New Business Models in the Recording Industry: an Artist's Perspective

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Abstract: *The recording industry has been going through a great restructuring process since 1999, when Napster was launched. Since then, recorded music sales have been falling most years and record labels are struggling to adapt their business to a new context. Hoping to fill in the market gap left by these companies, many innovative businesses have emerged, trying to embrace the technological changes. In this context, independent artists now have new options to grow by themselves, other than signing with a label. Based on the Business Model Canvas, a conceptual tool proposed by Osterwalder and Pigneur (2009), this article will attempt to analyze these new options, showing the differences between the independent artist's business models back then and now. Special attention will be given to the situation of the Brazilian market.*

1) A brief explanation about the Recording Industry

In the last few years, the recording industry has gone through great changes. In 1999, Napster, a piece of software created by Shawn Fanning, brought about a major change in the industry. It enabled music files (especially in mp3 format) to be shared through the internet, directly among fans, without the need for any intermediaries (recording companies) to carry out such connection. This exchange of files was carried out without any kind of payment by the fans, which caused recorded music sales (mostly CDs) to drop and brought about a crisis in the industry, since the recording companies and the artists kept demanding payment for such operation.

Despite winning the lawsuits against Napster, the labels weren't able to stop the so-called piracy (whether physical – copying of CDs – or virtual – sharing of files). New sharing software, such as Gnutella, Emule, Kazaa, among many others, continued to enable non-authorized exchanges among users, and this took enormous proportions in the industry. However, as Dubosson-Torbay et al (2004) show, the negative impact of downloading a free song is not so clear. In fact, many fans started downloading as a way to sample the music and then pay the artist and/or the label money, sometimes buying the CD, the vinyl, merchandise, tickets or even the same mp3 file on a legal site. Nevertheless, recording companies, desperate with such fall in their revenues, started to fight non-authorized consumption of music in a reactive manner, with lawsuits and anti-piracy campaigns, but with very unexpressive results.

In fact, as Tschmuck (2006) shows, this is not the first crisis record labels have had. They had difficulties accepting new technologies and styles in different moments in their history, such as the launching of radio and the emergence of rock music. In every crisis they had, artists were heavily hit, because of their high dependence on these companies.

Historically, the natural path for an artist to grow used to be through a recording company, which used to finance, publish, record, advertise and guide their career, in order to reach millions of physical products (CDs, DVDs, tapes, vinyl, etc.) sold. As a result, they used to recover their investment and make good profits, particularly with the sale of those products. With the crisis, the recording companies started avoiding risks, were forced to reduce their catalogue and cut down on their financings. This way, a large number of artists stopped receiving investments and, therefore, had to review their strategies.

Despite the constant fall of CD sales[1], broader music consumption has grown a lot in these last years if we consider concerts, sharing, and new services. Many companies were able to perceive opportunities and started working within this market. A great number of social networks, virtual stores, distributors and even collective financing sites emerged, with innovative business models, allowing new approaches for the production and consumption of music. And there also were the fans, which tasted the freedom of digital music and now wanted more music and more free products. The scene was ripe for disruptive technologies and services to emerge.

[1] Available data through subscription here:
http://www.riaa.com/keystatistics.php?content_selector=research-shipment-database-overview

These innovations represented a threat for the recording companies, but also created new possibilities for the artists. As Owsinski (2009) explains, all these innovations led the industry to the “Music 3.0” era, where direct artist-to-fan communication pervades, direct sales and direct marketing can be made to the fans, the audience is stratified and the middleman can be eliminated. Artists could finally start to take care of their own brands, as entrepreneurial independent artists. After all, for ages they have dreamed of alternative ways to be successful without the complex and disadvantageous agreements commonly signed with record labels.

In view of such situation, it became quite important for the artists to build their independent business model, using effectively the new available DIY (Do-It-Yourself) tools. Some tasks that were historically performed by labels and partners now can be done at home with free or low cost tools. Good quality home studios and instruments are affordable, online marketing is free through social networks and sales can quickly be made through iTunes, Facebook and the band’s website. According to Anderson (2006), one of the greatest characteristics of the internet era is that it became possible to discover niche markets and target your efforts directly at them. Through the internet it is possible to reach a number of people which before would be unreachable, both in geographical and numerical terms.

