



Healthier Music Industry

Consolidation to Lead to Needed Improvements in Marketing

The future of music sounds upbeat. The retailers that survived two shakeouts over the last ten years comprise a healthier retail account base than in recent years. A more competitive environment exists with two labels at the top with similar market share. This rivalry should produce innovative solutions for the music industry's problems. Consolidation put the music industry in its strongest competitive position since the mid-90s.

There are still challenges. The use of lawsuits must be constrained so music can return to being a consumer friendly industry. Loss-leading music to sell consumer electronics could ravage the business again. The industry only has a year to find a way to compete against the next generation of videogames poised to hit the shelves starting in 2005.

The music industry must embrace marketing to overcome these obstacles. If it can close the value gap relative to other forms of home entertainment—especially DVD and videogames—and return to being a consumer friendly industry, music can enjoy a sustained recovery.

Labels, not Consumers, Fueled the Declines

MAP caused music sales to decline...it just took time for the impact to be big enough to notice.

First the reality: the labels' embrace of minimum advertised pricing (MAP) in the late-90s created the ideal environment for declining sales. Under MAP, retailers lost cooperative advertising dollars if they advertised music below a fixed minimum price. A price support (also known as a price floor) has three effects: (1) it creates an incentive to increase supply, but not quality, (2) it makes substitute products more attractive, and (3) it creates a black market.

Our research shows a per capita decline in dollar and unit sales to 15 to 24 year-olds—the recording industry's core market—started in 1998. This was the year the record labels made widespread use of MAP to stem the wave of retail bankruptcies set off by a price war. It was also the time DVD hit the market, and Sony Playstation had its first full year of sales. The decline in music sales to teens and young adults began one year before Internet piracy became a hot topic.

	<p>MAP's artificially high prices prompted suppliers to increase production. The number of new releases surged during the late-90s. High prices created unrealistically low estimated break-even points for new releases, leading to greater risk-taking. As a result, CDs were rushed to the market with less scrutiny over quality and with inadequate marketing support.</p> <p>The music industry raised prices for a mature product format, while innovative products were poised to gain larger shares of discretionary purchases. Movie and game software offered enhanced sound, visuals, durability and features. Hollywood also released DVDs earlier in its product lifecycle and at a lower price compared to VHS. DVDs became the greatest consumer product launch in history, as CDs edged toward a sales precipice.</p> <p>Teens and young adults still wanted music, but craved the new movie and videogame formats more than music. Their desire for DVDs and videogames put pressure on their entertainment budgets, already constrained by higher music prices. They just could not afford everything they wanted. Something had to give, and that was older and pricier CDs.</p> <p>Consumers will not allow themselves to be denied what they want. Their first solution was to switch purchases from high-price mall stores to discount prices at the mass merchants and consumer electronic chains. This was not enough to expand their purchasing power satisfactorily, so they searched for creative ways to get what they wanted.</p> <p>Necessity once again was the mother of innovation. The solution to high MAP prices was piracy.</p>
<p>Piracy enabled consumers to expand their purchasing power that MAP constrained.</p>	<p>Piracy is a natural response to price supports by an industry or government. Call it an eye for an eye, music style: The labels encroached on fair trade, so consumers violated copyrights.</p> <p>Piracy is not a direct attack on the music industry, but a way for consumers to subsidize their purchases of movie and videogame industries. It is a way for consumers to get what they want the most, without giving up what they desire, but crave the least.</p>
<p>Pricing power must be earned though product differentiation.</p>	<p>Ending MAP returned the pricing of music to the marketplace from the realm of fiction. Pricing power must be earned by differentiating its product through marketing, instead of the labels' dictating terms to protect their accounts receivable. This should result in greater scrutiny of talent, more support for new release and marketing innovations.</p>

Consolidation Strengthens

Consolidation is harsh, but good: it leaves stronger participants.

Mergers, acquisitions and bankruptcies cleared out the financial plays at retail. Those that came in for the quick buck were the first to get bucked out of business. National Record Mart and Warehouse were shaken out, and Musicland, an acquisition apparently based on financial assumptions rather than a merchandising vision, is limping along.

Survivors, such as Handleman, Hastings and Trans World, are run by CEOs with more than three decades of experience each, and most of it with their current companies. They understand that retail is about consistent execution down to the smallest detail to satisfy consumer expectations. The retail part of the distribution channel looks stronger than ever.

Stable markets tend to have a leading company with twice the market share of its next biggest competitor. This described the recording industry before this summer's merger between the Sony and Bertelsmann music divisions.

The recording industry now has two labels of nearly the same size. This should trigger a fierce battle for the number one spot: Universal will fight to maintain its leadership, while Sony-BMG will vie to justify its merger. Sometimes their tactics might seem absurd and other times brilliant, but the intensely competitive setting will foster a period of innovation and create opportunities to be exploited by retail that will benefit the customer.

Two labels battling for market supremacy should spur innovative marketing.

Embrace Dual Disc, Shun iPod

One area that should be a catalyst for change will be the product format.

Apple's digital music store is a similar strategy to Best Buy's loss-leading music in the early 1990s.

