

# Internet Takes Music Industry Back to Its Roots

Josep Valor

IESE professor and director of the PwC&IESE e-Business Center



Record companies have held their power due to their role as crucial intermediaries between the artists and the general public. Now, however, the Internet is turning things upside down: while artists such as Radiohead, Madonna and Prince are making moves that highlight the impending expiration of the sector's current revenue model, they are paving the way for a new, lucrative—and quite possibly more balanced—business model.

With worldwide sales of over 20 million units under their belt, Radiohead is one of the most successful rock bands in recent years. Its smash hit *OK Computer* appears on all of the “all-time greatest albums” lists. So, this band from Oxford already had its place carved out in rock music history, but it may also go down in history as the band that gave the decisive push to a new business model for music distribution via Internet. On October 10 of this year, Radiohead made a general-public release of *In Rainbows*, its seventh studio album, but the group's fans could not find the CD in stores or download it from iTunes. The only legal way to acquire the record was to get registered on the group's website and download the songs there. On top of that, the band offered its fans a revolutionary payment model: they could pay whatever they felt like for each tune, or nothing at all if they so decided. It is true that other artists had tried similar experiments but this was the first time that a multi-platinum selling group was bold enough to give its followers the chance to name their own price for its music.

The band has yet to reveal the official figures from this risky endeavor, but the website Gigwise.com has announced that the record had already received 1.2 million “reservations.” Buyers had paid an average of \$8 for the ten new tracks, which would translate into revenues of nearly ten million dollars. The band's previous record, *Hail to the Thief*, has sold approximately two and a half million copies since its release four years ago. Based on artists' average take being two dollars for every disc sold in a store, Radiohead's new album *In Rainbows* would have doubled the profits from their previous record...before its official release date.

News like this shows that the recording industry crisis is being caused less by piracy than by the Internet, which has rendered the current business model obsolete by becoming the main music distribution method. Obviously, content distributed through the Web cannot be priced the same as that sold in a physical package. Record companies and copyright protection agencies will be powerless to change this reality, regardless of the amount of lawsuits or appeals they file. Despite their catastrophic predictions about the future of music and artists, the fact is that we are witnessing a

## Keys

**1** The average price of a newly released album in the United States is \$17, of which merely \$2 go directly to the artist in the form of royalty payments. The rest goes to promotion, manufacturing and distribution costs, as well as covering profits for record companies.

**2** The Spanish music recording industry association Promusicae says that in 2001, 78.9 million compact discs were sold in Spain, while in 2006, sales barely reached the 40-million mark, which equates to a drop in sales of almost 50% in five years. The forecast for 2007 predicts an additional 15% drop.

**3** Unlike other countries, in Spain legal music downloads is not catching on among users. Last year in Spain, 850 million songs were illegally downloaded off the Internet, compared to legal downloads.

return to the industry's origins. The concept of music as a physical product that could be bought and sold came about when distribution began on phonograph cylinders, or records. Prior to that, musicians had made their living by giving live performances of their compositions. It seems now that we are headed in that direction once again. The Internet increases music's reach and as a result, people are listening to a much broader variety of sounds.

This ease of access to all kinds of works could be one of the factors behind the current success of live music. Concerts represent more secure revenue sources for artists as these performances are a leisure product that, being live, cannot be canned or "pirated." Additionally, artists earn more money for their live performances than from CD sales, which explains why Madonna, who fills stadiums despite hefty ticket prices, has decided to use concert promoter Live Nation instead of renewing her contract with Warner, her record company since day one.

In a decision that received considerable flack from the industry, in July 2007, Prince offered his album as a newspaper giveaway in the UK, with the Sunday edition of The Mail. A few months later, tickets for a string of 21 concerts in London by the Minneapolis native sold out quickly, for a total intake of 26 million dollars. Radiohead has also announced its intention to play larger venues for its 2008 tour.

The latter example shows that it is possible to earn money by distributing music over the Internet, although the method used will be drastically different and most likely also more profitable for the artists than for the intermediaries. In any case, it is very unlikely that sales on recorded music will go back to generating profits comparable to those from the golden days of vinyl and compact discs. If record companies want to survive, they will have to shift their focus and prioritize record sales below talent discovery, promotion and management for artists who have once again become troubadours.