Reflecting over such points, the following section will present the Business Model Canvas created by Osterwalder and Pigneur (2009), which will be used as a tool to explain and describe the old and new independent artist’s models in the next section. After this, some thoughts will be made regarding the differences between the independent artist’s model before 1999 and the new model, as well as expectations about the future development of it.

2) The Business Model Canvas

There has been a wide discussion about business models in the last decade. Many authors have written about the definition of such concept (Magretta, 2002; Amit and Zott, 2001; Osterwalder, 2004; Taran et al, 2009), others about the main components of it (Osterwalder, 2004 and 2009; Taran et al, 2009; Johnson et al, 2009), or how it relates to the company’s strategy (Mintzberg et al, 2002; Christensen et al, 2004; Johnson et al, 2009). Some have worked on canvas (Osterwalder, 2004 and 2009; Taran et al, 2009;

Johnson et al, 2009), trying to create a schematic view and a practical tool to understand and use the concept in a business environment.

It’s fair to say that the Business Model Canvas presented by Osterwalder and Pigneur (2009) has become a widely accepted tool to build and analyze business models in many sorts of industries. The nine building blocks of his model represent how a business is structured, in order to deliver value to the target customers and profit with this. Therefore, this article will use it to analyze how independent artists may structure their own business models by using new available services, and possibly be more successful than signed artists.

The Business Model Canvas can be seen in the picture below:

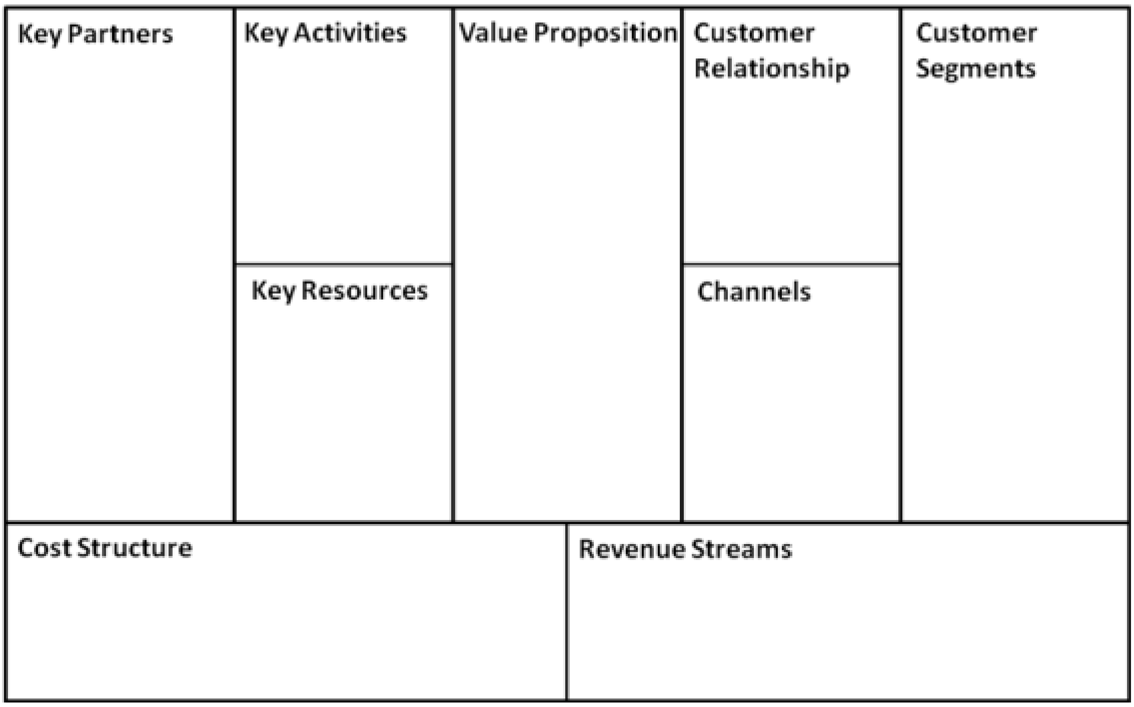

Figure 1: The Business Model Canvas (Osterwalder and Pigneur, 2009)

In order to understand the canvas, let’s see what each of the nine building block means:

- Key Partners:

This block describes the key partners of the company, as well as their key suppliers, outlining those that help create value for the customer. These partners and suppliers are needed to perform key activities and provide key resources that the company can’t do or get alone. These strategic partners and suppliers have built a network that reduces risk and uncertainty, optimizes the work and saves money for the company.