My first piece of advice: Beware of strangers bearing gifts, especially if they are iPods. Apple's digital music store is a similar strategy to Best Buy's loss-leading music in the early 1990s. If Steve Jobs is successful, iTunes can be just as destructive to the recording industry as the previous attempt of using music to move low-margin hardware.

The safer bet is Dual Disc. Combining DVD video with music is an excellent way to compete against the movie and videogame industries. It builds on successful trials that bundled video with a CD, and acknowledges the surge in DVD music video sales. Dual Disc adds value by enhancing the product offering, instead of eroding quality perceptions by cutting music prices.

Stop the Lawsuits	
<p>Lawsuits alienate young consumers, destroying the lifetime value of this large and important market segment.</p>	<p>My second suggestion: keep the lawyers as far away from your target market as possible. Only lawyers think it is a good strategy to sue a large portion of your core market and to alienate a generation of future customers to increase sales. Relationship marketing and the lifetime value of the customer obviously were not taught at law school.</p>
	<p>Lawsuits did what any obstacle does in the face of consumer demand: spur innovation. The RIAA attacked Napster's centralized structure, and decentralized P2P services such as Kazaa popped up. Now they are targeting Kazaa by spoofing files and suing 3,900 users: the result is a creative surge, using FTP sites, newsgroups, chat rooms and private networks that thwart the RIAA's remote browse function and offer new layers of protection for file sharers. Rather than praising the lawyers for eradicating Napster and Kazaa, revile them for being the inspiration behind eDonkey, Gnutella and others. The RIAA and its lawyers, in their attempt to strangle file sharing, are acting as a driving force for creating more insidious forms of piracy. They are wining battles but losing the war.</p> <p>Relying on the courts leads to a dead end. Great product innovation do not came out of a courtroom or from the reliance on politicians.</p>
<p>Decrease the demand for illegal music through marketing, instead of shrinking its supply through lawsuits and legislation.</p>	<p>The music industry must pursue a better strategy. Decrease the demand for illegal music through marketing, instead of shrinking its supply through lawsuits and legislation. Give consumers value and they will wipe out piracy. Redirect legal and lobbying expenses to developing better products and marketing that generate higher music sales. Research shows that this strategy works, and even offers specific tactics. The labels just need to embrace it.</p>

Market to Extend Recovery

This rebound in music sales may be brief. First, the recent “strong” sales growth is based on a comparison against a period of large declines. Higher volume is still great news, but it took a lot of pain to get that gain.

Second, there is something called an income effect—the relationship of sales to income. If sales and income move in the same direction, you have a normal good (necessities and luxuries are in this category); if they move in opposite directions, you have an inferior good. An inferior good can still be a wonderful product, but it is just less desirable than the alternatives out there.

Consumers trade up to more expensive and higher quality products as their incomes rise. This occurred during the late-90s, a period of rising employment and incomes. At that time the teen and young adult market started to abandon music for DVDs and videogames.

The income effect struck again at the end of 2003. Music sales picked up at a time when incomes were constrained by weak employment, record consumer debt and rising oil prices. Videogames sales were down during 2003, and the movie industry started fretting over slower growth. Consumers have been substituting higher-priced entertainment with a lower priced one.

High gasoline prices squeeze the spending power of young adults and low income shoppers. This accentuates the income effect, and tends to benefit music sales. But when spending power increases, watch out. As incomes rise, spending patterns will likely shift upward in price and perceived quality. Consumers will flock to new product introductions, particularly those planned for videogames.

Track the cross-price elasticity: how music sales respond to changes in the prices of substitute products.

With the increase in home entertainment options, it is insufficient to fixate only on the consumer’s responsiveness to music price cuts. More attention should be directed to how music sales respond to changes in consumer incomes and variations in the prices of substitute products—the cross-price elasticity. A gain in value relative to DVD and videogames should be the signal of an improving music industry, instead of a jump in total music sales.

Music sales might drop if the industry does not improve the marketing of music over the next year to close its value gap against movies and videogames. The need for better marketing ideas will become imperative as the launch for new videogames platforms draw near. By spending on product enhancements, marketing and increasing support for the distribution channel, the music industry can overcome the income effect and music's inferior status.

Conclusion

The threat of loss leading by legal digital download sites, damage to brand equity by the RIAA lawsuits, and the arrival of the next generation of videogames in less than 18 months pose serious challenges to the music industry.

Fortunately, more resources are under the control of the best managers in the industry. This core group of leaders realizes that the greatest threat to music sales is not illegal access to music, but the competition for entertainment dollars from the movie and videogame sectors. Identifying the problem is the first step to a solution, so the music industry is finally getting back on the right track.

Wall Street might think the music industry is doomed, but that is not necessarily the case. Adversity pushes creative businesses to become stronger, as much as it eliminates other companies. To sustain this revival in music sales, invest in research, focus on operations and spend wisely on marketing to close the value gap between music and the newer forms of home entertainment.

About Earful.info

Earful.info (Earful for short) is the source for strategic marketing solutions for the music industry. It pulls from marketing, economics and consumer behavior to equip readers and clients with the tools to avoid threats and exploit opportunities.

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