
The Changing Face of Music Delivery: The Effects of Digital Technologies on the Music Industry

March 31, 2004

Prepared for:

Department of Canadian Heritage

Sound Recording Policy and Programs Directorate



**Canadian
Heritage**

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canadien**

by

FAD
RESEARCH

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NOTE

To obtain an electronic copy of the appendices

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Executive Summary

The changes that are occurring in the way that music is consumed are of particular pertinence to anyone examining the effects of digital technologies upon Canadian society. These changes are far reaching and serve as harbingers of change that will occur in other traditional media industries including in the legal and regulatory underpinnings of businesses and in the media consumption habits of their audiences.

The current turmoil in music has highlighted the speed at which change can occur once the catalyst of digital media technologies is mixed with the reagent of a music consumer who appears disaffected with the primary package that music is delivered in, the audio CD. Album sales revenue in Canada has dropped 24% in the last five years. Retail space devoted to music has contracted 30%. Just how much of this is directly attributable to technology is a matter of some conjecture though it is more a discussion of degree rather than whether there is an effect. There is increased variety in modes of distribution and more choices available to consumers in how they engage music.

For all stakeholders in the business of music there is change that is occurring very much in real time. Every week there are dozens of articles focusing on these changes appearing and the issues of any single group are inextricably entwined with those of others, from artist to the consumer and all of the interested parties in between. This study was built on a solid background in the issues of the music and digital media industries, supplemented by periodicals, industry press and conferences and elucidated with 28 interviews of primary stakeholders conducted over a six week period. Material considered for this report was current into the last week of March 2004.

Two of the major distribution channels under discussion have serious challenges in their business models. The traditional CD distribution model is under pressure from the effects of changing dynamics in the retail business as well as the perceived value proposition the CD format and its associated price point by consumers. The much heralded alternative consumption model of digital downloads has yet to be proven out as a viable method of sustaining anything resembling today's industry. Download revenues, while growing, are less than .25% the revenue of CD sales in Canada. At some point the download volume accumulates to a sustainable figure but we are several years away from that time. In the meantime, label artist rosters shrink, label worker layoffs increase and all but the biggest artists have trouble achieving any market visibility. Digital music services are reminiscent of Internet Service Providers' business position in the mid-1990's with minimal margins.

There is possibly a third challenge looming in the form of streaming "radio" channels confronting traditional local market radio. Traditional radio is largely a local medium whose business model is determined by the construct of regulated air waves. As alternative channel choices visibly present themselves outside of the confines of the traditional regulated ones there will be pressure for changes to business models.

Business and revenue models for labels and rights holders are increasingly moving towards multiple incremental sources of income over a model that is associated more with the higher margin audio CD.

The copyright regime is under attack from two main directions. There is a current absence of clarity on the disposition of copyright as it relates to digital file ownership, transfer, and fair use. There is also a lack of accord on payment schedules associated with the new media between music industry stakeholders. Without clear guidelines for copyright issues, copyright holders are being denied fair treatment in law which in turn has social repercussions on how citizens perceive the value of creative works. Without clear agreements spelling out remuneration shares it creates uncertainty which impedes investment and decision making. It can only be unhealthy for a society's creative works to be devalued past a point where those producing them cannot earn a living.

Copyright law has direct bearing on the resolution of how to deal with piracy of copyrighted materials. On the one account it is likely digital technologies that allow file sharing have accelerated the progress of new distribution and marketing channels for music, on another it remains unjust that there are no remedies for those who feel that these same technologies facilitate the theft of their creative works. The absence of legal findings on the issue of unauthorized use does no one any good and likely impedes development of new media and new enterprise. Canada has been slow coming to grips with issues associated with copyright and digital technologies.

The imminent entry of foreign owned digital media distribution services will change remarkably the current Canadian music distribution landscape and have profound and lasting effects on Canadian media as a whole. Music is the pre-cursor to other media with higher bandwidth requirements. If foreign media sources market to Canadian audiences with their (the foreign) preference lists it presents particular visibility challenges for Canadian musicians and labels. Foreign services are much less likely to tailor their services to the Canadian audience. A chart list designed for American tastes will be likely the same offering for Canadians. It is highly unlikely that there will be other Canadian owned entrants into the digital download/streaming business. The two services, Puretracks and Archambaultzik, that are Canadian owned may be subsumed by the marketing weight of foreign services.

With a number of digital services offering seemingly undifferentiated products the prime determinants of customer value are convenience and price. It is Marketing's job to highlight convenience and price and create differentiation that translates into brand affinity.

While using the Internet for marketing and/or distribution may appear to have a low cost of entry, this is deceptive. e-Business is an involved and expert undertaking requiring interactive media savvy, technical expertise, business acumen and supporting partnerships. To do it well is not inexpensive particularly when competing in a global arena for attention. Marketing is critical to the success of any digital music enterprise. Marketing effort and expenditure tend to dwarf production and maintenance costs of Web based initiatives. Many marketing techniques that will be associated with the promotion of music are in the process of being developed and refined. Marketing music in a wired world will become a particular specialty.

Consumer choice and consumer value are the prime movers of change as facilitated by interactive digital media ceding control to the audience. User control is what distinguishes Internet media from all other media. User control is what audiences crave in the "attention economy". In a barrage of media it is empowering to be able to

be selective some of the time. The technology is also pointing the way towards increased portability, selection, and points of access to music though rumours of the death of the CD are exaggerated due to the widespread installed base of inexpensive reliable players in the market place and continued use of the home recorded CDR.

Technology is largely becoming less visible and less of a barrier to consumption of digital materials. Some would argue that it needs to become, in some respects, less accessible as a way of impeding the unsanctioned uses of copyrighted materials through the application of legal remedies and Digital Rights Management (DRM) software.

There are many opportunities for Canadian companies providing solutions to challenges presented through the inception of digital technologies into the music business. With the proliferation of broadband and its adoption by an increasingly literate and media saturated population, Canada represents one the finest test-beds in the world for new ideas in digital media. This married to the incomparable base of music, new media and communications talent in this country should provide ample ingredients to create new business. Issues that will remain centre on those of access to capital for improvements and start-ups and developing outward looking marketing initiatives.

Public funding is a great help but not a solution to the kinds of activity that need occur to truly capitalize on the digital opportunity that is now associated with music and may very soon be integral to other media. In order to do this public policy should continue to encourage partnerships with private entities and to provide incentives for private money to become engaged in the development of technology to serve evolving media enterprises as well as new interactive media applications for the new media that digital technologies are making possible.

1 An Introduction to the Future of Music

1.1 Introduction

FAD Research was contracted in early February, 2004 to create a snap-shot report relating issues associated with the effects of digital technologies for distribution and marketing on the Canadian music industry. In over 10 years of research and commentary on issues generated by digital technologies we cannot remember a topic that has been more emotional or more intensely discussed by stakeholders. It is a topic that offers a torrent of new outcomes and testimonials to tumultuous changes that are occurring in *real-time*. *Real-time* is a cliché in commentary on digital media but we would like to offer an indication about conducting research on this most interesting and complex undertaking using an example.

These are a sample of headlines that appeared on the CIRPA¹ (Canadian Independent Record Production Association) Web site in a 6 day period during this study:

Australian Music Industry Takes KaZaA to Court – Feb 9

Tower Records Files for Bankruptcy Protection – Feb 10

Puretracks Reaches One Million Milestone – Feb 12

Universal Music Canada Signs Distribution Deal With CinRam – Feb 14

Each of these headlines are indicative of radical changes occurring in a cultural industry whose basic business models and underlying audience's consumption patterns have operated largely unchanged for decades. Together they are an indication of a turmoil that is radically impacting every aspect of the music industry. At the root of these changes, perhaps the prime catalyst, are digital interactive media technologies. Truly part of the challenge from the research perspective was the sheer volume of current and cascading information generated every day on associated topics in this study.

Our task is to provide The Department Canadian Heritage (Sound Recording Policy and Programs Directorate) with current insight into the major issues reflected in daily headlines as they try to document the nature of the changes that digital technology is precipitating. Specific questions were posed to FAD Research and we have elaborated where appropriate. What follows is our snapshot and our best assessment of the issues surrounding the effects of digital technologies on the Canadian music industry as of March 31, 2004 at 10:30 am. We say this because at some point we had to cut off the steady influx of new information and fix this report in time.

In this study we heard of issues of music and morality, of politics and possibility, of changes in business, digital media technologies, media consumption and the rule of law. We hope that our resulting snapshot is useful in lending perspective to this complex moving target.

¹ <http://www.cirpa.ca/MBCCORE.cfm> CIRPA news page. See [Appendix 2](#) for the full text of the articles.

1.2 Methodology

FAD Research utilized a combination of information collection schemes in the preparation of this report. Because of the topical nature of our inquiry there seemed no end of news stories from every perspective covering aspects of the effects of digital technologies during the course of our five weeks of information collection. We are still reading current press releases and news coverage as we are composing this report.

During secondary source information collection we benefited from current materials in radio, TV, print (books and periodicals), Web news sources, both current and archived, as well as a plethora of music industry information and education Web sites. FAD Research was able to draw on a few current release (January 2004) research reports including the eMarketer Spotlight Report on Digital Music and the IFPI Online Music Report.

We were also very fortunate to have Canadian Music Week occur (March 3-6, Toronto) with the discussion theme “Reinventing the Business” during our investigation period. FAD Research was in attendance for numerous panel discussions and forums that gave us access to a very wide range of opinion from Canadian industry players as well as speaker guests from the United States in attendance. It also gave us first hand experience with the passionate nature from which positions are represented and the complexity and urgency of the issues that are being grappled with.

Perhaps the most important component of the research we conducted were the 28 personal interviews we managed to complete over a month’s time. We felt it was important to represent as many of the stakeholder groups involved as well as we could. Every interview participant contributed perspective to this very current controversy on the issues at hand in the music business and how digital technologies are instigating vast change. We felt that this elaborate primary sourcing was the only way to fairly represent the issues under consideration.

We interviewed distributors, artists, rights holders, digital media specialists, record company executives (large and small), government program administrators, lobby groups, lawyers and even a few music consumers. Many who could not make time for an interview responded via e-mail. People were very generous with their time and opinions and FAD Research would like to express our gratitude for their commitment, and in many cases their passion, in responding thoughtfully to our many questions.

FAD Research, in providing an overview of how the music industry employs the Internet, used a variation of our environmental scan methodology, providing a detailed review of representative sites from each of the functional categories (e.g. retail, record label, artist sites). Analysts compiled an overview of particular sites and then a compendium of links for additional resources in the categories. Included is also a usability assessment of the two Canadian digital download retail sites. FAD Research has a long history of association with e-marketing activities and formulating business models for digital media undertakings as well as providing insight to the music business. Some of this accumulated expertise will also have found its way into this document.

1.3 The Rise of Interactive Digital Media

Interactive digital media or “new media” has one distinguishing feature from all other media types. Interactivity. Its audience is described as a “lean forward” audience as opposed to a “lean back” audience as the individual audience member has *control* over what they are going to see and when they are going to see it. What enables *interactive* media is its main technical attribute. It is digital technology in that it involves computers both in its creation and delivery.

The attributes of digital technology may seem rather obvious here in the early part of the 21st Century but interactive media has only really become a *mass* medium through the wide-scale adoption of the Internet in the last 7-8 years. It has had a phenomenal adoption rate when compared to other media (print 300 years, radio 30 years, TV 15 years). The potential for communication utilizing the capabilities of multimedia (text, graphics, moving picture, sound) supported by computer technology (mass storage, search capabilities, information manipulation) with a unprecedented degree of interconnectivity (Internet, wireless networks) and portability that has only started to be explored.

There is a great deal of potential for designing new systems of communication that are “mass” in their reach but highly personal in their delivery². Numerous ways of presenting information in a useful fashion that are above all *useful* to an audience member’s information needs. That is the great boon of interactive digital media in that the user controls the flow of information. The user chooses what is useful and what is not very quickly. As bandwidth or the means of transmission becomes less of a barrier and a vast array of tools have been made available, music has been pushed to the forefront as one of the next grand possibilities for digital media. This has created a great deal of turmoil and change within the institution of the traditional music industry.

As with any change though there exist both challenges and opportunities. In the sections that follow we will focus on how digital technology has affected distribution and marketing practices in the music industry.

1.4 A Short History of Change in the Music Industry

Since the initial broadcast of recorded music over the radio, an on-going struggle for control has woven its way amongst the sheet music. The musicians’ unions in the 30’s and 40’s translated the advent of recording music on flat vinyl and broadcasting it to eager audiences as the death of live music and an end to their livelihood. Musicians fought a brief self-defeating battle. Recorded music was here to stay, and the fight for ownership had begun.³

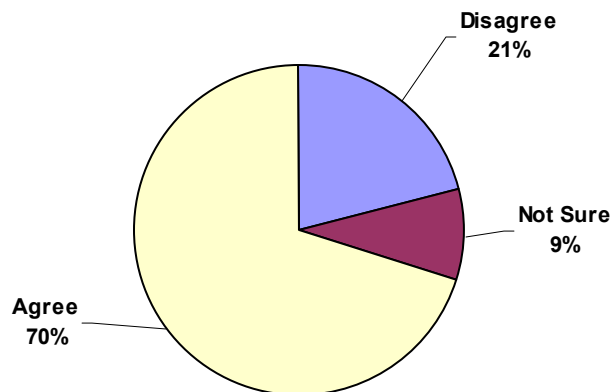
² For a good discussion of human-centric systems see *The Unfinished Revolution*, Michael Dertouzos, 2002.

³ *Playback- From the Victrola to MP3, 100 Years of Music, Machines, and Money*. Mark Coleman, Da Capo Press, book published late 2003. Required reading for anyone looking for concise perspective on where the music industry is today and how it got here.

This struggle, however, wasn't just isolated to music rights. The early creators of the software, from Edison to Berliner, maintained a running competition on whose product came closest to duplicating the natural sound of performance.

The attention to reproductive detail culminated in what was considered the foremost quality carrier ever invented -- the compact disc. With the introduction of the first commercially available CD's in 1982, two important events began to take shape. The sales of cassette tapes began to decline, and record companies began telling consumers they had to replace all their old vinyl albums with this new, "indestructible" medium featuring vastly improved sound. The record companies didn't give consumers any price breaks and charged a premium for the new carrier, making the new purchase, more expensive than the original vinyl albums. Cheaper to manufacture and distribute, the CD holds more material and has an improved sound, this high margin item represented Value over the previous delivery medium and it was duly embraced. Some would rationalize that the decision to place profits before satisfying consumers' needs is one reason why today's music fans so heartily embraced the concept of free downloads. They say they were merely making up for paying excessive amounts when previously buying pre-recorded CDs.