- Key Activities

Key Activities are those activities, processes and tasks required to execute the Value Proposition properly. They may also describe the activities needed for the Distribution Channels, Customer's Relationships and Revenue Streams.

According to Osterwalder and Pigneur (2009), these activities may be categorized as: Production, Problem Solving and Platform/Network.

- Key Resources

Key Resources are those physical, intellectual (brand, patents, copyrights, data), human and financial resources that are required for the company's Value Proposition, Distribution Channels, Customer Relationship and Revenue Streams work.

- Value Proposition

The Value Proposition is a general view of the company's portfolio in a value perspective. It must be clear in describing what motivates customers to buy those products or services. These motivations may be related to: Newness, Performance, Customization, "Getting the Job Done," Design, Brand/Status, Price, Cost Reduction, Risk Reduction, Accessibility, Convenience/Usability.

Four questions must be asked in order to understand the company's Value Proposition:

1) What value do we deliver to the customer?
2) Which one of our customer's problems are we helping to solve?
3) What bundles of products and services are we offering to each Customer Segment?
4) Which customer's needs are we satisfying?

- Customer Relationship

Description of how the relationship between customer and company is sustained. The goal is to know how customers want to be contacted and at what level of attention. It is also important to consider how this relationship is integrated to the rest of the business model and its cost.

Some examples of kinds of customer relationships are: Personal assistance, Dedicated Personal Assistance, Self-Service, Automated Services, Communities, and Co-creation.

- Channels

Channels are the way through which a company reaches its customers. This block primarily describes how they are doing this now and how customers want to be reached. It also describes how integrated the channels are, which channels work best and which are most cost-efficient and, finally, how the channels are being integrated with customers' routines.

Channel phases:

1. Awareness: How do we raise awareness about our company's products and services?

2. Evaluation: How do we help customers evaluate our organization's Value Proposition?

3. Purchase: How do we allow customers to purchase specific products and services?

4. Delivery: How do we deliver a Value Proposition to customers?

5. After sales: How do we provide post-purchase customer support?

- Customer Segments

This block describes what the company's customer segment is, outlining the most important ones. One company may target mass markets, niche markets, segmented markets, diversified markets or even have a multi-sided platform that delivers different value propositions to different customer segments.

- Cost Structure

Cost Structure describes the key costs of the model (especially the cost of key resources and key activities) and the strategy that supports the company's choices in terms of costs.

The authors explain that the model could be "Cost Driven" (leanest cost structure, low price value proposition, maximum automation, extensive outsourcing) or "Value Driven" (focused on value creation, premium value proposition).

Most common issues addressed in this block: Fixed Costs (salaries, rents, utilities), Variable costs, Economies of scale, Economies of scope.

- Revenue Streams

This is where we explain how the model generates money and the different streams related to different value propositions and different customer segments (and their respective importance).

Some important questions to be considered: For what value are our customers really willing to pay? For what do they currently pay? How are they currently paying? How would they prefer to pay?

Types of revenue streams: Asset sale, Usage fee, Subscription Fees, Lending/ Renting/ Leasing, Licensing, Brokerage fees and Advertising. The company may choose to use fixed prices (e.g.: List Price) or dynamic prices (e.g.: Negotiation).

After getting to know the canvas, it's possible to see that it is primarily designed for companies. However, the business underlying bands and artists nowadays can be very similar to the functioning of a company. Artists and bands are represented as brands, with the proper marketing and sales strategies. So, in the next section we will assume that this model can be applied to them, in order to explain how they generate and deliver value to their customers (fans) in a financially sustainable way. We will outline the main new tools available to independent artists and how they impact on each block of artists' new business models.

