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The impact of the Internet on small independent record labels: an exploratory study

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Abstract: - This paper explores and evaluates the business and distribution models of small independent record labels. Small independent record labels were chosen, as literature on the subject to date only explains the impact the Internet has had on the music industry from the mainstream record labels point of view. Our exploratory survey findings suggest that the Internet had a significant effect on small independent record labels. The paper discusses the implications of these early findings and suggests possible ways forward.

Key-Words: - online music, business models, distribution models, e-business

1 Introduction

Online music stores have been criticised for charging too much, dictating what the consumers can and cannot do with their music and not offering a wide enough selection [1]. Still, online music sales have been growing fast, since 1997 when "music downloads from the Internet started bothering the music industry" [2]. "The pop single is undergoing an unexpected renaissance thanks to the popularity of Internet downloads, with figures showing the digital format has overtaken CD and vinyl sales for the first time." [3] In fact, in April 2005, digital downloads were integrated in to the UK official singles chart alongside physical CD singles (a separate download chart can also be found at the official charts web site: www.theofficialcharts.com), a clear indication that online music and online distribution of music is here to stay.

Established players like Apple, Napster Microsoft, Sony, Virgin and others have so far dominated the market. Now that the online music market is gradually maturing, small independent record labels have the chance of exploiting the opportunities arising from the transformation of the music industry. In fact, many of them are already doing so.

This paper explores and evaluates the business and distribution models of small independent record labels (SIRLs). These include recording studios that may or may not handle the distribution of their music. Small independent record labels were primarily chosen, as literature and reports on the subject tend to discuss the impact that the Internet has had on the music industry from the mainstream record labels point of view.

Also, as the vast majority of them are micro-businesses they can not afford to adopt a passive stance to market changes that have created enormous music stores. Hence, existing strategies have to be reviewed, under the light of the new market conditions. In addition, SIRLs have to face the positive or negative consequences, depending on which 'school of thought' one subscribes, of copying of their products ("although there have been theoretical efforts to understand the economic consequences of copying, it is difficult to find studies that empirically estimate the parameters judged to be important in markets exposed to piracy" [4]). More specifically, if, as the music industry claims, illegal copying and distribution via peer-to-peer networks is damaging the industry, then SIRLs that mostly rely on their music sales revenues will be in relatively greater danger.

The article starts by presenting the main three models of distributing music online, before presenting our exploratory survey's results. We conclude with a discussion of the implications of the results and potential strategies for SIRLs.

2 Online music and e-business models

Many definitions have been proposed for what a business model is, but still no generally accepted definition has emerged [5, 6]. For example, Timmers [7] defines a business model as "an architecture for the product, service and information flows, including a description of the various business actors and their roles, a description of the potential benefits for the various business actors and a description of the sources of revenues", while Afuah and Tucci [8] suggest that business models indicate how a company achieves competitive advantage.

When it comes to the online music the three most important business models are the á la carte business model, the subscription business model and the streaming business model.

2.1 The á la carte business model

The á la carte business model is also known as pay-per-song downloading, as the customers are charged per downloaded song. Customers can buy a single track without having to buy the whole album. This is similar to what has 'traditionally' been the case with CD singles, although not every song can be found as a single.

Examples of the á la carte business model include Apple's iTunes store with more than 800k tracks, Napster with more than 1m tracks and MSN Music with more than 500k tracks.

2.2 Subscription business model

The subscription business model operates in the same way as subscribing to a magazine for a period of time. The customer pays a set fee to gain access to a music library for a certain period, usually a month. Should the customer decide to end the subscription, but keep the music downloaded, then an additional fee has to be paid. Often, customers are not automatically given permission to copy their music to anything other than their own computer.