Percentage of Adults in the U.S. Regarding Whether a Decrease in CD Price Point Would Result in Less Music Downloading, September 2003



FAD Research Inc. with data from Harris Interactive, January 2004, as published by eMarketer

Figure 1 Likelihood of Purchase With Reduced CD Price

The music industry was given a wake-up call as early as 1993 by a techno-visionary who spoke at that year's Canadian Music Week. Nicholas Negroponte warned show participants that if they weren't in the digital business in 10 years they should polish

up their resumes. His prediction fell on mostly deaf ears. Ironically enough, even he didn't fully realize the speed with which the consumer backlash to the current state of affairs would occur.

1998 was the year wherein consumers started to fulfill Negroponte's prophecy... it was the year of Napster. But it was also something more insidious to the industry. It was around the same time that recordable CDs became a consumer commodity. Music lovers could now purchase inexpensive home hardware that allowed them to record their own CDs. Digital technology was giving consumers a choice of how they interacted with music. The result was that in 1999 less than 1 percent of the all the retail racked CD and cassette titles sold more than 10,000 copies.⁴

Consumers were indicating they weren't buying what the record companies were selling. A June 5, 2002 article appearing in USA Today highlighted the situation when it revealed that for the first time in the ten years SoundScan had been tabulating album sales, 2001 represented a year-to-year sales decline. More headlines began to scream the state of the industry. A September article of the same year in the *Wall Street Journal* pointed out some staggering numbers, "World-wide music sales totalled \$39.8 billion in 1996, but were down to \$33.6 billion last year [2001]". But for the manufacturers of blank CDs, they were heady days indeed. 2001 was the first year sales of blank CDRs outnumbered recorded CDs.

On September 6, 2001 the *Wall Street Journal* cited that for the first time since 1966, no album sold 5 million copies in the U.S. in the past year.

What about the state of the Canadian music industry through all of this? Even though they'd been warned to get involved with technology in 1993, sales of pre-recorded music in Canada fell to \$881 million in 2003 from a peak of \$1.5 billion in 1998, five years after the prediction.⁵

The consumer was now telling the music industry how they wanted to deal. They were circumventing corporations and redefining copyright law in one huge digital grope known as *file sharing*. Through this activity and through replicating multiple copies of a single legitimately purchased disc and circulating to friends (in some cases selling CD's at flea markets) digital technologies were severely impacting the traditional business model. Not only were music fans displaying a disregard for ownership, they had also decided to alter one of the original tenets of music reproduction -- sound quality. As written in the book *Playback*, "...today's generations divide over *how* they listen to music, not what kind of music they enjoy. One truism of digital music already seems so obvious, that people will settle for *decent* sound—something less than state of the art—as long as the price is right and musical selections are vast and unfettered.⁶

⁴ Ibid, page 174.

⁵ Toronto Star, Tyler Hamilton, March 1, 2004

⁶ *Playback*, Mark Coleman, 2003, page xvi

It's a business that traditionally is not keen on innovation or change because it disrupts the cash flow. You know that radio was going to be the end of recorded music, sheet music, live music, and cassettes and home taping were going to be the end of music. I think that this change is more substantial change than some others but I think that this is what happens with changes in technology and business.

- Label owner, distributor, artist.

Others along the way pointed out a new trend was underway in how we enjoy music. Robert Moog, developer and creator of the Moog synthesizer told the *New York Times* in 1999, "There has been a very long trend away from music as a social activity. Before the radio and electric phonograph, people made their own music, for themselves and each other. What I see now is that, more and more, we're all in our own little boxes, using the fruits of technology to make or listen to music in isolation."⁷ Through miniaturization and portability people use their music players to create a pervasive individualized "soundtrack" to their lives. The demand for music has never been higher yet its value, as reflected in what consumers appear willing to pay for it, has plummeted⁸. Both the hardware to play it and the software (the music) are of less consequence. Hardware is interconnected and unobtrusive and innovations in sound quality, while ongoing (such as Dolby 5.1 Surround), have less impact on consumption. In the twenty first century, music isn't driving technology, it's domesticating innovation, just as it did with another wondrous contrivance, the phonograph, 100 years earlier. With the amount of other media pulling on attention spans the business model becomes more than ever based upon convenience and price.

So what can be learned about consumption habits with the proliferation of downloading and peer-to-peer networks. It's how audiences go about consuming music. As discovered in *Playback*, "If CD equals controlled delivery, then sheer amplitude defines Net music. Napster and other file-sharing schemes aren't just about stealing music; file sharing encourages listeners to pursue hunches, check out tips, indulge whims, and develop new enthusiasms. The tight, narrow-cast focus of traditional music marketers and the so-called broadcasting industry increasingly misses the point."⁹

All along, the almighty power of selection has been driving the runaway popularity of Napster and its spawn, such as KaZaA and Morpheus. "Music downloading thrives on the Internet, and not only because it's free. The main attraction is unlimited scope, endless selection—a musical buffet for growing appetites."¹⁰

Now let's look at the global issues this presents to all the stakeholders involved.

⁷ *Playback*, Mark Coleman, 2003, page 114

⁸ This is also naturally reflected in the subsequent stock evaluations of the major labels as well.

⁹ *Playback*, Mark Coleman, 2003, xvi

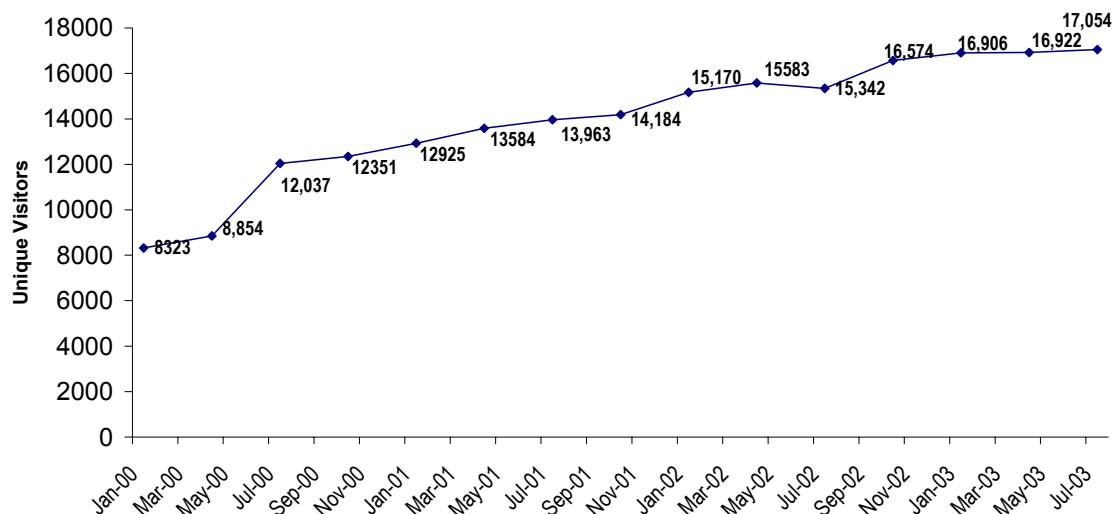
¹⁰ *Ibid*, page 199

2 Distribution – Global Issues and Canadian Context

2.1 How People Engage Digital Media – Media Paradigm Shift

Currently in Canada the rate of Internet adoption has flattened in the last few years and holds fairly constant, after considering all points of access (home, work, schools, libraries) at about 75% of the adult population¹¹. Of this, it is estimated that approximately 60% of access is broadband or high speed in nature.¹² From a media consumption perspective this amounts to the addition of another mass distribution and marketing channel. It is another distribution and marketing channel that is audience driven to an unprecedented degree. The Internet is a channel that seemingly has fewer restrictions than those encountered in the traditional and regulated media.

Total Canadian Online Population Growth



Source: comScore Media Metrix Canada

Figure 2 - Trends in Internet Usage

As of August 2003, comScore Media Metrix reports that Canadians use the Internet on an average of 23 different days each month and spend a monthly total of 1,912 minutes or 31.8 hours there. The Internet has clearly taken a prominent place in the

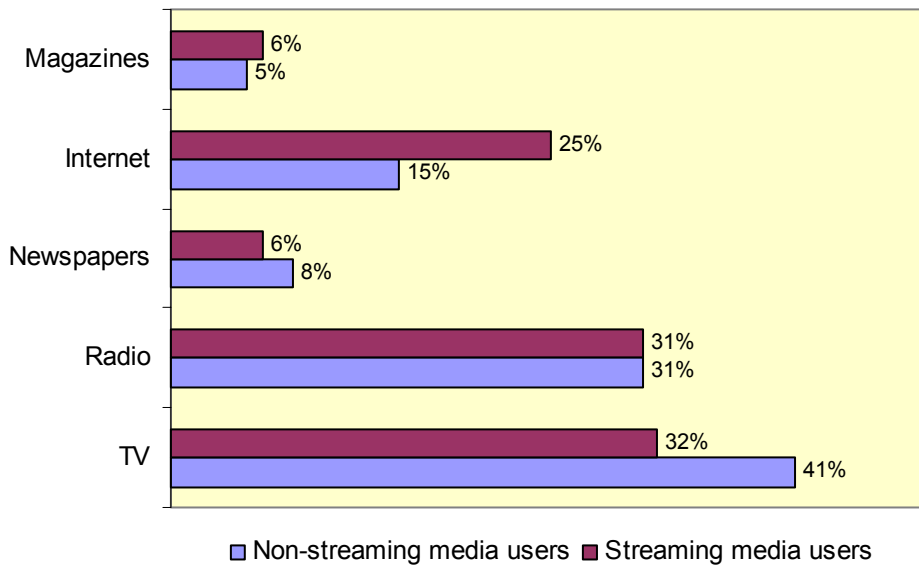
¹¹ Ipsos, *The Canadian Interactive Reid Report*, page 5, Fall 2002 . U.S. figures from Pew Internet put 63% of their adult population using the Internet as of December 2003.

¹² Omnia Communications, 2004

media consumption of connected Canadians, who devote an average of just over one hour a day to surfing, browsing, chatting, and shopping.¹³

While the primary activities for most people accessing the internet remain personal communications through e-mail and messaging, and conducting information searches via the Web, it is becoming an established channel for media consumption. People even engage it simultaneously with other media, multitasking (i.e. while watching TV), accessing online print publications, interactive games, and in some cases, music. This consumption along with an increasing comfort with certain types of transactions like personal banking, ordering books, music CD's, software, bidding on eBay have all contributed to the discovery and success of business and revenue models for the newest media channel.

**Per Cent of Time Spent Per Day with Select Media
Amongst Streaming and Non-Streaming Media Users
in the U.S, January 2004**



FAD Research Inc. with data from Arbitron/Edison Media Research, March 2004 as originally published by eMarketer

Figure 3 -Per Cent of Media Time Spent by Medium

Business and revenue models associated with these online enterprises have helped re-establish enthusiasm and investor interest after the much needed shake out that occurred with “dotcoms” starting 4 years ago. Online properties actually measure their audiences and know a great deal about them. Advertising, data mining, and strategic perspectives are actually attaching working value propositions to online media properties. Many properties are becoming lucrative, others are realizing their place in the distribution and marketing mix and are being valued appropriately.

¹³ From comScore Media Metrix reports cited in “The Internet as an e-Health Channel”, FAD Research Inc., November 2003

The Internet is obviously the highest profile digital media channel but there are others, themselves with varying degrees of interactivity, that are allowing new transmission and consumption possibilities. Most notably amongst these are various wireless possibilities (cellular phone, Wi-Fi), and services delivered via satellite, cable, and through digital radio signals.

Along with the active connected channels of distribution there are also the digital media platforms. These are things like the myriad of storage gadgets that make it possible to engage standalone digital media. Portable DVD players, personal organizers that allow access to e-books, and naturally of principle concern to this report, devices that facilitate music consumption (see Appendix 3 [New Hardware Platforms for Music](#)).

I think the shortening of the cycle between the artist and the audience is an ongoing situation and this is what the computer is doing for the business, but I'm confident that it will be a good thing in the end.

Andy Maize, artist and principal at Maple Music

The great advantage many of these digital technologies afford the user is that of control. This translates to more choice, increased portability and 24/7 access. This is a fundamental concept in appreciating how digital technology affects the marketplace. As a general and overriding principle, value and convenience drive the adoption and therefore the success of any new consumer technology. This will be as true for access to music as it is for any other technology digital or otherwise.

"If you don't make life more convenient or give me something I want, where's the business?"

-Shelley Stein-Sacks, MEP Fund Administrator, Telefilm Canada

2.2 Stakeholders

Throughout our discussion of the effects of digital technologies on distribution and marketing of music we will be making reference to the effects upon the array of stakeholder groups touched by the changes. FAD Research was fortunate to speak with numerous parties from many of these groups through the course of our research. The issues that effect these groups are complex, dynamic, and inextricably intertwined. Opinions we encountered were passionate, resolute, ambivalent, convincing, conflicting, accordant, apocalyptic, hopeful, depending upon the group, the issue and, in some cases, the spokesperson. The overriding message is that the technological changes affecting the music business are important and non-trivial in nature.

Sound bites are being used to describe very complex situations. It's easy to say record companies are greedy, publishers are stupid, artists are naive, everybody attaches one word to everything. These are complex issues.

- Ted Cohen, Vice President Digital Development and Distribution, EMI

2.2.1 Music Retailers

2.2.1.1 Traditional

These are divided into two groups which would be the chains (HMV, Sam the Record Man, MusicWorld) and the "Mom & Pop" shop, the owner operated record/CD store. A former executive from one of these chains was interviewed for this project.

2.2.1.2 Big Box

"Big Box" refers to the large chain consumer goods outlets, the Best Buys, the Wal-Marts, the stores whose primary business is not music at all but they remain huge driving forces in creating dynamics in the business of music as a consumer item. We received and reviewed a great deal of commentary on the effects that these operations have had.

2.2.1.3 Online Physical Product

The earliest concept for online music distribution were Web sites engaged in e-commerce activity, distributing CD product in a manner not dissimilar from mail order catalogue sales. Early entrants in this space included Chapters Indigo (former executive interviewed for this project), Sam the Record Man (former FAD Research client), and Cdnnow.com. The CD is far from dead as a delivery medium, though its price point and usage are changing radically (see [HPStarbucks](#) sidebar).

2.2.2 Major Labels

We were fortunate to get several interviews with representatives of both international labels and their Canadian subsidiaries. Some of our interviews were with former

executives of major labels as well. There is a great deal of perspective both real and imagined in the press associated with this group. We reviewed an extensive array of periodicals including music industry press and interviewed the President of their main Canadian trade organization, the Canadian Recording Industry Association (CRIA). FAD Research has assisted EMI Music Canada on a number of projects associated with their digital media enterprise in the past. The major labels are often cast as the THEM in the “US (music lovers) and THEM” of most public debates associated with this topic. They are by far the largest investors in Canadian music.