3) The Contemporary Independent Artist's Business Model

Until 1999, artists' business models were heavily dependent on elements they couldn't control themselves. Record Labels historically had control over most of the processes. Artists didn't have many options to fund their recordings, tours or projects in general, so: the label acted as an investor to them; only recording studios had the right equipment to record in good quality; it was nearly impossible to get their music and merchandise in big retailers without the connections, money and know-how that an experienced company such as a label had; independent artists targeted their music to the (small) local niches and signed artists targeted mass markets, making physical distribution and advertising very expensive; there was no easy way to connect artists and fans; and the money was mostly in selling recorded music through physical channels. So, most independent artists dreamed of signing with a big record label to have access to all these elements, since the prevailing independent model could not be effective without them.

We may summarize the ineffective independent artist's business model in the late 1990's using the Business Model Canvas, as in below:

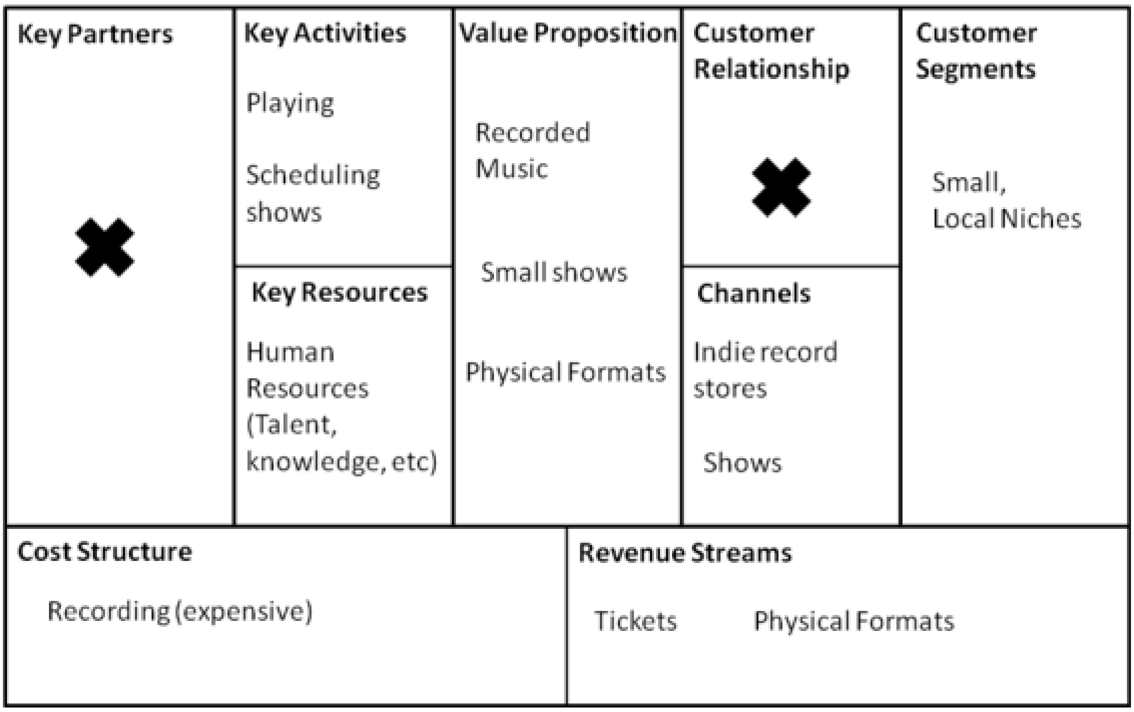

Figure 2: The Ineffective Independent Business Model of the 1990's

With the technological innovations in the music industry ushered in by the Napster era, the independent artist has earned more possibilities when it comes to building his business model and career. Signing with a record label isn't the only possible way to survive making music anymore – the artist now has the tools to manage and keep their business at an affordable cost and earn money.

This section describes some concepts and examples of how they can build their own business model, which was named "The Contemporary Independent Artist's Business Model." It is built over the following blocks:

Key partners: Campos et al, (2008) say that the interaction between consumers and companies has been growing for the last years and is now one of the most important characteristics for building new business models.

Nowadays, the main partner of the artists is their fans. Thanks to social networking, artists are much closer to their fans and can rely on them to help with ideas, opinions and even funding. Crowdfunding has become a popular funding method and the fans actually enjoy helping. "Kickstarter," "Sell a Band" and "Please Fund Us" are three examples of successful websites in this direction.