An example of a service offering subscriptions is Napster which although uses the á la carte model, it also offers subscriptions for unlimited music for a monthly fee. "The drawback is that you don't have any burning rights, and if you stop subscribing you can no longer listen to the tracks you've downloaded". [1]

2.3 Streaming business model

Services like the Real Network's Rhapsody allow customers to stream the music they want to listen to, i.e. to listen to the music as it is being downloaded. The customer pays a time-based fee to listen to unlimited music during that period. Customers do not get to permanently own the music tracks they listen to.

The streaming model is similar to the subscription model in that there is a time-based fee involved. On the other hand, the streaming model allows the user to listen to music instantly rather than having to download it first. As music is streamed, the tracks are never actually downloaded onto the customer's computer.

Of course, in order to listen to their music, customers have to be connected to the Internet. Such condition poses significant restrictions on how one can enjoy music.

2.4 How will you listen to your music in the future?

The above three models illustrate many of the fundamental changes that have occurred to how customers buy and listen music. For example, the á la carte model allows customers to be as selective as they want, the subscription model gives unlimited access to customer, but they do not get to actually own the music, while in the streaming model customers have to be online to enjoy their music.

Customers may also face other restrictions such as which device they will use to listen to their music, as many services and devices support proprietary formats. These formats are usually compressed formats in order to allow for faster downloads. Although the difference in quality is probably not noticeable by human standards and may even not matter for most customers, one cannot 'ignore' that what is actually being purchased and downloaded is not of 'CD quality'. Hence, customers may end up buying a product, which is not of the 'traditional quality' and comes with many more restrictions.

To make the online download music experience even more complicated there have been cases where services are only available to residents of specific countries (as indicated by their credit card address). These sites may provide better deals which are not though available to everyone, something that challenges one of the main advantages that the Internet offers: geographical independence. In addition, local services can often take advantages of local legislation that may raise questions when it comes to their applicability on an international level. Even if such services provide better deals, the customer has to still wonder whether by downloading music for which he paid he is actually infringing copyrights [1].

The market is undoubtedly going through a phase of rapid changes, but its growth and maturity cycles seem to be extremely fast. Perhaps the customers' and the industry's familiarisation with the Internet and the many years that online distribution of music has been around, e.g. via P2P networks, has actually helped the paid services. These market changes should be carefully examined by SIRLs in the context of their current and future plans.

3 Results

3.1 Methodology

Our prime aim was to formulate hypothesis for future research projects. Still, at the same time we wanted to draw an approximate picture of the companies we were interested in and the strategies they were involved in.

As this is an exploratory study we decided to use a web survey to gather our results, before embarking on a more in-depth study. A web survey was considered the best option, as it was the most efficient and quick data gathering process. We used a world-wide directory of independent record labels, although a great number of them were located in the United States and the United Kingdom. Participants were invited by email to complete the survey anonymously.

3.2 Results

The vast majority (94%) of the 34 survey participants were micro and small businesses with less than 25 employees (82% had 1-10 employees). Half of the responders (50%) had been in business between 1-4 year, while 74% of the labels began trading during a period that the Internet was beginning to be recognised as a useable business tool. Only 15% of the responders said that they had been in business for more than 15 years.

88% of the responders produced 1-25 albums, 6% 26-50 albums and the remaining 6% 51-100 albums a year, which is what one would have expected by looking at the aforementioned company sizes.

The responses received indicated that the record labels participating in the survey produced a variety of genres, like hip hop, reggae, jazz and rock. We also found that many of them where involved in more than one genre of music.

When asked how much their companies were overall affected by the Internet most of the responses indicated a relatively strong (32%) or very strong influence (50%). However, it seems that the Internet has not equally affected their distribution methods. Although, 47% of respondents replied that the level of impact was relatively strong to very strong, 29% indicated little or no impact. 21% of respondents suggested moderate changes in their distribution methods. Responders were also asked to approximately quantify their past distribution methods with a total sum type of question. It was found that the among all the responders 48% of the distribution was through high-street shops, 19% through Internet shops, 21% directly to the customer and 12% through other means, usually direct sales at gigs. When they were asked to quantify their current distribution methods the main change was approximately a 10% shift of distribution from high-street shops to Internet shops. There was also a 6% increase in the music distributed directly to the customers. For a few of our responders distribution methods did not change at all, simply because they were not trading prior to online music. On the other hand, as one of our responders said: "more records sit on the shelf because the stores no longer need to stock the little guys stuff because they assume the listener can get it direct: only the listener is often too lazy". In such cases online distribution can help SIRLs reduce overheads as discussed in the following section.

