from Pandora is between 7/93 and 8.5/91.5.

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<sup>26</sup> Retrieved on 2014/01/28 from <http://musicbusinessresearch.wordpress.com/2013/06/17/is-streaming-the-next-big-thing-the-business-models-of-music-streaming-services/>

<sup>27</sup> Christian Phéline, Musique en ligne et partage de la valeur - État des lieux, Voies de négociation et rôles de la Loi, Rapport à Madame la Ministre de la Culture et de la Communication, Novembre 2013. p.41

« Une analyse au cas par cas serait nécessaire pour faire la part exacte de ce qui y relève ou non dans ce tableau d'ensemble d'obstacles au marché résultant, soit de la présence de concurrents en position dominante, soit de conditions antiéconomiques imposées par les fournisseurs de catalogues les plus puissants. »

<sup>28</sup> An Economic Analysis of SOCAN Tariff 22. A, Dr. Stanley J. Liebowitz, April 30, 2010. Filed in evidence as SOCAN-4 (public version) in a proceeding before the Copyright Board of Canada.

<sup>29</sup> Copyright Board of Canada, Evidence filed for the hearing into the **Reproduction of Musical Works by Online Music Services (2005-2007)** Exhibit CSI-27, **The Value of the Use of the Repertoire of CSI by Online Music Services**, A report prepared for CSI by Paul Audley and Douglas Hyatt, Paul Audley & Associates Ltd. April 28, 2006 (paragraph 109)

<sup>30</sup> Idem at paragraph 111

<sup>31</sup> Adding the three shares totals 19, labels get 37% (7/19) of \$0.72, artists get 21% (4/19) and publishers/songwriters/composers get 42% (8/19).

<sup>32</sup> This information was confirmed in email exchanges with officials at NMPA, ...

<sup>33</sup> Copyright Board of Canada, Statement Of Royalties To Be Collected By NRCC For The Public Performance Or The Communication To The Public By Telecommunication, In Canada, Of Published Sound Recordings Embodying Musical Works And Performer's Performances Of Such Works, [Tariff 1.A – Commercial Radio In 1998, 1999, 2000, 2001 And 2002], Decision Of The Board, August 13, 1999. P.33

<sup>34</sup> Christian Phéline, Musique en ligne et partage de la valeur - État des lieux, Voies de négociation et rôles de la Loi, Rapport à Madame la Ministre de la Culture et de la Communication, Novembre 2013. « Annexe 1 » Lettre de mission.