According to Fjeldstad and Andersen (2003), value networks emerge from these relationships, which use the interaction and cooperation with consumers to generate new products for the market. For Tapscott and Williams (2010), those consumers (fans) are motivated by many different factors, ranging from simply having fun to altruism. So, the crowd can be a great asset for artists, as they may help without costing any direct money. However, they need to feel engaged and motivated by the artist, who has to be effectively present in social networks, interacting and providing them with new content.

In Brazil, crowdsourcing services are still a new business, with "Movere.me", "Catarse" and "Embolacha" being the most popular websites for this. Other interesting Brazilian initiative is "Queremos." This website relies on crowdsourcing to enable medium-sized international artists to come to Brazil and perform. For this, they sell upfront reimbursable tickets, and when the minimum production cost in achieved, the concert is guaranteed. The upfront tickets cost more than the regular ticket, but if on the day of the concert the audience reaches a certain number, fans start getting their money back and may even recoup all the ticket value.

Some big Brazilian companies outside the music industry, like Natura (Cosmetics), Oi (Telecom), Vivo (Telecom), Petrobras (Oil) and Itaú (Bank), have started to fund music initiatives that used to be funded by record labels. CDs, DVDs, shows and even tours are in their portfolio. The investment works as a sponsorship and helps new and experienced artists. Attaching an artist to a company's brands is a great alternative for both sides, because the artist gets the advanced money that they need and the sponsor improves its visibility.

Key Activities: In order to be successful, independent musicians have to accumulate several functions, other than to just make and play music. Independent musicians need to engage in most business activities for their career, since they normally can't afford paying employees. So, they have to do themselves most of production, recording, accounting, marketing, etc. (production activities in general, according to Osterwalder and Pigneur's categorization). The good news is that nowadays their work is much easier and more efficient because of new technologies and the internet. They can manage email lists and social profiles and do some pretty decent targeted marketing. With new recording and computing technologies, many musicians have their own home studio and good music instruments for affordable prices. The important point here is that independent artists must now be more than just musicians, and that's a good thing. They can lower their costs, do a professional work alone, never sign with a label and still be profitable.

Key Resources: When we think about the key resources of artists, we first think about their artistic talent. The knowledge, inspiration, intelligence and other human aspects are the basis for music creation.

However, technology also plays an important role in the artist's life today. It may reduce costs and improve the sound quality. And it may even be almost as important as the human factor in music. Today, many musicians rely on computer effects, and that has become their trademark. Today, artists' Key Resources rely on a mix of human and computer resources to generate value to the market. The band Gorillaz, for instance, couldn't exist without computers, projectors or technology in general.

One good Brazilian example is the funk style from Rio de Janeiro. Originally created in the slums, this very popular style often relies only on sampled beats and a singer, who normally has very little knowledge about music theory or how to play instruments. Nevertheless, the funk industry is estimated to earn more than R$10 million per month just in Rio de Janeiro[2].

In Pará State, Brazil, there's also the Tecnobrega style, which like the funk style, comes from a poor class and strongly uses computer technology. Besides the music style innovation, Tecnobrega artists' main innovations are in the distribution channels. Since they don't work with labels and their audience is mostly composed by middle-class/poor customers, they encourage street vendors to pirate their CDs and sell it to fans, without earning any share. This way, they allow customers to buy CDs at affordable prices and generate high word-of-mouth marketing so they can make enough profit on concerts. According to Lemos et al (2008), the Tecnobrega industry is now worth R$ 5 million per month and is a fast-growing market.

Value Proposition: The concept of value proposition has been changing in the recording industry for a long time. For decades, the physical formats were dominant. Fans bought vinyl discs, cassette tapes, CDs and other media so they could own the music (physically). Until the digitalization of the music, it was all about ownership.

After the digital formats emerged and physical piracy/digital sharing grew, access to music has gained importance. Fans want to listen to music everywhere, in any device, and the streaming model started to gain popularity among them. That's the "music like water" approach that Kusek and Leonhard (2005) mention. According to them, music "wants to be free" and streaming models may play a greater role in the music industry soon. According to Campos (2010), connection range, stability, prices and speed are still a great barrier to this technology in many countries, such as Brazil.