Responders who indicated that their company was distributing music over the Internet, were asked to specify which model they were using. It was found that 52% used the á la carte model, 10% the monthly subscription model, 19% the streaming model and 19% other models (e.g. online CD sales).

When it came to whether the label's marketing methods were affected 59% indicated that marketing methods were relatively or strongly affected (24% strongly affected). Again there were significant numbers of record labels (18%) that had not changed their marketing methods, despite the introduction of online music.

Production methods remained relatively or completely unaffected by the Internet for the majority of the companies (50%), 21% somewhat influenced and with only a 15% of the responders replying that their production methods were relatively strongly or strongly affected. The same pattern was found when it came to artists' contracts. 41% of respondents said that artists' contracts were not affected at all. Another 41% though replied that artists' contracts were relatively or strongly affected (18% strongly affected).

Perhaps the most interesting of all our results was that the vast majority of the surveyed labels (88%) considered the Internet to be an opportunity and not a threat. This was also supported by the answers received when responders were asked for their opinion on whether Napster/Apple iTunes and other online music stores affected the music industry negatively or positively. 27% thought that music stores had neither negative, nor positive effect, while a total of 64% thought that online stores had a moderately or strong positive effect on the industry.

When asked for their opinion on the future music distribution of their company the majority of answers (67%) indicated that the future will be a 'mixed' one, i.e. the distribution will take place both through traditional and online outlets. 11% of the answers indicated that distribution will predominantly be through traditional shops, 14% suggested a movement towards digital music distribution, while 8% corresponded to the 'other' option. Interestingly, no respondent selected the option 'we are not going to distribute music online'.

4 Discussion

The results obtained from the web survey suggest that the Internet has had a significant effect on the small and medium enterprises of the music industry. It would appear that the wider impact of the Internet has been in the areas of distribution and marketing methods. The Internet allows for new ways of distributing products as well as giving access to a global market. As suggested by Gross [9], artists and independent record labels now have the opportunity to distribute directly to the customer, breaking the oligopoly that the major record labels enjoy. This can have a great impact on the industry, as the smaller independent record labels will be able to compete against the bigger players in the industry. It is unlikely though that they could compete on price. With only a few albums a year that may belong to different genres it is difficult to come up with an offering that will be volume oriented.

On the other hand, being able to distribute directly to the customer allows the catering of niche markets. As distribution costs are minimised and bigger audiences can be reached, SIRLs could even open up to previously commercially difficult to justify areas. Especially as "digital music can be reproduced at nearly zero cost, reducing distribution costs compared to physical formats of recorded music" [10], SIRLs can undertake the fulfilment costs in exchange for direct access to the customer.

Reduced costs and direct access to customers are possibly the reasons why SIRLs perceive the Internet as an opportunity that may significantly influence their decisions on how they distribute their music in the future. In fact, many of them already distribute over the Internet or even solely over the Internet, filling the gaps that the rest of the industry has left: "the music and software industries have become increasingly concerned with piracy and developed a defensive approach to digital distribution" [11], instead of adopting an embracing approach.

Also, by catering for niche markets and dealing with the customers directly small studios may have the opportunity to offer other services and products forming strong direct links with the customers. Managers will have to shift the focus of their strategies from the cultural goods, i.e. music itself, to the customer, since the physical artefact, i.e. the CD or vinyl or even the MP3 file, is disappearing. [12]

The same could also apply when it comes to the relationships between the labels and the artists. In particular SIRLs have to look carefully at the possibility of artists bypassing them and distributing directly to their fans.