2.2.3 Smaller Labels - The Independents (Indies)

The Indies are the smaller independently owned and operated labels, many of whom are felt to have the most to gain from a dismantling of the status quo in distribution and established marketing practice. They have a few artists on their rosters and often have the bumpiest of rides in the hit driven markets, when they can manage access at all. Often they will focus on particular niches. Examples of these Canadian labels are Le Groupe DKD, Stony Plain, Netzwerk Records, Maple Music and Marquis. We interviewed a number of representatives of small labels and their representative trade organizations L'ADISQ (Association québécoise de l'industrie du disque, du spectacle et de la vidéo) and CIRPA (Canadian Independent Record Production Association).

2.2.4 The Digital Doers - Digital Service Providers (DSPs), Streamers, Digital Tools Makers and Gadget Suppliers

These are the instigators, if you will, of the whole debate on changing business models. It is this group that has created, enabled and promoted the whole idea of digital music distribution and marketing. These are the people that provide the capability to fulfill the needs of digital media users. They are makers of the software, hardware and services that comprise the new ways of facilitating music consumption. FAD Research has made a business out of understanding this diverse group. For the purposes of this study specifically we interviewed hardware makers, digital download service specialists, secure data transfer specialists, streaming media companies, music business experts versed in technology, technology business experts specializing in music, marketers and new media firms.

As previously noted, Canada presents an incredible test bed and opportunity given the market penetration of broadband transmission assets, both with the internet and other well developed aspects of the communications infrastructure (wireless, cable, satellite, etc.). Canada also has a highly capable cadre of technologists looking for opportunities to leverage digital media into businesses.

2.2.5 Distribution Outlets (Portals, ISP's, Audience Aggregators)

Distribution outlets are typically anywhere in the digital media domain where audience contacts a music service through a brand. These are traditionally (if you can speak “traditionally” about a medium that is not even 10 years old) places like Internet Service Providers (ISP's like Sympatico and Rogers') and portals and audience aggregators like Yahoo! and AOL. Increasingly both music specific branded sites like iTunes and Puretracks as well as consumer brand sites like Wal-Mart are becoming engaged in music sales. For this study, in addition to following daily commentary and

trend reports, FAD Research spoke with representatives of distribution outlets both branded for music (DSP's) and those providing a contact point with audience who are promoting their own brands through the use of "white label"¹⁴ music services. There were also a number of lively discussions involving distributor reps convened at Canadian Music Week which we also attended.

The proliferation of outlets demonstrates that technology is less of an issue and that digital media can be dispensed through a multitude of distribution points.

2.2.6 Rights Holders/Publishers

Rights holders and publishers are the copyright holders and through their collective organizations, the custodians of copyright. We spoke with artists that are the holders of their own copyright on their works as well as representatives of their collectives that are charged with protecting copyright of their members as well as negotiating, collecting and distributing revenues associated with the use of copyrighted works. This constituency was well represented in the proceedings of Canadian Music Week. Collective organizations include such groups as SOCAN (Society of Composers, Authors and Music Publishers of Canada), SODRAC (Society for the Reproduction Rights of Authors, Composers and Publishers), and the CMRRA (Canadian Musical Reproduction Rights Agency).

It is fair to say, that in the current debate over new business and revenue models, that members of this group are cast as the adversaries of the major record labels and to a lesser extent the DSP's.

2.2.7 Artists

Artists are a constituency with widely divergent views on many issues. In the debate over changes in the music business they may be the quietest group and also the group with potentially the largest stake, as ultimately the changing music distribution system impacts directly upon their livelihoods. We interviewed a number of artists directly and naturally followed any available opinions that surfaced in the media.

One thing that can be said about this group, and perhaps contrary to some other stakeholders claims at times, there is a diversity of opinion amongst musicians about the impact of digital technology on their industry. There seem as many opinions on what constitutes fair compensation on their artistic works as there are styles of music. There is also a seeming reluctance to engage publicly on the issue. Perhaps it is that, as much as music has perhaps become a consumer product like many other things, music is seen as an artistic enterprise and is most comfortable away from the business pages of the press. It would be fair to say from our conversations that artists are largely uncomfortable at the podium discussing business affairs, even if it is their business on the agenda.

¹⁴ White label services are music dispensing services (both for download and streaming access) that are fronted by a consumer brand, like an internet portal or retail outlet, but are actually supported by music specific "back-ends" like MusicNet or Moontaxi/Puretracks.

2.2.8 Music Consumers – Last But Not Least

I'm not going to sit here and defend to the death a model that shouldn't be defended. I just think that the consumer wins. It's a great time to be a (music) consumer. People have to get their head around that the hierarchical models of telling people what they can have are done! The user drives.

- Streaming media company executive, former executive at a “bricks and mortar” music retail outlet and e-commerce pioneer

Music consumers are really what the industry is supposed to be all about. Music touches nearly every aspect of media saturated lives in our culture. They are the key participant group that shapes markets. Throughout debates over changes in the use of media and changes in the music business they are co-opted, lambasted, coddled, misrepresented, ignored and misunderstood. Part of this is the ability of various interest groups to control the forum of debate through lobbies and the press. Part of this is ignorance of the issues and their complexity – a failure of the same interest groups and news media to convey what is at stake. Part of this is an inability of public institutions to adapt in the face of rapid change. Part of the lack of a clear picture of public demand and desire is an absence of opinion research and an understanding of emerging digital media consumption behaviour.

Canada does not generate much research on media audiences that isn't connected to particular agendas such as those of trade organizations. This is particularly true as it relates to new media. Canada needs an equivalent to the Pew Internet & American Life Project (www.pewinternet.org). “The Project aims to be an authoritative source for *timely* [our emphasis] information on the Internet's growth and societal impact, through research that is scrupulously impartial.”¹⁵ Canadian audiences are distinct in how they approach media consumption and public policy should be shaped using informed opinion detached from lobby groups. In a converging communications world, travelling at Internet speed, decisions need to be made expeditiously with as current information as possible.

One of the primary findings of this study is that we encountered both notionally and in expressed opinions is the idea that audiences have a special relationship with artists and music. This is a feeling expressed in many world cultures.¹⁶ Further to this relationship and in light of current debate there is a feeling that there is a “huge mechanism”, as one interviewee explained, that has inserted itself between the audience and the very personal relationship they have with music and musicians.

¹⁵ <http://www.pewinternet.org/about/about.asp?page=4> The Project “will create and fund original, academic-quality research that explores the impact of the Internet on children, families, communities, the work place, schools, health care and civic/political life.”

¹⁶ The musician Baaba Maal from Senegal once expressed in interview the special relationship that the musician holds in his society. He believes that it is the musicians' job to express the conscience of the people and that they are listened to before the politicians.

2.2.9 Summation

Understanding the myriad of issues around how technology is changing the music industry is a challenging task from any point of view. Few cultural and business institutions ever get their evolved practices affected as radically as has happened in the case of music. Changes are numerous, drastic, relatively sudden and painful for most of the stakeholders concerned. At times this project was a bit like an adventure in Wonderland in trying to understand the variety of conflicting points of view, the technologies involved, and the emerging business models. FAD Research is relieved that we only had to describe some of the issues, not solve them.

2.3 The Faltering of Music Retailers and Physical Product Sales

The customer is being amazingly transparent telling you what the threats and opportunities are for the paying music industry. When you see the shift week after on Marketwatch in terms of walking from traditional retail,... they are walking about price, convenience - price, it's ALL about price. If they're voting because of dollars then they don't see intrinsic value.

- former music retail executive

The troubles for music retail began with the downturn in CD purchasing starting in about 1998. Our research indicates numerous reasons that may account for portions of this failure. True to our quote above, part of it may have been the package itself. *Playback* contains a number of discussions around delivery platforms and one that is applied to the disenchantment with the CD is the feeling that 74 minutes is too much media real estate to fill consistently and in a fashion that meets consumer value expectations¹⁷. The price then becomes too high. The process was possibly exacerbated by an economic downturn setting in at the turn of the millennium.

¹⁷ Playback, Mark Coleman, 2003, page 175.

CDN Album Revenue & Units Shipped

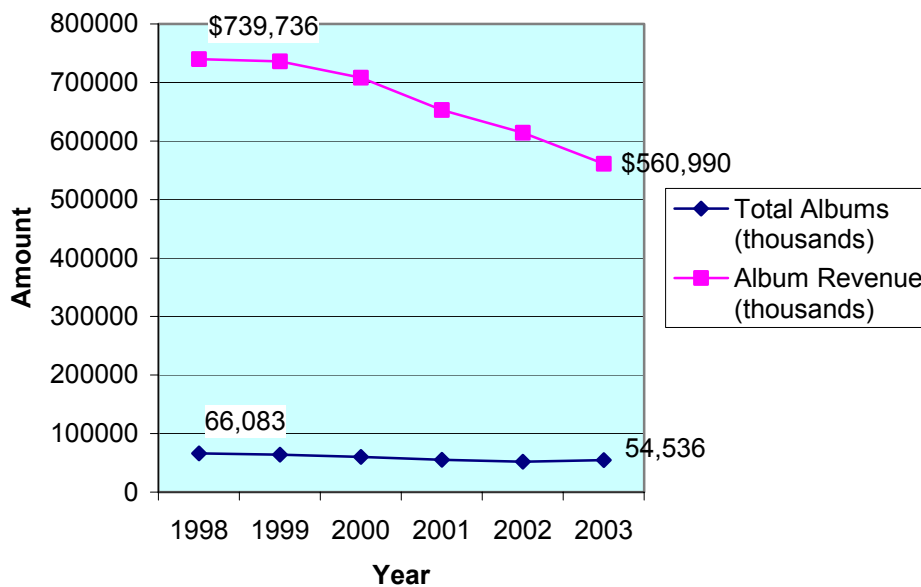


Figure 4 Canadian Album Revenue & Units Shipped

Chart - FAD Research with CRIA Data, 2004

Another overriding retail story from this period is the rise of the Big Box store as a phenomena coinciding with an increased focus on chart product. Big Box stores have increasingly accounted for the lions' share of units sold for the major labels at retail (as much as 70% according to a stray comment from the CMW). This allows them to make huge demands on suppliers, of all kinds, turning music into a "loss leader" to get people into these mega-format stores. The result is shrinking margins and unbearable pressure on music specialty stores including the chains such as Sam's¹⁸ and HMV. They have reverted to a "grocery store" model, selling less music than renting shelf space to the major labels who now focus mainly on Pop product.

The share of displayed inventory devoted to DVD sales has increased dramatically (60%) though this is seen as a temporary measure and by no means a solution. The number of stocked music titles has plummeted in all retail outlets and the more traditional outlets have tried to elicit marketing support from the record labels to combat the seeming inevitability of Big Box outlet domination.

The sales downturn could be seen as somewhat of a self-fulfilling prophecy. There is a fatigue it seems associated with Pop product. At the same time that Big Box retail is pushing a chart orientated selection that is increasingly restricted, there remains a possibility that the industry is missing market by not catering to the growing and increasingly divergent tastes of older consumers, niche interests, and regional (local)

¹⁸ Sam the Record Man filed for bankruptcy protection in 2001.

music acts.¹⁹ It appears to be a situation that is unable to be addressed in the world of physical retail product. A consumer solution for lack of choice exists perhaps in the realm of online ordering of physical product from the likes of Amazon, eBay, Indie labels, niche online retail (Maple Music) and to a much lesser degree going direct to artists themselves. It is also possible in major urban areas for the occasional specialty and “used” CD stores to do a reasonable business.

So it could be said that the state of available retail choice, packaging, and perhaps price point and the possibility of consumer fatigue is making alternative forms of music acquisition – namely digital distribution – that much more attractive for consumers. It offers all of the convenience, selection, competitive pricing, even the facility to “try before you buy”.

Other factors are pointing Indies in the digital direction representing something of a necessary alternative of questionable promise at this point as they are entering the great unknown of digital distribution. They have increasingly limited access to both exposure through music media and shelf space offered in stores that are becoming less about music and certainly less about certain kinds of music.

I asked one industry maven about an apparent upturn in sales (8%) evident through some industry stats at end of 2003 when compared to 2002. He indicated, that after a multi-year decline that things were merely going from gruesome to only terrible and that the figure is but a “blip”, probably temporary due to a few late 2003 mega-hits in the Pop world. Lay-offs continue at the majors with the re-adjustment of business practices related to the manufacture and distribution of physical product.

2.4 Copyright

2.4.1 What is it?

Copyright is a legal term describing rights given to creators for their literary and artistic works. It is a property right. For purposes of this study, more specifically, the owner of a copyright has certain exclusive rights regarding the use of a musical work. These rights are protected and remunerations for their use are negotiated in Canada largely through collective organizations who represent performers, composers, and publishers of musical works (SOCAN, CMRRA, SODRAC) working within the framework that is Canadian copyright law.

International protection for copyright first received attention in 1886 with the Berne Convention for the Protection of Literary and Artistic works. Its aim was to ensure that nationals of its member states were protected in their rights to control, and receive payment for, the use of their creative works. In 1893 the organization became known as the United International Bureaux for the Protection of Intellectual Property, eventually taking its current name of the World Intellectual Property Organization (WIPO) in 1970. As a specialized agency within the United Nations its mandate is to

¹⁹ Playback, Coleman, 2003, >35 years of age in 1999 accounted for 35% of U.S. sales, ten years earlier that was only 27% of total sales, page 174. Traditionally a great deal of business is driven by selling back catalogue, if it isn't being stocked on shelves, no matter what the price, it isn't being sold.

administer intellectual property matters recognized by the member States of the UN.²⁰

The U. S. Congress passed the Digital Millennium Copyright Act (DMCA) on October 12, 1998. With its ratification the United States agreed to uphold the two Internet treaties, the Copyright Treaty (WCT) & the Performance and Phonograms Treaty (WPPT), signed earlier in December 1996 at that years WIPO Geneva conference. Within this Act were additional provisions addressing related matters of concern to stakeholders in the music industry:

- In general, it limits Internet service providers from copyright infringement liability for simply transmitting information over the Internet.
- Service providers, however, are expected to remove material from user's web sites that appears to constitute copyright infringement.
- Requires that "Webcasters" (streaming entities) pay licensing fees to record companies.
- The DMCA also states explicitly that nothing established in the treaty concerning *circumvention of copyright protection systems* would affect the rights, remedies, limitations or defences to copyright infringement, including fair use.²¹

Canada has yet to ratify the 1996 WIPO Two Treaties, but the matter was recently addressed in a March 9, 2004 address before the Standing Committee on Canadian Heritage by The Honourable H  l  ne Chalifour Scherrer, the Minister of Canadian Heritage in the Federal government. "I want to state that we still intend to ratify the WIPO treaties once we have properly identified the impacts of doing so²²."