Streaming sites are mostly based on subscription models, some with free versions. Spotify, Pandora, Deezer and Rdio are good examples of success in the streaming business, even though they haven't proved (yet) to be more profitable than selling digital or physical music.

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[2] Source: http://cpdoc.fgv.br/sites/default/files/fgvopiniao/Configura%C3%A7%C3%B5es%20do%20mercado%20do%20funk%20no%20Rio%20de%20Janeiro%20-%20FGV%20Opini%C3%A3o.pdf

Other example of changes in the value proposition for artists is the comeback of old formats like cassette and vinyl. Consumers like audiophiles and highly engaged fans are again interested in those formats. Trent Reznor, from the band Nine Inch Nails, has done an amazing job selling not only vinyl, but also a great variety of products (DVD, Blu-Ray discs, autographed products, merchandise in general and even digital songs) on bundled packages and limited editions. This kind of initiative adds value to those products, and prices can be higher than they would be if they were sold separately.

Björk tried a new approach. Her team created a smartphone/tablet app that proposes a new experience of interactive content for the fans. In the app, fans can see lyrics, photos, play games and hear music, all at the same time. Songs are sold through the app for US$1.99 each (or US$9.99 for the full album).

As we see, there are many ways to create and add value to music. The CD is not the artist's core product anymore; there are also several new unexplored value propositions that can be very profitable.

Customer Relationship: With the rise of social networks and blogs, the relationship between artists and fans has gotten closer, and they are interacting in several ways. Many fans have been experiencing co-creating value with their idols, whether remixing songs, giving ideas, voting on queries or just sharing posts and songs. This kind of relationship may benefit both sides. The desire of proximity and interaction with artists, which was always a dream to fans, can now be satisfied through social networking. And also the fans can interact with a community of people with the same musical interests, which increases the word-of-mouth marketing possibilities. Artists can get good feedback and market their products to the right audience, at low costs. According to Owsinski (2009), the more engaged fans may spend much more money than the less engaged.

Channels: Thanks to the internet, independent musicians have a lot more distribution channels now than they had before. Back then, it was almost impossible to sell music on a big scale without being signed with a record label. Now, there are plenty of options to sell digital music through digital stores like iTunes or even at the artist's website. Music has gone to the cloud and the distribution is a lot easier. Artists can even distribute their videos, podcasts and ringtones at low cost or for free. And if they are competent (or lucky) enough, their content might "go viral" (get millions of views), which could result in a big boost in popularity, leading to signing with a label (and having some leverage to negotiate).

One of the greatest elements of iTunes is that it has democratized the music distribution market. Now it is possible for any artist to sell their music without a label, at a decent rate (artists can keep up to 70% of sales, much more than selling through labels' channels) and at a very low cost. The Brazilian version of iTunes was launched on December/2011 and it is expected to drastically increase digital media consumption, as it did in many countries.

Currently, artists have other ways to sell their digital music, through digital distributor companies or independently. Digital distributors (such as CD Baby, Tunecore, Bandcamp, and others) help raising awareness about the artist's songs, so it can be sold through a large number of virtual stores, where it can be delivered to users, which evaluate the album and may purchase it. Artists also gets a bigger cut in sales, since the only intermediary is the digital distributor, who takes a smaller cut than physical retailers and the record label do.

Physical sales are still possible to make, even without the support of a big label or retailer. One option is consignation. Many indie record stores works with this option. The other is to sell it at concerts and on tour. Customers usually are more inclined to buy a band's merchandise after seeing their concert. It's a place where everybody is a potential customer and the emotions lead to impulsive shopping.

Another important channel is the artist's website. Even though there are plenty of options to sell the artist's products, his website remains as their home, where they can customize anything, even prices. Their website and their social profiles are the best places for providing post-purchase customer support and perform a complete service to fans.

Customer Segments: Chris Anderson's Long Tail Theory (2006) shows us that in the virtual world, storage and distribution costs are greatly reduced and virtual shelves can have many more products than physical ones. Thus, the virtual stores get more democratic, and non-hit artists can dispute customer attention with best-selling ones.