Many of the labels surveyed were not prepared to use the Internet as their only method of distribution. Instead, they indicated their preference for a mixed distribution model. Whilst wanting to maximise revenue, they seem to recognise the importance of maintaining the established distribution methods, in order to maintain that part of the existing client base, that is more comfortable with this method of purchasing music. The online music industry is still developing, and these record labels need to evaluate its relative success over a period of time, before making changes to its distribution methods. This is indicated by the 27% of respondents who appear undecided as to whether or not Napster and Apple iTunes have had a negative or positive effect on the industry. It is likely that they will perceive their impact on the industry positively, only if they can clearly identify the benefits of online music distribution and relate them to their own business and operational models.

When it came to the preferred model of distributing music our findings agreed with the literature and the current market trends that the á la carte model was the most popular. Of the record labels that already sell online, 52% used the á la carte model.

Although the á la carte model is currently the most widely adopted model, many believe that the subscription model will take the lead in the long term. The main argument tends to be that "whether shoppers would want to pay $10,000 for 10,000 downloads or $10 for monthly access to more than 10,000 songs." [13] If this is the case, then SIRLs will be forced to distribute their music through services that can provide such volumes. SIRLs could even establish their own cooperatives in an effort to compete collectively against the mainstream labels and distributors. It difficult to assess whether customers who are subscribed to a service will be willing to pay separately for music as their decisions will depend on many parameters, perhaps most importantly on the type of music they like to listen to. Managers working in the cultural industries, like the music industry, will need to be able to predict emerging consumption profiles in advance and prepare mixed strategies to handle the period of transition. [12]

The same applies to the streaming model, which may have more potential to rival the á la carte model than a subscription-based one. 19% of the record labels surveyed currently use the streaming business model to sell their music. Although the streaming model requires the customer to be online, as wireless devices, (e.g. mobile phones) become part of our daily lives then the streaming models momentum may get even bigger.

5 Conclusions

Our results indicate that the Internet has had a significant impact on small independent record labels and on their distribution methods. Independent record labels are choosing to explore the opportunities made available by the Internet, as it has led to reductions in their distribution costs and it also allows them to reach a much larger market, bypassing the distributors. This can be beneficial to the customer, as increased competition usually brings with it greater choice at lower prices.

At the same time increased competition will force SIRLs to re-evaluate their strategies and business models. We suggest that SIRLs may need to become more customer oriented by offering more than just music to their customers.

In anyway, even though the big labels drive the major changes in the online music industry, researchers should also pay attention at what is happening at its periphery.

6 Further Research

Further research is needed to examine in depth the changes that have occurred and the ways that SIRLs plan to face the market challenges. Our results could be used to formulate hypothesis that could be evaluated by a survey focusing on the details of the SIRLs music models, especially in the context of their currently provided services, the possibility of offering a complete package to the customers and the relationships among SIRLs, artists and the big distributors.

To start with, a detailed account of the music distributed, especially in cases where the label deals with more than one genre, and how this distribution took place over the last five years is needed to understand better the rationale for each SIRL's adopted strategy. Such an account will also provide evidence for the resources required for small labels to compete over the Internet and how they manage these. In particular, future research should seek to examine whether there is scope for small labels to provide added-value services.

In addition, the relationships with artists and consumers should be examined, perhaps qualitatively, from both sides. These relationships are paramount to the strategies that SIRLs would need to follow, if they are to offer added-value services.

Future research could also examine whether SIRLs could form ‘music cooperatives’ under which they could distribute their music. Such an initiative could help SIRLs achieve the benefits of economies of scale and help them compete collectively against the bigger market players.

Finally, as online music has grown to become a very competitive market, innovation will be key to SIRLs and new entrants success. The possibility of new viable business models and their potential should be accessed.

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