Many participants in this study believe that there is an absence of an appreciation of the urgency in some government circles of the importance of clear copyright guidelines and in getting in accord with the rest of the world on the WIPO Treaty. Some participants would also extend this sentiment to certain industry players as well. One association leader remarked that, "Cultural self-interest (of organizations) seems to override any awareness of the realities of what is needed."

The Copyright Board of Canada is responsible for adjudicating the Canadian Copyright Act. As such, they define the first owner of the copyright:

- in a performer's performance, is the performer
- in a sound recording, is the maker; or

²⁰ As presented on the website of the World Intellectual Property Organization, http://www.wipo.int/about-wipo/en/gib.htm#P23_2347

²¹ Overview of The Digital Millennium Act, UCLA Cyberspace Law & Policy Institute, <http://www.gseis.ucla.edu/iclp/dmca1.htm>

²² As found on-line, http://www.canadianheritage.gc.ca/pc-ch/min/discours-speeches/2004-03-09_e.cfm

- in a communication signal, is the broadcaster who broadcasts it.²³

In the case of an artist signed to a record label, the musician has assigned the use of their work over to the record label for particular types of uses. Some labels, BMG for instance, will not sign a new artist or act without getting assigned full rights of usage including digital rights. This ensures the label the freedom to negotiate new business arrangements without a re-negotiation of use with the artist. One of our label contacts for this study estimated his company currently holds 10,000 artist agreements most of which require a direct consultation with an artists' management for something as insignificant as a CD price point alteration. Many of these agreements were reached without any considerations for digital distribution and over time, will all be re-visited in light of current new market realities.

SOCAN describes that the Canadian *Copyright Act* creates several distinct and separate rights that belong to anyone who creates music or lyrics (a musical work), including:

1. the right to *produce* or copy the musical work (e.g., sheet music);
2. the right to *reproduce* the musical work, which includes:
 - mechanical rights (i.e., audio reproductions such as sound recordings); or
 - synchronization rights (i.e., reproductions of the musical work in audio-visual productions – films and videos); and
3. the *performing* right, which gives copyright owners of musical works (words and music) the sole right to perform their works in public, or to communicate their works to the public by telecommunication (e.g., broadcast), or to authorize others to do so in return for royalty payments²⁴ [these are laid out in the description of the various *tariffs* on the SOCAN's informative Web site www.socan.ca] .

Copyright adjudication and administration form the basis of many of the legal issues pertaining to digital piracy, fair use by consumers, and fair remuneration to rights holders. Many of the interviews FAD Research conducted with music industry personnel, from artists, to labels, to distributors, contained pleas to change and simplify the copyright regime in Canada. The Minister of Canadian Heritage, Madame Scherrer, in her March 9, 2004 comments to the Standing Committee on Canadian Heritage said,

“There is no doubt that we must modernize the *Copyright Act* as soon as possible. The emergence of the Internet and new digital technology has shaken entire sectors of our society.”²⁵

²³ The Canadian Copyright Act, Section 24, <http://www.canlii.org/ca/sta/c-42/sec24.html>

²⁴ From SOCAN's informative online brochure, <http://www.socan.ca/pdf/en/SOCANGovtBroMar02.pdf>

²⁵ http://www.canadianheritage.gc.ca/pc-ch/min/discours-speeches/2004-03-09_e.cfm

The regime of copyright is too complicated. We need one regime that makes sense. That multiple stakeholders can come into and work through a process that makes sense for everybody. The issue is not who should be paid what, the issue is the complexity of the regime, that it's a disincentive for a fair settlement. You have to work too hard. You are spending too much time in an adversarial process (instead of a negotiating process) instead of investing in your business and paying rights holders.

-President of a digital music distribution concern

2.4.2 Copyright Infringement - Piracy of Physical Product

Physical product piracy potentially begins anytime individuals have the hardware necessary to duplicate a source. Frequent examples are found throughout the history of music. Vinyl records are transferred to reel to reel tapes decks and later to more portable cassettes. With the advent of the recordable CD and associated hardware, and because the source material was digital in nature, it was now possible to make perfect copies of source materials and re-distribute them either free to friends or for a modest charge at flea markets and the like at far below retail prices. The computer software industry has had this difficulty for years. Illicit trade in software being highly motivated by the price point of many programs and the ease of acquisition of “free” copies. As with any technology associated with computers it has become easier and more inexpensive to transfer files from legitimate to illegitimate copies and to redistribute this highly desirable material very widely to unscrupulous consumers.

For some, this form of illegal duplication proves a greater enemy than for others. FAD Research interviewed Earl Ferns of Desi Records, a distributor, producer, publisher and label of East Indian music in North America, Europe and India. He explained that the effects of piracy have been quite dramatic. Piracy is completely out of control in the East Indian music distribution industry. The resulting margins for music discs are very, very slim - 50 cents a disc with an average shelf life of only 30-90 days. Mr. Ferns says much of the recording and distribution business has ground to a halt because of CD piracy, the inability of authorities to enforce copyright protections and a price point collapse.

The existence of large scale physical product piracy in the Canadian marketplace is evidenced by a number of annual arrests by the Royal Canadian Mounted Police. Examples include the arrest of two men, and seizure of 1,000 pirated CDs, at the Pickering flea market on July 7, 2002. The two accused were charged with fraud and knowingly offering for sale and infringing copyright copies of sound recordings.²⁶ International statistics collected by the Canadian Recording Industry Association (CRIA) state that CD recordable piracy tripled in 2001 and significantly contributes to the \$5.8 billion global piracy market.²⁷

²⁶ News Release, July 10, 2002, http://www.rcmp-grc.gc.ca/on/press/2002/2002_july_10_e.htm

²⁷ News Release, June 9, 2003, <http://www.cria.ca/news/sixcharged.htm>

2.4.3 Copyright Infringement - Piracy in an Online World

Anything that can be converted to digital information can be shared via digital file transfer. Files can be created, replicated and disseminated through networks and across an ever widening array of digital media devices from computers to cell phones to personal organizers. This creates a tremendous challenge for those defending copyrights and the unauthorized use of intellectual property. The only limiting factors really are the literacy of users to employ digital media tools and there remain some minor restrictions around the amount of bandwidth to enable transfer.

I'm sick of the attitude that because a technology is able to do something then it's fair game to use it. If you can pick a lock it's therefore OK to enter my house?

-Ted Cohen, VP Digital Development and Distribution, EMI

There are extensive undertakings to provide some protection through the use of Digital Rights Management (DRM) for various platforms for music. We discuss this in a following section. Several of our interviewees discussed the ease with which media can be manipulated and copyright violated and one put forward the notion of re-introducing "friction" into the equation. The idea is that it has become too easy to violate the copyrights and that if just a little more effort were required to gain access to materials it would be sufficient to inhibit the activity to some degree.

Extensive tools, formats and protocols have been invented to allow digital media manipulation by music consumers. What follows here is a brief accounting of where piracy began on a mass scale with the invention of a compressed file format called MP3 and the co-opting of File Transfer Protocol (FTP) into a file sharing paradigm that changed the media forever.

2.4.3.1 Peer-to-Peer Networks – Legacy of Napster, Kazaa, LimeWire, etc

A college dropout was the first to construct a program that many in the music industry hold responsible for the systematic dismantling of their business model. When Shawn Fanning helped his college roommates find music files through hard drive to hard drive transfer, he developed what has been dubbed peer-to-peer (p2p) file sharing. With a central computer as host, the software enabled other computers to quickly sift through file names, locate what they're searching for and download the file from the computer storing the file. Named after a childhood moniker of its author, Napster allowed file sharing amongst machines, making the locating and transferring of MP3 files more accessible.

Combine this with the advent of hardware capable of writing, or burning, CDs, and you have now placed the ultimate choice in the consumers hands. Now you can download MP3 compressed files from the Internet or "rip" files from a commercial CD, save them to your computer, and at your convenience, burn your own CD. The record company, the retail record store and all the other "middle men" associated with music delivery had now become irrelevant. No longer did music fans have to trek off to their local music retailer and purchase a CD package, the format the record label

wanted them to buy. They could collect from a near infinite selection of “free” material, storing it, sharing it, copying it to CD media of their own.

To put themselves back into the mix, the record companies in the U.S., through their trade organization the Recording Industry Association of America (RIAA), did what they felt necessary to survive. The lawsuit against Napster would be fought on the grounds of copyright infringement, and the resulting revenue drop. Napster lost the court battle and the next year shut its doors to bankruptcy. But not until after German-based entertainment group Bertelsmann paid \$85 million to buy Napster in an attempt to continue its underground success. The demise of Napster, and the shutting of its doors, may have represented a lost opportunity for record labels to harness the technology and work with the loyal followers of this new distribution model. Interestingly enough, the judgment for the industry stated that the Napster application was found illegal by copyright infringement, but that peer-to-peer services were not inherently illegal.

To Napster creator Shawn Fanning, the ruling was an injustice to music fans, and in 2002 he said, “It may be hurting the music industry at this point, but my view is consumers have the ability to learn about new and interesting music, and the barrier is lowered in a way that gives them control over how they experience it. I think those are positive things”.²⁸ Napster was the prime force that allowed the creation of the culture of file sharing, the notion that copyrighted media was accessible for free, the notion that subsequently led to a wholesale devaluation of music in the eyes of many consumers who became unwilling to purchase music on CD media for \$17.99.

There is some evidence to suggest that for many it was not the willingness to pay as much as the package being offered. For while CD sales were falling, sales of singles globally exploded, in the U.S. increasing 173.5% from 2002 to 2003.²⁹ The exception to this situation was Canada as, according to one of our interviewees, there was never a singles consumption culture developed here. This may be in part due to the relatively low price point of CD’s when compared to the rest of the World. What was \$18 in Canada was typically £18 in the United Kingdom or \$18 USD in America.

The Napster experiment was enthusiastically followed by new p2p networks including KazAa, Morpheus and Gnutella. In August 2003, Forrester Research estimated that the music industry in the U.S. had already lost \$700 million due to peer-to-peer networks, and that by 2008, CD sales would be down 30% from their year 2000 peak.³⁰ A look into the future, published by Informa Media Group, predicted that losses from peer-to-peer networks are expected to continue to nearly double from 2003 to 2008, when it expects to lose \$4.7 billion to such file sharing. They also expect digital music to grow from just 4.5% of sales in 2003 to 11.9% in 2008³¹

It’s estimated that 34% of U.S. Internet users downloaded music in 2003, but that number relates to data collected on usage in the earlier part of the year. Once the RIAA started their legal campaign, there is evidence that the numbers of downloaders

²⁸ Playback, Mark Coleman, Da Capo Press, 2003, page 198

²⁹ eMarketer Spotlight Report: Digital Music, January 2004, page 2

³⁰ As quoted in eMarketer Spotlight Report: Digital Music, January 2004, page 4 and from interview with Josh Bernoff, Principal Analyst Forrester Research, CBC Radio 1, March 10.

³¹ Ibid, page 4

decreased as the year progressed³². With the Napster judgment in their favour, the RIAA began a campaign of suing defendants with large numbers of shared files to try to stem the downloading tide. Legal suits against individual downloaders were initiated and, although slow to take effect, began to discourage former casual downloaders -- 80% of the consumers who had deleted files had fewer than 50 files saved; just 10 % had more than 200 files.³³ To the recording industry, this meant the desired effect was taking place. Mainstream America was beginning to understand that file sharing was not without consequences, that media is not *free*.

Peer-to-peer file sharing and the use of illicit files carries additional risks not associated with copyright violation but with violations of the file share software users' computer security. P2P networks are file sharing programs that are not potentially only restricting themselves to desired media files. Media files themselves aren't always what they appear to be either. In Canada CRIA was able to send 750,000 warnings to file sharing users by masquerading as media files. More insidious are the viruses, worms, and Trojan horse programs that can be sent via the same means. These programs are capable of destroying data, hijacking computer resources, even stealing critical information like financial records from unwitting users. See an example description of one of the nastier currently circulating versions of such a virus in our [Peer To Peer Peril appendix](#).

2.4.4 DRM and Attempts to Regulate and Secure File Use

A great many interviews for this study openly acknowledge that there will always be piracy. Though it is generally agreed as well that illicit use will likely decline if file manipulation is made slightly more difficult and/or has technical restrictions built into its use. As a part of a multi-pronged assault on piracy, labels have been using various forms of DRM (Digital Rights Management) techniques on both physical and virtual music products. The technique entails the use of encryption and software to afford users specific rights to the use of copyrighted music materials. This goes to the notion of introducing *friction* back into the media equation. Various schemes are in place that disallow or restrict the ability to transport and copy files, while not unassailable they create a significant disincentive to casual file pirates.

There will always be music theft. People are hacking cable, satellite, lots of things. It's a societal problem.

-Streaming media executive.

This is a delicate path for the industry to tread with consumers who have become accustomed in large part to ultimate portability. It is a somewhat difficult case to rationalize to this audience decreasing the ease of use that technology has brought and that the industry has been very slow to address. Phrases like "putting the genie back in the bottle" are often uttered in this discussion. It is the debate over what

³² Pew Internet & American Life and comScore Media Metrix, *The Impact of Recording Industry Suits Against Music File Swappers*, January 2004. www.pewinternet.org

³³eMarketer Spotlight Report: Digital Music, page 7

constitutes piracy and what constitutes “fair use”³⁴. There are more opinions on this than there are stakeholder groups. They run a full range, from the many consumers who feel that they have purchased³⁵ the right for unlimited personal use of the music as they see fit – to the representatives of rights holders like the CMRRA who feel that if the DRM associated with a legally acquired download allows 10 uses then they are due mechanical payments per track X 10 at the time of purchase. This answer undoubtedly lies somewhere in between as this issue is very much in contention.

2.4.5 Addressing Piracy from Studio Sources – Digital Business Opportunity

One of the prime sources of pirated materials in the music industry is actually from files lifted right from the recording studio. It has not been that unusual to be able to discover releases of new artist materials *before* they appear in retail outlets in CD form. These materials appear most often through file sharing networks. Their illicit release results in huge monetary losses for all elements of the business from retail, who lose the highly attractive new music sales, to labels, rights holders, and naturally the artists themselves. Until recently, the digital master of a high profile release from a company like EMI would be physically walked in CD form, with accompanying security, from a recording studio to the airport and flown out to the geographic distribution areas, to the CD replication facilities in places like Toronto.