The niche markets have grown and different tastes can now be served. Fans can now buy songs that wouldn't be available before in physical stores, especially from independent artists. This opens many new opportunities to those artists. Suddenly, they don't necessarily need to play on the radio or sell millions of CDs to be profitable. They can actually earn enough money if they can find their audience and target their products at them properly. So, the main task for artists regarding customer segments is to find out who their potential fans are, which has become easier via social networks.

Cost Structure: The cost structure for musicians is today much lighter than before. Recording costs are low, since it's possible to record at home with decent quality and cheap equipment or even get crowdfunded to do it. Advertising and marketing can be done through social networks mostly for free. So, it has become much cheaper to work as an independent artist than before. Tour costs, however, are still the heaviest expense for them, but with market research and a good relationship with fans, it's easier to schedule concerts at strategic places (where your niche market is), sell upfront tickets and reduce risks.

Revenue Streams: Until the beginning of the 21st century, recorded music sales represented a great percentage of an artist's income. This percentage has been dropping systematically since physical sales have been decreasing after Napster was launched. Since then, other sources of income have been growing in importance.

The first one is concerts. Musicians are touring a lot more to make up for these losses, and thanks to social network marketing, the concert market has been growing. According to Pollstar data[3], concert tickets are getting expensive as the demand gets higher. However, touring can be pretty exhaustive and many artists can't do this for much time.

The second is digital sales and subscription streaming services. They are two growing income sources in the music industry. With the popularization of digital stores, especially with the launch of iTunes, more fans have opted to legally download songs, even if it's possible to download them for free. High-quality lossless files are also an option for selling digital music to demanding fans, because they are a scarce product and targeted to the engaged fan. Subscription streaming services are growing fast too, as we can see with Spotify, but it still doesn't generate enough money for artists and labels.

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[3] http://www.pollstar.com/atpDetail.aspx?SearchBy=A

Merchandise is the third. As Mike King (2009) explains, merchandise can be a very profitable business for artists. However, the above-mentioned example of Trent Reznor shows that artists have to be creative when selling products, not only designing, but also selling them. It’s important to sell products with high added-value, such as scarce products and bundled packages.

Finally, Crowdfunding is the newest income source for artists. This source can be really interesting because it has small risks (if the goal isn’t reached, the project dies and nobody loses money), and if approved it yields advanced money, which in the past, the artist could only get from a label.

As we see, although physical sales are much lower than before, artists can still be profitable with other revenue incomes. Typical sales are made using list prices, as in virtual stores, although some experiences have been made using variable prices (like Radiohead’s album “In Rainbows”). The key appears to be mixing different revenue streams and selling it in innovative ways.

Finally, considering all these blocks, we are able to summarize them as the Business Model Canvas proposes. So, the Contemporary Independent Artist’s Business Model is represented below.