A Toronto based company called Musicrypt (www.musiccrypt.com), was interviewed for this study, and aside from giving us a great deal of insight into the nature of DRM technologies, demonstrated how digital media peril has been turned by them into digital media opportunity. Their Digital Media Distribution System (DMDS) product allows for encrypted and secure file transfer both from production facilities to CD replication plants and additionally it provides a secure distribution and data collection system for distributing music files directly to radio broadcast outlets. This product is exceptionally innovative and is currently being marketed and used in Europe and the U.S. as well as here in the “test bed” of Canada. EMI Music Canada and Universal Music Canada currently use this direct transfer method to secure and expedite their production and distribution processes.

There are innumerable opportunities in the new digital music market for innovative approaches to facilitate business through improved distribution and marketing as the one described above.

2.4.6 Current Court Challenges – Notions of “Fair Use”, Privacy

CCH Canadian Limited vs Law Society of Upper Canada

A recent ruling in a non-music related copyright case, that was originally contested in 1994, CCH Canadian Limited vs. The Law Society of Upper Canada, could provide legal precedent for ISP’s to eliminate any liability on their part in respect to how their subscribers use the service (i.e.: copyright infringement through file-sharing activities).

³⁴ Sometimes called Traditional Rights Usage (TRU). See CCH Canadian Limited vs. The Law Society of Upper Canada. Michael Geist in a panel at Canadian Music Week, stated that Canadian courts have been champions of exploring the notion of fair use of copyrighted materials by consumers.

³⁵ In our interviews it was mentioned a couple of times that in some cases consumers had purchased, over the years, the same material a number of times as record labels put forward new packages such as vinyl, CD, cassette. Part of this re-issue mentality may be contributing to consumer fatigue.

The judgement absolved the Law Society library of liability for providing on-premise photocopiers that were used to reproduce copyrighted materials for law firms. The provision of the copy technology to library patrons did not constitute authorization to use the copiers for purposes of copyright infringement. The Court also ruled that "users rights", exceptions to copyright infringement, were acceptable in regards to photocopying copyrighted material for private study or research. The question for the music industry is whether a liberal interpretation of "users rights" will extend to the private copying exception under the Copyright Act.

CRIA vs. Canadian ISP's

Successful lawsuits in the United States against hundreds of individuals for using free music-swapping sites has lead to a similar legal thrust in Canada. The Canadian Recording Industry Association has tracked the online activities of 29 suspected "egregious" uploaders and now wants their Internet providers to release their names and addresses. This raises a plethora of issues. Fighting to quash the request is the Canadian Internet Policy and Public Interest clinic. A legal group established by the University of Ottawa's Faculty of Law, it maintains that identifying uploaders by IP address is imperfect because IP addresses are randomly assigned and temporary. They also claimed that collected subscriber information is private and disclosure means attacking principles guaranteed by the Charter of rights and Freedoms. All five Internet service providers -- BCE Inc., Rogers' Communications Inc., Telus Corp, Shaw Communications Inc. and Vidéotron -- have stated they would abide by a court order. At stake is the music industry's attempt to use legal prosecution to quell illegal file swapping CRIA claims has cost the Canadian music industry an estimated \$425 million since 1999. On March 31 of this year the Federal Court of Canada ruled that the plaintiffs represented by CRIA had not established a case that would oblige ISP's to have to reveal the identities of the alleged infringers of copyright. At the same time the court said that the privacy concerns were not enough to prevent a subsequent disclosure should CRIA be able to make a case. CRIA is currently fashioning an appeal.

2.5 Legal Digital Distribution Systems

2.5.1 Streaming & Download

In the mid-90's Canadian cable systems began offering digitally transmitted streaming music services such as Shaw Cable's DMX or the CBC's Galaxie services offering over 40 distinct channels.

In 1996 Real Networks popularized the digital transmission of streamed "radio" sources across the internet. CBC was one of the early entrants into providing an additional globally available channel for their broadcasts through the use of the Real Audio client/server software. Numerous Internet radio sources were beamed out to the world during the Internet development boom. Devices, sites and software allowed access from any PC, thousands of radio and radio-like channels through Philips iM-Tuner software (www.sonicbox.com) and sites such as the early broadcast.com and audionet.com. Most of these sources had one thing in common with early Internet initiatives and that was the quest for a business model, though some have evolved into successful streaming ventures like Sympatico's Musicmatch (www.musicmatch.ca).

Throughout the turmoil created by p2p systems, the Napster court challenge, many enterprises were struggling notionally with fashioning legitimate digitally distributed music services including companies interviewed for this study like Montreal's eWorldmusic and Toronto's Musicrypt and Iceberg Media. Developments were slow (by normal Internet business standards) because of the complexities of the environment and the adversarial nature of the stakeholders even within the confines of a single interest group, the major labels. This is demonstrated by the fact that it took until late 2001 for the "not ready for primetime", label backed services of Musicnet (EMI, Bertelsman, Warner, Real Networks) and Press Play (Universal, Sony, Yahoo!) to launch. These systems offered streaming and downloading working on a subscription pricing model. They did not allow for portability either through burning to CD (and disconnecting most consumers from their home stereos) or porting off to MP3 players³⁶. Another grave flaw inherent in these early services were the restricted catalogues. Neither service had anything approaching a wide selection as neither contained works from all of the major labels³⁷. Restricted selection and access plus limited portability equals diminished value proposition especially when compared to what the illegitimate services allowed.

Slow to understand the full implications of digital distribution, having managed quite nicely on the high margin CD format for 20 years, record companies were not quick (relative to the pace of digital business and digital markets) in coming to a strategic solution to the emerging demise of their business model. In fairness this kind of collaboration is frowned upon in Canada outside of the confines of trade associations like CRIA and CIRPA under federal Competition legislation.

³⁶ Playback, Mark Coleman, Da Capo Press, 2003, page 204.

³⁷ These systems carried a predominately Pop catalogue and 'back' catalogue offerings did not include obvious choices such as The Beatles and The Rolling Stones.

What did help accelerate the offering of legitimate download services in the U.S. and Canada was the ironic realization that in order to defend copyrights effectively in the courts, it would be necessary to offer the public comprehensive legal download alternatives to p2p services. This resulted in the accelerated launch schedules for Apple Computer's iTunes service³⁸ in the U.S. with a number of others following suit including white label offerings through Musicnet, Rhapsody, and Napster 2.0. In Canada Puretracks (www.puretracks.com³⁹) launched in October of 2003 also the beneficiary, if you can put it that way, of long awaited collaboration between labels, publishers/rights holders and rights collectives. In December the launch of Archambaultzik.com (www.archambaultzik.ca) brought music download to French Canada⁴⁰.

Download services, in order to operate in a given national geographic area, must purchase their digital file inventory from the major label's business units doing business within that area⁴¹. Historically labels have administered the payment of royalties resulting from the sale of song titles into various distribution media back to the collectives representing copyright holders. With the advent of digital distribution for music download the CMRRA, who represents somewhere in the neighbourhood of 65% of music publishers, have moved to shift the burden of administering "mechanicals"⁴² to the digital start-up music distributors.

There has also been a protracted period of negotiation of two years in coming to a payment/royalty schedule suitable to all parties. The CMRRA has been fixed on a "pennies per download" model which deviates from the percentage of each download model agreed to by the distribution entities and labels. At present this negotiation remains unsettled. A number of our interviewees expressed frustration over this with one commenting sarcastically, "and this is why Canada, with its 10 year long lead in both Internet literacy and massive broadband penetration had download music services after countries like Italy". Most see it as a squandered opportunity for Canada's music industry and its digital media business. The matter of payment is unsettled, creating uncertainty for Puretrack's investors, and monies collected from sales are currently put in escrow until such time as an agreement is reached.

More competitors will drive efficiencies of the marketplace in providing customer value. The only way we will have more participants is by having clear licensing regime. One reason iTunes may not be here is because it's too confusing.

Alistair Mitchell, Puretracks

³⁸ Launched April 28, 2003. Remarkable in many ways, not the least of which was the fact that it has inventory from all the major labels but also that this inventory contains no DRM restricting use. It currently has 400,000 songs in its inventory of titles.

³⁹ It's an interesting aside that if one types in www.purtracks.com a browser will point to something called filesharing.com a site facilitating mainly illegal file sharing. This is clever marketing on the part of file sharers.

⁴⁰ Puretracks has also announced a French language site/service. The result of a recent deal reached with Sympatico.

⁴¹ It is our understanding that this cost is somewhat variable per track, label to label.

⁴² Mechanicals are the rates applied and collected for "mechanical reproduction" of musical compositions. Traditionally collected through the labels, this is not a minor undertaking. (see www.cmr.ca)

Streaming services such as Galaxie, Moontaxi, Musicmatch and Iceberg seem to have been much easier to deal with relative to track download services as, once measurement of “airplay” could be agreed upon, the remuneration due rights holders could be readily dispensed in a model not unlike that of radio to groups like SOCAN and SODRAC. It is our understanding that there is still some discussion here but it was acknowledged by one collective representative that they are quite pleased to be realizing additional revenue sources from the new music delivery technology.

2.5.2 Cultural Intrusion?

Canadians are faced with an interesting cultural incursion into their media space in the immediate future. Poised for entry⁴³ are several U.S. based download/streaming⁴⁴ services. Some of these will enter under their own brand names like iTunes and Napster 2.0. Others will be offering “white label” services to Canadian brands such as Rogers’. White label means that while a music download site is fronted and branded by a familiar consumer brand – the back-end, or the engine that drives the system, including the database of music inventory, the billing system, and most importantly, the manner and priority in which music is presented for sale is operated by a service potentially operating a number of other music distribution sites. These online services are the virtual equivalent of the Big Box store.

In 1998, as a result of the New Media and Broadcast Hearings, conducted by the CRTC (Canadian Radio-television and Telecommunications Commission)⁴⁵, it was determined that the federal government would not engage in regulatory activity associated with new media content and services, “...the Commission will not regulate new media activities on the Internet under the Broadcasting Act.” FAD Research appeared in front of these hearings as an expert witness and there is potentially a large problem with this hands-off approach now that Internet sources of content are quite indistinguishable from traditional broadcast media sources⁴⁶. The “problem” occurs if you believe that the current broadcast regulatory scheme is the only way to secure the production of Canadian culture in electronic media. Capabilities and possibilities are approaching a point where the chaos associated with digital technologies and the music industry may be a backwater compared to the torrent of effects that other content services may have on cultural media consumption like films and TV.

Music services are the “thin edge of the wedge”. The entry of foreign owned services will have profound implications for Canadians looking for music that interests them

⁴³ Currently cross-border transactional activities are not allowed as a condition of licensing music inventory. U.S. services screen based upon credit cards and their mailing addresses for billings. Canadian sites use a method that screens based on IP addresses (Internet access points registered to specific Internet Service Providers) of potential customers.

⁴⁴ These in addition to a widening array of Internet based radio stations. As marketing for these enterprises becomes more internationally focused increasingly Canadians will turn to the like of Virgin Radio from the U.K. and the recently launched high profile talk radio channel www.airamericaradio.com.

⁴⁵ Outcome of CRTC hearing on new media and broadcasting.
<http://www.crtc.gc.ca/archive/eng/Notices/1999/PB99-84.htm>

⁴⁶ The great revelation for FAD Research at the time of the hearings in 1998 was that we could easily foresee the day when new media would not be considered some, pardon the expression, fad media, a subsidiary somehow of traditional broadcast, but when it would be actually quite the opposite. Broadcast content production and distribution would be instead a subset of what are new media undertakings, as such the basis for the regulatory framework, administering bandwidth and regulating content, becomes untenable. This is not an “if” it is a “when”.

online, not to mention the impact on Canadian artists and labels looking to get their work in front of Canadian audiences. Music in many cases is consumed on the basis of regional markets. This is most apparent in a market like Quebec, though the Quebec French language market is likely most secure of the Canadian regional music niches, as it is protected by language and a well developed celebrity star system.

“Like everything else (in media) the Canadian distribution system, the electronic distribution system for music has always been a strong interest to the Canadian government, to ensure that some of these other entities (the U.S. new entrants) don't completely submerge any opportunity for Canadian artists. They have to move really fast though.”

Duncan McKie, President Pollara and also a director of Puretracks

American interests may be perplexed by the different consumption habits of Canadians and the ability of download services to cater appropriately to local markets. This may well represent a competitive advantage for Archambault and Puretracks⁴⁷. There is some speculation over the seeming late entry to Canada of Apple's iTunes. One interviewee speculated that they may be in midst of realizing “that Canada is not the 51st state”. Many have speculated and American interviewees have stated very clearly in the course of this study that the process of gaining rights clearances is currently a huge block to the timely launching of download services in Canada⁴⁸. At the same time Canada remains a highly attractive market with a population adept with digital media and widespread broadband usage.

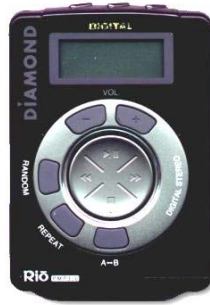
There was some speculation in our interview with Alistair Mitchell of Puretracks that it will be unlikely that there will be an entry to market of another Canadian owned music service. “We won't have a second chance at this”, he says. With the incursion of multiple U.S. services imminent and an oversupply of service and barriers to entry south of the border (requiring a second purchase of music inventory) for Canadian companies, it is unlikely that investors would back such a Canadian start-up. FAD Research agrees completely with Mr. Mitchell's analysis.

⁴⁷ Puretracks told us in interview that they are going to great lengths to engage Indies in their site.

⁴⁸ It would be difficult to identify another issue that so many people identified as a block to offering more and better download services. It came through in interviews and was very evident on the floor and at the podium at Canadian Music Week that there is great frustration with the current situation.

2.6 The Role of Hardware in Distribution

Music players have become primary elements of conveying the music experience in a digital age. Home based systems are increasingly interactive in capability. As one Canadian Music Week participant put it, portable players have become “commodity fetish objects”. It is these portable players that are the focus of much of the attention.



An early RIO MP3 player

The interoperability discussion between digital players has become a parody of the religious discussion of PC vs. Mac approach to computing architecture, operating systems and interface. Mac the nimble under Steve Jobs managed to get to market quickly with a truly elegant piece of equipment, the iPod, connected to the iTunes service it has managed to claim currently around 70% of the download market. Apple has become a major stakeholder in the success of digital downloads using music to sell hardware.



The iPod

Apple hit first and hit hard and it hit upon the things that Apple has done very well historically in catering to consumer needs. They introduced a complete music management system with downloads, 250 streaming stations, software for burning custom CD's and they did something heretical that they had *never* done before, they released a version for Windows. The catch is that you can only offload tracks to an iPod because the idea is not to sell music, they make no money at this, the idea is to sell hardware. The software package and iTunes files are incompatible with PC operating system portable players which there may be 60+ models offered from a myriad of manufacturers this year. There is talk of opening up the Apple system but as far as the consumer is concerned this discussion will shortly become rather "moot". All portable player systems will feature the same basic capabilities:

- Sufficient storage and organizational capabilities to store several thousand tracks
- Interoperability with other consumer electronics devices such as home and car stereos
- Radio reception capability to receive Over-The-Air, satellite, Internet, etc. source broadcasts

Several of our interviewees related the differences that digital devices have made in their enjoyment of music over the Jurassic CD players. We heard of revelatory experiences about how the devices have changed the musical lives of people who have always been surrounded by music. Transporting thousands of tracks of music to have effortlessly at one's beck and call gives some insight where media consumption is headed and that we are in early days of the transformation⁴⁹. Computing devices fade into the background of everyday things and into the foreground moves a ubiquity of media experience.

We have included an [appendix](#) giving some small indication of the variety new devices heading to market this year.

⁴⁹ Jim Griffin of Cherry Lane Digital of New York made the comment from a CMW panel that the CD as a media is probably going to endure for some time due to the low cost and large installed base of the players. FAD would agree with this and add that unlike the shift from vinyl to CD we haven't yet had a compelling difference in the quality of the sound that is being delivered which would help motivate people to adopt another hardware platform beyond a concern for storage and portability.

3 Marketing

3.1 Brief Introduction to e-Marketing

e-Marketing is the process through which marketing through interactive means is conducted. It is its own specialty, its own medium. It can be used to call attention to interactive services and products or it can augment marketing activities in an offline world. It is immediate, can be highly targeted, tailored and measured and it is paramount in an effective campaign to bring attention to online services such as those associated with music properties.

FAD Research has been conducting research to support e-marketing activities since the early days of the Internet. Music Web sites in Canada appeared as early 1993-4 with early entrants such as Nettwerk Records⁵⁰ and EMI Music Canada⁵¹ maintaining and developing presences where their audiences were looking for their favourite bands.

Common techniques include providing Web sites URL⁵²'s, every business today includes these addresses prominently displayed. e-Mail carefully implemented can still be effective. Banners and buttons, pop-ups and interstitials, and rich media including audio components are in use routinely in marketing music sites. Search engines tactics, guerrilla and viral marketing, and newsletters can all be used judiciously to cultivate audience relationships and target niche audiences. If 90% of business is marketing then 95% of *online* business is active and persistent marketing.

3.1.1 eMarketing Music – Digital Business Opportunity

Music business activities have become exceedingly focused upon e-business activities associated first with the Web and now with online distribution initiatives. For one company this has spelled opportunity. eWorldmusic of Montreal, after dabbling very early on with digital download, streaming, and e-commerce music initiatives on the net, has settled into a specialty niche that is proving to be quite successful. They have developed a specialty business in marketing and promoting French language artists in Quebec and around the world. Their president, Olivier Trudeau, believes that digital music has only been propelled rapidly into a legitimate business because of online piracy. His current business model is that of providing cross media (including online and offline) promotional activities for music to drive traditional CD retail sales. eWorldmusic has also built online music shopping services for companies like Telus (www.globetrotter.net).

⁵⁰ Nettwerk was so good at it that they set-up a separate new media production business to sell their construction expertise to other players in the music business. Terry McBride at Nettwerk is widely acknowledged as being a visionary in this area.

⁵¹ EMI Music Canada, another early experimenter, broadcast the first Webcast of a Canadian band, the Tea Party during Canadian Music Week in 1994. It was the 4th such event of its kind in the World. Because of bandwidth requirements the show could only be viewed then at universities.

⁵² <http://www.webopedia.com/TERM/U/URL.html> - Uniform Resource Locator- a.k.a. Web address

FAD Research would agree, that having researched the business models, and with the proliferation of music services of all kinds, then it is likely the business of providing marketing services is more immediately promising than that of distribution.

3.2 The Face of Canadian Music On The Web

FAD Research conducted a restricted environmental scan for the *Changing Face of Music* project. We did this to provide the Sound Recording Policy and Program Directorate with an overview of the kinds of Web initiatives that are going on in the Canadian music scene.

Our analysts for the review portion of the project were people very experienced in the Canadian music scene. They have assessed thousands of music Web sites in their careers. We attached a relative numerical rating (see reviews here - [Canadian Music On The Web – Site Reviews](#)) based on sophistication of sites though this shouldn't necessarily seem to be a comment on a site's "effectiveness". Simple can be quite effective. The rating is more a gauge of relative technical sophistication coupled with information architecture and what currently passes for State-of-the-art in Web. Additionally we provided a simplified grid with notes pointing out some of the key elements in an effective music marketing initiative.

3.2.1 General Discussion of the Canadian Music Web

Overall, there is a wide variation in the degree of use and effectiveness of interactive marketing in the Canadian music industry. "Small players" often use interactive marketing in pioneering new ways in an effort to capture an elusive audience in a highly competitive "attention economy". Some larger/more established companies are lagging behind in their use of interactive marketing, particularly those that are closely tied with other forms of traditional media. Being innovative in marketing and Web content requires an innovation orientated corporate culture. This is typical of businesses with secure unchallenged business models that do not rely on R & D activities to move their businesses forward.

The most effective examples discovered in our survey have been neither the complete newcomers (who may lack the budget and manpower to support strong new media initiatives) nor the heavy-hitters (who perhaps are still succeeding using "old" models well enough to resist new methods of doing business). The interactive success stories instead are companies that have already established some presence in the music business but, for individual reasons, must "try harder" to keep their place in line or to position themselves more advantageously in what are increasingly crowded spaces.

Examples include:

- Blue Rodeo (popular Canadian band that recently lost its major label support and has since gone forward with their own independent label) and Nettwerk Records (well-known as an innovator but still not a multi-million dollar concern like the big record companies).
- Arts/music organizations that have substantial marketing budgets but who still have to work hard to attract audiences in a competitive

market can use interactive marketing effectively for CD and ticket sales, performance schedule updates, news, contests and more. (i.e. The Winnipeg Symphony Orchestra – see appendix 5]

The dynamics of the “Attention Economy”, in which multi-nationals often influence what gets reported, what gets talked about and who gets what buzz, has an enormous impact on the success of marketing techniques used by Canadian artists and music interests. This is where the *attention*, be it transactional or promotional in nature, largely becomes the business at hand. If there is one lesson, amongst many learned during the dotcom era, it is that if you build it, they will *not* necessarily come. They that have audience will rule, and this can be split into two kinds again between raw numbers of “eyeballs” (or in our case ears) looking for music or it can probably be niche oriented special interest audiences that have been drawn by effective deployment of interactive marketing tactics. Music and digital media have the potential to revive the idea of the Portal.

One of the most prevailing myths about using the Web for sales and marketing is that it is cheap and easy to do. To do it well and effectively, costs. Though the online environment, at least viewed in isolation, can represent a bit of a levelled playing field for smaller labels and artists who have both no media access at the present time and restricted access to retail shelf space. We offer this example given to us by Ric Arboit, President of Nettwerk Records:



Figure 5 Nettwerk/NuTone Exposure on iTunes

This is a screenshot of the main Electronica page of Apple's much talked about iTunes site. The parent site is responsible for about 70% of the digital download activity in the U.S. What we see here is an ad banner for the NuTone label. This is one of Nettwerk's affiliate labels. They did not pay for the placement. This is the Web equivalent of a banner ad on the first page on an inside section of the Wall Street Journal. This puts NuTone on an equal or superior footing to *any* label in Electronica in the world and increasingly for Canadian labels this is where they need to be going. Ric Arboit refers to digital download services as a "Godsend".

It's not just about being Canadian for Canadians, it's about being Canadian for the World. We've got to start focusing on that with our marketing, especially with the Internet. If you don't do that you will never be competitive.

Roma Khanna – VP Interactive Services, CHUM TV

Marketing is near everything in modern business and in the interactive media business it is about engaging and conducting an ongoing dialogue with your audience/customer. Digital media allows you to know more about this audience than any other mass medium there is and the careful nurturing of this relationship is critical to maintaining any e-business today.

"Marketing strategy in performing arts organizations has become particularly important in the increasingly competitive environment in which the arts operate. Since the late 1980's there has been a necessary shift in focus to audience development away from product development. This change in focus is being encouraged to ensure the long-term viability of performing arts organizations and micro-economic reform." – International Journal of Nonprofit and Voluntary Sector Marketing, V7, #2.

3.2.2 Costs of Internet Enterprise

The Internet is a number of technologies rolled into a multi-faceted *interactive* media channel. It is e-mail. It is Web. It is file transfer protocol (ftp). It is the production of media of all types – text, graphics, photos, video, animation, and yes, audio. It is inseparable from a myriad of supporting technologies such as databases, Domain Name System (DNS) lookup services, micro-payment services, encryption technologies, to name a few. It is complex and involved like any media when it is done well and asking how much it costs is like asking "how much is a TV commercial?". Like a TV commercial the production cost of the "spot" is only a small part of the overall cost of a campaign or in the case of a digital media service, a Web site is merely one component, the face, of the product itself.

Using interactive media to promote a music undertaking can be as varied an exercise as a fan site maintained by a fan, a branded multi-site extravaganza like CHUM's "Much" properties, or a massively database driven transaction focused site like Puretracks. These have costing models associated with their production that go from inconsequential to 7 figures. As we have said, this is only part of the story, the consistent marketing of the interactive presence itself is as important as the content if we are talking about a Web based initiative. In other words it may cost \$50 to digitize

a track⁵³, or \$100 for a full album, but many times that to draw the traffic to the place where one can acquire it. It makes little sense for artists big or small to “go direct” on their own when there are businesses arriving that can move CD’s and digital downloads. It is the marketing of music Brand identity that becomes the be-all and end-all in the decision to go direct to the consumer. There is a fair amount of specialized work in creating brand awareness, a vibrant marketing presence online, as well as transaction and fulfillment arrangements.

It is likely only a matter of time before opportunities like our Netzwerk example above are paid opportunities only and the main points of access for exposure become virtual versions of the bricks and mortar retail store where exposure is rented. Much of the power will lie in the hands of the audience aggregator, with the consumer or music information portal. A distinguishing feature of online shopping is that if the customer chooses to find alternatives they are readily available at the click of a mouse⁵⁴. The skill in demand will be the one that helps position music products in a pleasing fashion in front of consumers. Marketing again.

One most distinguishing feature about interactive media is its immediacy. To be competitive, outlets for music must maintain current information and current inventory. These maintenance costs are not insignificant. When it comes to “how much does a site cost” there is no rule of thumb though given specific cases FAD Research is capable of reverse engineering for purposes of competitive analysis.

3.3 Usability Analysis of Music Transactions in Canada

We have included a somewhat detailed usability report (see [The Canadian Music Download Shopping Experience – A Review](#)) prepared by a lead analyst at FAD Research. This report is provided to illustrate the kind of analysis necessary when designing and assessing customer experience on the Web. In any genre of site, but most particularly with ones involving a transactional experience, where there are a number of competitors offering a similar product, the user experience becomes critical to retaining audience and gleaning the ever important repeat visitor/buyer.

The two most important determinants for success with a music distribution enterprise are marketing to ensure awareness of your services and the user experience that occurs once a potential customer engages your offer interactively. It is very straightforward, the customer needs to know where you are located and be presented with an offer that fits a need. Secondly, once they have engaged in learning more about the offer, they need to be incrementally satisfied at every step right up to when a buying decision is made through to when the product arrives⁵⁵. Anything less than satisfaction will result in a lost customer as the next competitive offer is but a mouse click away.

⁵³ Indiepool (see review in appendix 5) is currently advertising this rate for indie artists wishing to list tracks on Puretracks.

⁵⁴ Typically a site has 6-10 seconds to make an initial impression and if there are any glitches in the interactive experience along the way to transaction then it takes very little effort to locate an alternative retail source.

⁵⁵ This last part is the fulfillment portion. Canadian consumers face first a challenge of finding Canadian e-commerce services (marketing challenge), and second Canadian business faces a challenge of operating successfully in a catalogue business model, something that the Americans are very adept with.

We've got to start focusing on that (International marketing) with our marketing, especially with the Internet, if you don't do that you will never be competitive.

- Interactive Marketing VP

Several of our interviewees, when commenting on the Canadian music download shopping experience, felt that our services had launched prematurely for several reasons. Incomplete catalogues, bumpy transactional experiences, technical difficulties early on were all cited. U.S. services have been somewhat delayed in market entry into Canada. The moment one does launch here, the music download business in Canada goes truly global in the way that it must compete.

4 e-Business Models

The music industry has been spoiled. They have controlled the distribution of music by producing CD's, and thereby have also protected their profits. So they have resisted Internet distribution. The music industry has to re-invent itself. We can no longer control distribution the way we used to.⁵⁶

–Nobuyuki Idei, CEO, Sony

There are some significant challenges associated with forging new business and revenue models for digital music services. Most of these revolve around assimilating change and arriving at new agreements that work for all of the stakeholders. The most fundamental of these propositions is the value proposition to the customer. It is on the basis of this that the success of all subsequent business will be assessed.

The business is much more about partnerships. It's much more about bringing a number of specialized skills and companies together and sharing both on the upside and downside of any business. It is more about making a little bit of money in a lot of places over maintaining large control over a high margin business. You can't expect the other people (companies) to play ball with you if you're trying to maintain such control on things when there are so many opportunities out there. Digital channels and tools have opened things up.

- VP broadcast distribution outlet, music portal

⁵⁶ eMarketer Spotlight Report: Digital Music, January 2004, page 3.

4.1 The Business Models of the Prime Delivery Formats

4.1.1 Physical Product – CD's

In an attempt to describe in some detail the emerging digital streaming/download model we will describe the existing legacy model for physical CD product as it is currently operating.