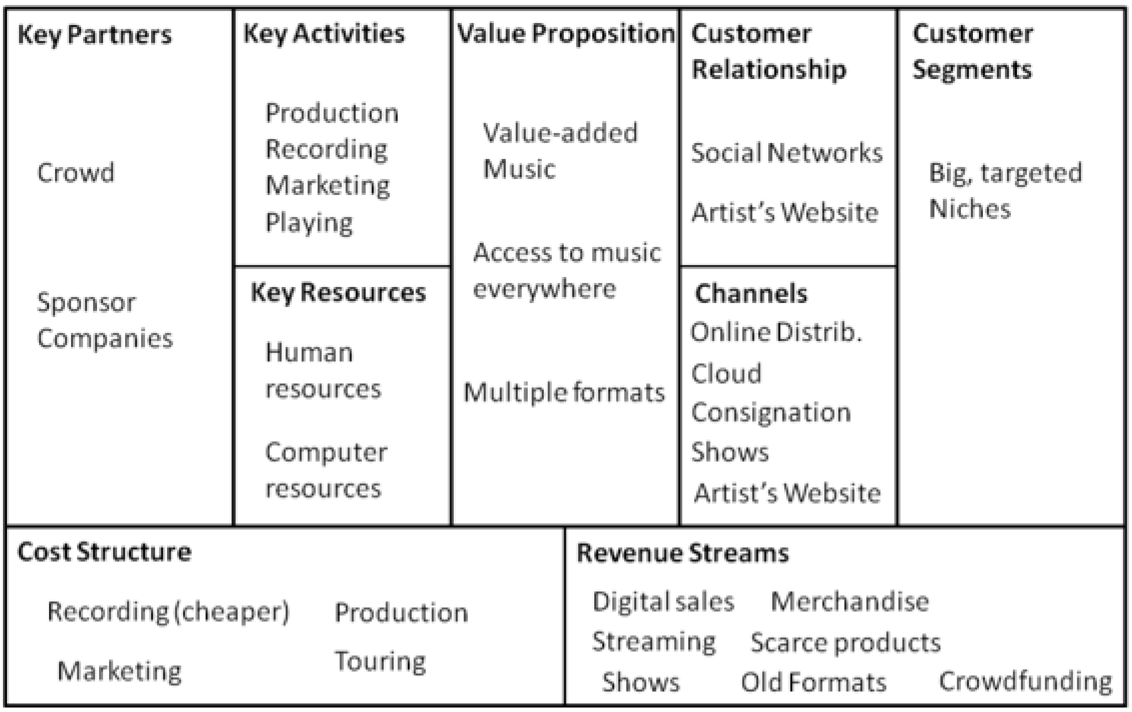

Figure 3: The Contemporary Independent Artist’s Business Model

4) Conclusion

As we can see when comparing both models, many recent innovations in the music industry have helped independent artists to establish a consistent business model by themselves. Record labels have lost much of their power and control over some processes, especially when it comes to distribution channels and resources. However, they are still a big player in this industry. Today, most big artists still work with labels for many reasons: great sums of advanced money, know-how, connections, work with big retailers and high-circulation media, reduced risks, etc.

Competition to sign with labels has become harder, as they have reduced their budgets and prioritized big artists instead of investing in new ones. Today, most labels only sign new artists when they are "ready," i.e., when they represent less risk and have already shown high revenue potential.

So, artists have to master their business models even before considering contacting a record label. Fortunately, many blocks of the old model are being improved with the emergence of new music services and technologies. As these services and technologies evolve, the model gets more consistent and bands may succeed by themselves, without having to consider signing with a label.

In order to be fully functional, the Contemporary Independent Artist's Business Model needs to see improvements in market services, especially in funding (Key Partners), and distribution (Channels).

Streaming services, for instance, have a great potential to develop and be widely used by independent artists. Currently, most of the biggest streaming services (Spotify, Pandora, Deezer and Rdio) are only available in a few countries (Brazil, for instance, doesn't have the first three and Rdio has just launched), because they are subject to technology and legal issues (such as connection speed and prices and copyright laws). So, they can't afford to pay competitive copyright figures to artists over the number of times the songs are played, which leads these services to be used primarily as a marketing tool. It is expected that, once streaming services reach a bigger number of paying customers (subscribers to premium versions), these figures may increase.

The crowdfunding system also needs more time to prove it can actually be a consistent alternative to label funding. Today, it’s very difficult to estimate the chances of reaching the project goal, because services are new and Bands are still trying out this system. Partnerships with companies and investors may be needed to boost the development of these services.

Although these services need improvements, the key improvement must be in changing the independent artist’s role in the market. As many services and technologies surge as opportunities for their growth, they need to get used to work at different tasks efficiently. It is still difficult for most of them to perform several activities as self-entrepreneurs. In general, artists don’t have the sufficient know-how to make good budgets, marketing plans and other business activities, nor to interact with recording technologies (equipments and software) or even with internet services (social networking, site maintenance, digital marketing). They now have less time to do their core activity, music, and dedicate themselves to activities that were usually performed by third parties.

Special attention should be paid to the relationships with fans. Nowadays, connecting with fans is a foundation to building artists’ business models. Doing a good job engaging fans provides better information on who they are (Customer Segments), what for and how much they are willing to pay (Value Proposition and Revenue Streams) and how and where to connect with them (Channels and Customer Relationships).

Today, we see that it is actually possible to be independent and successful. Many artists show innovative business models but, in fact, there is no recipe for success. Building an independent artist’s business model needs hard work, commitment and creativity – all of which have always been the characteristics of successful artists.

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