Stakeholder	Change Elements For CD Model	Outcome/Forecast
Retailer - Traditional	<ul style="list-style-type: none"> ▪ Increased competition ▪ Lower prices ▪ Reduced interest in the CD package 	<ul style="list-style-type: none"> ▪ Restricted inventories ▪ Shrinking margins ▪ Shift in product mix to DVD ▪ Traditional record stores under extreme pressure. ▪ Niche focus possible in urban areas ▪ Marketing demands on labels to help combat Big Box threat
Retailer - Big Box	<ul style="list-style-type: none"> ▪ Large wholesale buying power. ▪ Selling music as a "loss leader". Using music to attract customers to store ▪ Top 100 focus limits choice 	<ul style="list-style-type: none"> ▪ Will continue to sell anything with sufficient demand
Major Labels	<ul style="list-style-type: none"> ▪ Drastic decline in retail space and retail margins with the CD format ▪ Consolidation in multi-nationals ▪ Big Box retail making huge demands for price concessions ▪ Threatened by proliferation of illicit file sharing and replication 	<ul style="list-style-type: none"> ▪ Exploring alternative business models actively ▪ Incentive to make digital work for big music ▪ Aggressively defending copyright ▪ Less artist development taking place as market become more "hit" driven than ever ▪ Staff lay-offs
Indie Labels	<ul style="list-style-type: none"> ▪ Limited access to distribution channels, media and retail exposure 	<ul style="list-style-type: none"> ▪ Exploring alternative means of marketing and distribution some in digital domain ▪ Organizing with other Indies
Digital Doers	<ul style="list-style-type: none"> ▪ e-Commerce and e-Marketing are well established businesses that substantiate the new digital channel ▪ Challenging traditional business models through a global orientation and addressing new demands customers are making for technology 	<ul style="list-style-type: none"> ▪ Forming partnerships with all players ▪ Creating new business models ▪ Making businesses out of music hardware, software and digital music distribution and marketing

Publishers	<ul style="list-style-type: none"> ▪ Experiencing revenue declines due to decrease in CD sales and file sharing 	<ul style="list-style-type: none"> ▪ Adjusting to the idea of developing new revenue possibilities ▪ Defending copyright ▪ Seeking partnerships
Artists	<ul style="list-style-type: none"> ▪ All but the biggest artists are getting limited exposure ▪ Divided opinions on the effects of file sharing ▪ Very difficult to get record deals or access to music distribution and promotional media ▪ Alienation from the debate 	<ul style="list-style-type: none"> ▪ Actively exploring alternative distribution moving CD's through e-Commerce and sales direct at shows ▪ Considering alternatives ▪ Seeking partnerships
Consumer	<ul style="list-style-type: none"> ▪ Mainstream music market has become all about mass market ▪ Disenfranchisement with CD as a consumer package ▪ Access to alternative digital channel very enticing 	<ul style="list-style-type: none"> ▪ Continued gravitation to digital media consumption ▪ Looking for ease of consumption, choice, price, lack of restrictions on "fair use" ▪ Continued interest in niche CD products

The following is a diagram of the existing revenue pricing model for a typical CD sold in Canada as provided by industry sources. Market pressures have put a strain on every segment of the pricing pie. The days of the retail outlet with 300,000 titles as Sam's Yonge St. store in Toronto claims to have are over. A typical Wal-Mart carries a mere 4,000 titles. The wide selection inventory has become untenable, as have major labels' rosters of regional or niche performers. According to CRIA retail space has contracted 30% in the last couple of years. The CD format will likely endure for some time yet but the "early adopters" and music lovers are actively seeking alternative means of consumption and our group the Digital Doers are moving in partnership with the audience aggregators to fill that need. The CD format in its current package is on the wane and its high margin business model has dissolved after a 20 year run.

Costs of a \$17 Canadian CD

Source - Keepmusiccoming.com

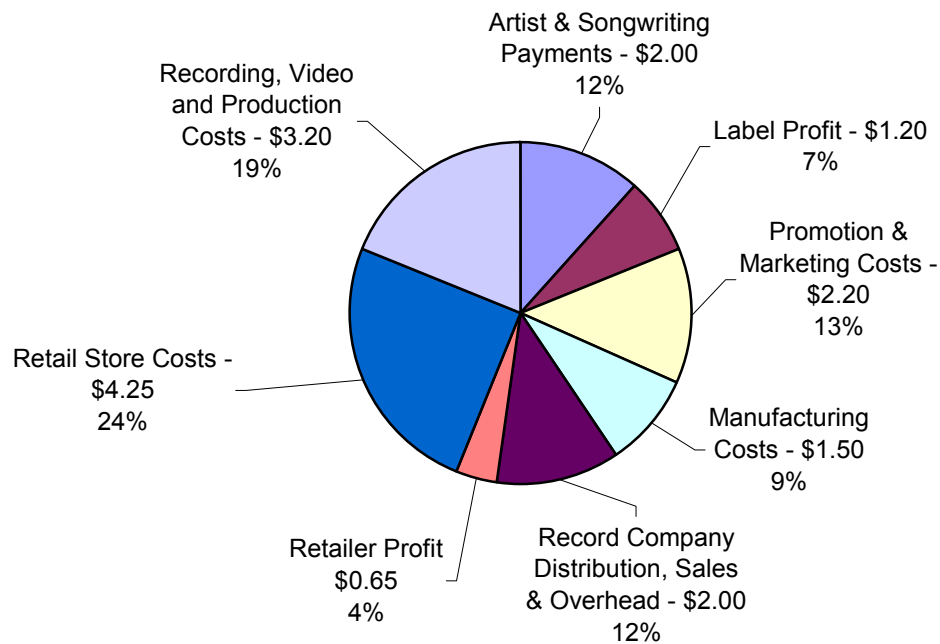


Figure 6 – Revenue Model for a CD

4.1.2 Digital Business Models – Streaming/Download

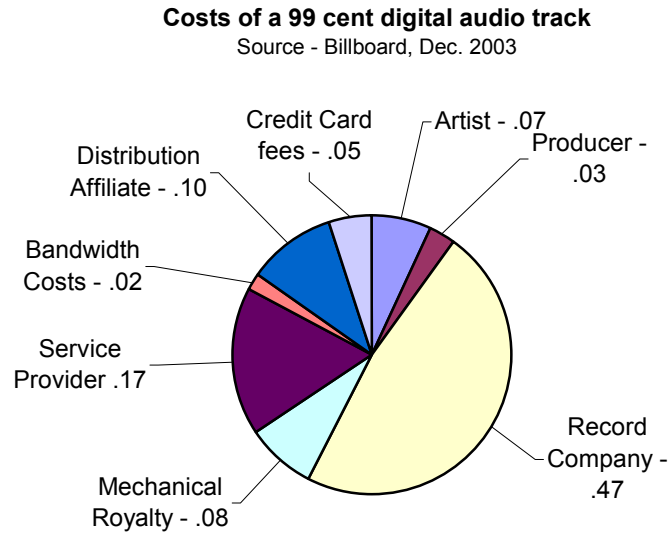
This brings us to an examination of the emerging business models for the coming digital platforms. The pre-eminent online service offerings are combinations of streaming and music track downloads. Streaming elements vary from free to subscription bundles some including a certain number of downloads. Straight streaming services that have been operating since the mid-90's work on subscription models. Those with interactive system capabilities will likely move to offer download services as well.

Stakeholder	Change elements in Digital Model	Outcome/Forecast
Retailer - Big Box	<ul style="list-style-type: none"> Maintaining stranglehold on CD retail while using brand (Wal-Mart, Best Buy) to move into digital distribution business 	<ul style="list-style-type: none"> Price cutting on digital download (Wal-mart undercuts iTunes, Rhapsody undercuts Wal-Mart)
Consumer Goods	<ul style="list-style-type: none"> Newest entrants into the music business Using brand clout to offer music as part of their customer experience 	<ul style="list-style-type: none"> Seeking partnerships with major labels and the Digital Doers Creating new product offerings (such as HP/Starbuck's see insert) Utilizing white label DSP's
Larger Labels	<ul style="list-style-type: none"> Managing change Consolidation in multi-nationals Defending copyright Adapting marketing and packaging to offer value Demand for catalogue Low margins high volume necessary 	<ul style="list-style-type: none"> Forging new partnerships Negotiating new digital business models New products (ringtones, games) for a new media channel Lawsuits and court battles Offering exclusive content Little money for artist development
Indie Labels	<ul style="list-style-type: none"> Need to gain access to digital distribution Pressures to defend copyright Need to improve marketing Low margins high volume necessary 	<ul style="list-style-type: none"> Opportunities to circumvent traditional channels by going "consumer direct" A levelling of the marketing and distribution "playing field" Seeking partnerships with other Indies Offering exclusive content
Digital Doers	<ul style="list-style-type: none"> Increased demand for music services of all descriptions Revenue models untenable for long term without significant growth of audience Pressures to differentiate service 	<ul style="list-style-type: none"> Negotiating new business models with music industry stakeholders Too many DSP's and streamers – struggle will be to distinguish services Using software to sell hardware (Apple model)

Distribution Entities	<ul style="list-style-type: none"> ▪ Anyone who has audience (ISP's, portals, broadcast outlets) will have to offer music services streaming and download 	<ul style="list-style-type: none"> ▪ Likely that bundling will occur – music with cable, music with cellular, music with satellite services, music with Internet, etc.
Publishers	<ul style="list-style-type: none"> ▪ Defending copyright ▪ Finding new outlets ▪ Managing changes 	<ul style="list-style-type: none"> ▪ Negotiating new business models with traditional and new entrant stakeholders ▪ Negotiating new royalty schedules
Artists	<ul style="list-style-type: none"> ▪ Big names in a different place than small names who are in a different place than “no names” ▪ Labels are increasingly selective and demanding on artist choices 	<ul style="list-style-type: none"> ▪ Makes increasing sense to maintain control over rights ▪ Propelled to digital marketing as a new and required channel
Consumer	<ul style="list-style-type: none"> ▪ Perplexed over status of p2p ▪ Acquiring new music consumption habits ▪ Potential for restricted choice in accessing Canadian content ▪ Emerging services and platforms 	<ul style="list-style-type: none"> ▪ Choices made on value – once provided with convenience and choice the only thing then is price ▪ Many services to choose from with very similar offerings ▪ CD will linger as a format though it may become increasingly custom in nature

As with the CD product business model before we have provided a cost breakdown based upon a 99 cent a digital download from a U.S. Source in the chart below. Interviewees for this study were very reluctant to share any information about the breakdown currently under discussion for use in Canada. One comment we heard about these negotiations was that the CMRRA is negotiating on a fixed price model (e.g. 10 cents per track per download regardless of the price point) while the other stakeholders are negotiating on a per cent basis (e.g. a given stakeholder share would be 15% of any price point). These negotiations have been very arduous and the subject of many remarks by study participants and attendees of the CMW.

Figure 7 –Revenue model for US digital download



FAD Research Inc., March 2004, with data from Billboard.

Your goal as an artist is to get into the hands of as many people as you can. You're making deals with tech companies with consumer brand companies, you do whatever you can to get things out there.

-Kelli Richards, Brainstorm Marketing (former executive at Apple Computer and EMI A&R)

Digital services will undergo accelerated feature revisions catering to consumer demands for increasingly personalized services. Canada is experiencing a little calm before the storm of entries from the U.S. Canadian services are struggling out of the gate and while they are fine for the moment as “the only games in town”, they will come under extreme pressure for Canadian market share the instant U.S services begin to operate locally. (For a detailed transaction analysis see [The Canadian Music Download Shopping Experience](#) appendix).

Any forecast of revenue for digital distribution at this point is pure conjecture. Estimates for the U.S. last year that included online CD sales had a 550% variance.⁵⁷

⁵⁷ Source eMarketer Spotlight Report: Digital Music, 2003, page 4

4.1.2.1 Déjà vu All Over Again... DSP's - ISP's All Over Again?

FAD Research, in the Fall of 2003, conducted extensive research to formulate the business cases associated with the Digital Service Providers of music. Through the course of our research on the *Changing Face of Music* Project we were able to further corroborate our previous analysis with new evidence and discussions with our interviewees. Everyone that we asked was in agreement with the idea that the current situation with a proliferation of streaming and download services is very much akin to the Internet Goldrush period in the mid-90's when many believed that there was money to be made in providing Internet connectivity alone. This proved to be a low margin and then a no margin business. It resulted in a radical consolidation of services. FAD Research predicts that similar events will occur amongst DSP's in the next few years with the many services contracting to a very few and becoming subject to commodity pricing.

MARCH 16, 2004

NEWS ANALYSIS

By Stanley Holmes

Starbucks Tunes In to Digital Music

A partnership with HP will see customers ordering songs-to-go with their java.

It already has the labels singing a happy tune

Here's a deal: Sip on a mocha latte while using headphones to listen to any of 250,000 songs you call up on a computer. Then order the ones you like -- burned on your own CD -- to go. Who's the dealer? Starbucks ([SBUX](#)).

On Mar. 16, the Seattle coffee giant unveiled an in-store music service allowing customers to do just that, using Hewlett-Packard ([HPQ](#)) tablet computers to make their choices. The first musical Starbucks opens in Santa Monica, Calif., and the service will expand into 2,500 stores over the next two years. "This is not a test," says Starbucks Chairman Howard Schultz. "We're going for it."

Known for taking innovative risks, this is Starbucks' boldest attempt to redefine "the Starbucks experience" since it pushed overseas in the mid '90s. Company execs say the effort is aimed at capitalizing on the forces revamping the music-retailing industry, where advances in digital-music technology push customers onto the Internet and traditional brick-and-mortar record stores struggle to survive.

"BIG IDEA." With 30 million weekly customers who go to Starbucks not just for its many beverages but also for its ability to create an attractive lifestyle brand around upscale coffee culture, execs think they see a huge market for selling music. "We have a unique opportunity to leverage the trust people have in the brand," Schultz says. And for the folks making the music? "The artists don't want to go to Wal-Mart ([WMT](#))," Schultz says.

While he won't discuss revenue projections, he sees the move as a "big idea" with "much bigger impact than we've had to date." The coffee chain already has licensing agreements with most of the major record labels that will give it the ability to offer everything from Britney Spears and The Polyphonic Spree to Yo-Yo Ma and Ray Charles.

If Schultz is right, the ramifications could be huge. Starbucks thinks the service will significantly add to its \$4.1 billion in annual revenue while enhancing its brand. For the music industry, still reeling from digital piracy and sharply declining sales of CDs, Starbucks could make shopping for music both legit and fun again.

Figure 8 Technology Meets Consumer Brand

4.1.3 Summing Up Digital Music Related Business Models

New digital services and their business models are emerging weekly. They are as diverse as the approaching infinite manifestations of digital media itself. There are ringtone services being offered by partnerships with cellular companies and the likes of MuchMusic. Microsoft will be offering a service that rents music catalogue to users by the month. Hewlett-Packard has their partnership with Starbuck's for custom CD's (see sidebar below). Pre-loaded portable digital media players, are being considered. The music market is opening up to new possibilities and it remains to be seen just how consumers will engage.

It is a near impossible task to offer a complete summary of business models for digital music beyond what we have mentioned here. There are several things that any business model delivering music product to consumers will have in common.

- A number of partnerships to secure music inventory, distribution, administration of transactions and royalties, marketing, access to audience
- A service offering that represents value to the consumer
- A revenue model that makes sense to all partner participants

Currently there are significant challenges within each of these elements.

The record company executives that we spoke with see the multi-year decline in revenues and the layoffs and know that it will be some time before things improve. They are actively exploring new product offerings based on diversifying their business model away from the one that has vanished for CD. Attaining multiple incremental sources of revenue becomes the operative strategy.

Those we spoke with that are close to the new models associated with the track download business know that it will be some time before the model can be demonstrated to work. It will be likely 3+ years before this becomes a significant revenue stream that is profitable beyond its costs of marketing, costs of transmission, costs of transaction, and costs of royalties (rates having yet to be determined). This means that Canadian purveyors of streaming and particularly download must have very deep pockets to endure the looming marketing wars from U.S. services and to await the development of market.

The size of the current download business need be put in some kind of perspective. If the Canadian download services managed to serve approximately 1,250,000 paid tracks (which we believe to be exaggerated) from their launch dates until February 2004, this would amount to something approaching \$1.75 million in revenue. Canadian record labels, selling the old *threatened*⁵⁸ CD platform during the same period did \$290.5 million in business⁵⁹. Profit is entirely another matter of course but it is entirely reasonable to assume that the download business is not making money while the CD business is making a great deal less than it was.

⁵⁸ The dollar value of album sales has declined 24% since 1998. See [Album Revenue](#)

⁵⁹ Source <http://www.cria.ca/indstats/indstats0104.htm>

The current business models are not working well, if at all. This propels the forces of change and translates to rather a chaotic state of affairs. Industry participants seem confident it will work out but many of them are wondering aloud whether all the pain will result in a timely and profitable return to stability in business conditions.

4.2 The Regulatory Regime Revenue Models

In Canada the collection of [tariffs and mechanicals](#) falls to the collective rights organizations such as SOCAN, SODRAC and the CMRRA. These are the monies collected associated with performance and reproduction rights of composers and music publishers. Literally from granting the *copying* rights.

New distribution methods (download, streaming, ringtones, custom CD) have introduced opportunities for re-structuring the payment/reward models of the past and for creating new schedules. Some stakeholder groups may be seen as attempting to address perceived inequalities in previous arrangements as they were applied in traditional (CD/Broadcast) models.

The other kind of payment that the regulatory regime is set-up to address is that of *private copying* as administered through the Canadian Private Copying Collective (CPC). Originally created in 1999 this group represents authors, publishers, recording artists and record companies. Digital technologies and their ease of use have created situations where there are obvious and pervasive violations of copyright occurring. P2P file sharing and extensive copying through *burning* CD's have resulted in an indisputable loss of potential revenue.

Canadian copyright law has laid out through the Canadian Copyright Act provisions for payments due copyright holders. In an attempt to address the new digital media business models and the infringement of copyright through illicit file use there are two separate sets of negotiations amongst stakeholders occurring at the moment.

The first set of negotiations are associated with an attempt to arrive at new reward schedules related to legitimate digital business models such as the one illustrated in (Figure 2) the U.S. digital download reward schedule above. Canadian negotiations have been going on for at least two years. Currently there is an agreement to reach an agreement but no time schedule as to when this may occur. This creates uncertainty in the marketplace for investors in digital media enterprises and is an unhealthy state for Canadian business to be in. It has seriously delayed the entry of all foreign owned services and delayed the start-up of Canadian ones.

Presumably if you're good enough to be paid you should be able to try and make a living at making music. I can't think of any other job... do you expect a plumber to come into your house and install a toilet and not get paid just because he loves his job?

Blair Packham, independent artist

The second set of discussions are an attempt to arrive at workable framework for awarding compensation to those groups represented by the CPCC. The groups most hurt by digitally facilitated copyright infringement. There already exist schedules associated with levies on recording media of various kinds. Consumers pay a current levy of 29 cents on an audio tape and 21 cents on a blank CD-R disc. There is currently also a \$25 levy on portable devices like the iPod sold at retail. These tariffs are intended to create pools of capital that are subsequently divvied up to the impacted parties in the music industry. Naturally there is opposition to this way of doing things from more than consumers⁶⁰. Retailers and hardware manufacturers do not like this approach as it adds directly to their retail prices on storage media and digital music players. We noticed at the CMW that those in favour call the charge a “levy”, while those opposed call it a “tax”.

The levy/tax is problematic in that it is quite abstract. It is based largely on quantifying the not quantifiable (How many illicit copies have been made?) and inadvertently *taxing* those groups like those who may use CDR's but for data backup, not music copying⁶¹.

The customer isn't always right. Sometimes the customer is a shoplifter.

-Rik Emmett, artist

We heard a great deal of discussion at Canadian Music Week about various ways of simplifying micro-payment structures for legitimate digital music service and addressing lost revenue from illicit copying. One of the major alternative methods towards creating a revenue stream for the music industry revolves around creating a sizeable pool of capital by imposing a levy/tax on carriers of Internet services. Needless to say, most ISP's are not keen on this proposal. The thinking is that this scheme would convert media into a utility service with the revenue models administered either be the government or industry depending upon who's scheme you are listening to⁶². One of our interviewees, Philippe Le Roux of VDL2 in Montreal, believes that if such a utility scheme were implemented it would be like granting a license to p2p file sharing. People would feel no compunction to use legal download services if they felt that they were already paying a “tax” on media. One of our artists we interviewed felt that such a “levy” was perfectly justified in that the ISP's are building their customer base by counselling file sharing as part of their marketing activities to promote broadband use.

These are immensely complicated negotiations. The first set are confined to Canada with international business implications. The second set around creating pools of capital are international in scope and stand to be affected going forward by court challenges related to the defence of copyright against illicit copying and a number of other mechanisms. Reaching an agreement on either or both of these issues is a

⁶⁰ <http://www.ccfda.ca/> Canadian Coalition for Fair Digital Access

⁶¹ In fairness, it bears mentioning that there is a provision called “zero-rating” which exempts certain enterprises from the levy. But it places an administrative burden on the majority of payees that they are unlikely to endure.

⁶² L'ADISQ in Quebec is promoting a “3% solution” as one of our interviewees put it. They are rumoured to have buy-in from Videotron on the idea and if the CRTC actually approved it would constitute a very unique global test case for the idea of “media as a utility”. One “brief” we encountered from another source on a rationale for a similar payment model was 94 pages long.

problem but not reaching an agreement of some kind is a much bigger one. With two failing business models in play the music industry must arrive at alternatives to the way things are being done at present.

5 Funding Assistance to e-Music Initiatives

FAD Research was asked as a part of this study to look into funding initiatives that could potentially provide assistance to digital music initiatives. In each of our interviews where it made sense, we asked our subjects to comment on their knowledge of currently available programs and whether they had any suggestions for improvement. Specific to funding we interviewed the program team at the Ontario Media Development Corporation in Toronto and the head of the Music Entrepreneurs Program at Telefilm Canada in Montreal. FAD Research has extensive experience in both formulating funding criteria and administering new media business funding assistance applications for the likes of Telefilm, the Bell New Media Fund, Sasktel New Media Fund, the Canadian Heritage New Media Research Networks fund, and CANARIE.

The short answer is that there is little public funding available specifically singled out for e-Music activities. There are a couple of limited new media content funds that could certainly be tailored to new media projects that include a music industry component. But these are chronically under funded when examined in terms of the demand by all manner of new media content projects. The Music Entrepreneurs Program (MEP) has to date had more funding for its one program than all of the new media content funds we are currently aware of, combined in Canada, be they publicly or privately funded.⁶³

In the course of our interviews we discovered that all program participants we spoke to were quite satisfied with the public programs that they described. Naturally there was an expressed interest in that the funding levels should be renewed, maintained and increased. The FACTOR (<http://www.factor.ca/>) program was repeatedly cited first as having key impact to the health of Canadian music initiatives. There were a couple of comments concerning administrative overhead associated with applications for all types of funds but these concerns were not pronounced.

We found the MEP initiative administered under the Canada Music Fund to be particularly forward looking and considerate of the elements necessary to create successful e-music businesses. It was quite intriguing to discover the level of partnership that the fund actually engages in with the participants. In our assessment it looks to us that the MEP is doing many things right in assuring that their investments are a success. We discussed the MEP with both successful applicants and those who had been turned down. We would hope that in future that the MEP be allowed to partner with not only Canadian music interests but also Canadian technology businesses attempting to serve the music industry's evolving e-business activities.

There is no bank that will finance innovation for the music industry. Further there is some requirement for marketing support for labels promoting Canadian artists to

⁶³ It is noteworthy that all traditional media have business models that are not predisposed to research and development and appreciating the impact of changing technologies. It is a study in the culture of the speed of decision making in different business sectors that describes how change occurs. One way to accelerate the consideration of change is to provide incentives for companies to do so.

Canadian audiences through digital means. A policy decision will likely have to be made soon about support in the marketing initiatives of Puretracks and Archambault. As U.S. branded download services enter, and as Canadian consumer brands launch music services utilizing “white label” back-ends both domestic and imported, decisions will have to be made on whether (and how) to support Canadian music industry efforts to get in front of their audiences. We would extend the consideration to include initiatives constructed both for the domestic marketplace and to the far more lucrative export market.

There will be likely no more new Canadian owned, music distribution services that provide their own catalogue, back-end, and billing. Uncertainties in the marketplace (some associated with copyright protections) and increased competition will marginalize investment. It would make no sense from an investor's point of view to back a Canadian service unless it had some value proposition towards export.

There are many opportunities to promote Canadian talent and to provide innovation in the digital world of music services by Canadian companies. Some of this activity for the music business is occurring in small Canadian owned interests, in small labels and technology firms. Consideration should be made to support these initiatives through programs that provide:

- seed capital
- business acumen
- technology development assistance
- marketing and export support
- support for music production
- support for knowledge exchange
- encouragement for partnerships between stakeholders

Tax credits (labour, investment and R & D) have been utilized successfully to develop digital media products and entire clusters (Montreal is the most noteworthy⁶⁴). Development and promotion of these kinds of initiatives should be constantly considered. These arrangements, where public and private interests combine resources, are the most promising arrangements for developing new e-music enterprises.

We have included a short compendium of provincially based initiatives for the music industry for reference. Some of these programs include elements that both directly and indirectly could be seen as supporting e-music initiatives. (see [Provincial Sound Recording Government Assistance Programs](#))

⁶⁴ Throughout the middle to late 90's Quebec supported a number of economic development initiatives in the form of various development funds and tax credits. These were focused on stimulating growth in the technology sector and have created a vital cluster, where none existed before, where new businesses have started and multinational companies have chosen to locate themselves.

6 Summary

New partnerships are forming and proliferating. Old partnerships are being reworked, some of them painstakingly, as the new channel is being used to redefine legacy relationships. Technology is emerging. All participants (including music consumers) are busy determining what constitutes value. Only time will tell but it will be settled based upon convenience, choice, user control resulting in a price that consumers consider fair. Revenue models for both retail CD product and download services are not working for all participants. This is a part of the glimpse of “Wonderland” we encountered through the project. At present this amounts to a disconnect for the music industry and it will continue to strain and promote change for the music industry for the foreseeable future.

There are a couple of areas where there is government involvement that need urgent attention, if the Canadian music industry is going progress, resulting directly from change due to the proliferation of digital technologies. Call them *unstated* policy objectives perhaps. They must be addressed because they affect the whole timbre of the industry and how it relates to Canadian society. These areas are centred on copyright and its protection. The concerns over 1) piracy and the rule of law related to theft of intellectual property and 2) fair and equitable arrangements for remuneration to music industry stakeholders. These *Grand* issues as discussed earlier in the report (see - [Copyright](#)) impact all other considerations and without their resolution, very little and inadequate progress will be made either in the enabling of music culture or in developing associated businesses.

Part of the discussion we did not include earlier relates to a theme that cropped up in our interviews and investigation of the notion of the “theft” of intellectual property. Put in the words of Ted Cohen from EMI it is the concept of establishing another type of DRM, a Digital Rights *Morality*. This would be in cultivating a societal appreciation both in sentiment and in law that intellectual property has value and that those that create deserve to be acknowledged appropriately⁶⁵.

⁶⁵ Susan Crean wrote a March 17th, 2004 letter in the Globe & Mail that spoke to this morality issue and the diversity of opinion that exists within the musicians community.

6.1 Possibilities for Action Related to Stated Policy Objectives

Policy Objective 1: “To enhance Canadians’ access to diverse Canadian music through existing and emerging media”

Policy Considerations	Possible Action
<p>Dynamics in current music industry business models have led to a preponderance of Chart/Pop product and marketing emphasis, less exposure and restricted market access for Canadian content of all genres.</p>	<ul style="list-style-type: none"> ▪ Perhaps consider a strategy of market development in addition to product development. Raise awareness for Canadian product generally and cultivate audiences. This would support supply and demand as well.
<p>Disposition of the product offerings of foreign distribution entities. Will they give any prominence to Canadian content? They will be entering the market very soon and their effect will be profound⁶⁶. “Marketing is 95% of online business.”</p>	<ul style="list-style-type: none"> ▪ Formalize a position on the support of Canadian owned distribution services. ▪ Regulation of content of foreign services is not likely an option. ▪ Consider supporting <i>any</i> service that promotes Canadian music to Canadians. This would include <i>new</i> and diverse music as well.
<p>Many Canadian music enterprises are utilizing digital technology. Canadian technology firms are discovering new products and services to serve the music industry.</p>	<ul style="list-style-type: none"> ▪ Consider furthering a co-ordinated approach to content/technology policy. ▪ Make requisite marketing plans that include an online media component as a requirement for certain funding programs

⁶⁶ Streaming media services from foreign sources will begin the dismantling of Canada’s broadcast regime. The consumer is presented with choices and they will choose what they value. Music services and Internet radio are a harbinger of change to the whole Canadian regulatory environment.

Policy Objective 2: “To increase opportunities available for Canadian music artists and entrepreneurs to make significant and lasting contribution to Canadian cultural expression.”

Policy Considerations	Possible Action
Key to attaining this objective is engaging capital to back cultural and technological enterprises. Part of this equation is certainly to engage private capital to a significant degree.	<ul style="list-style-type: none"> ▪ Continue and promote the successes of public/private fund partnerships ▪ Examine new possibilities to provide incentives for private capital to engage
Some music initiatives relate to very niche markets and musical interests but they are worthy of support.	<ul style="list-style-type: none"> ▪ Make sure that smaller interests can access the expertise necessary to market and distribute to niche markets ▪ Support marketing collectives
Realize that markets for culture are truly global in nature. Canadians have the music, the talent for communications, and the technological means to go global.	<ul style="list-style-type: none"> ▪ Support export sensibility. Think of Canadian music as the marketing equivalent of an Indie label.

Policy Objective 3: “To ensure that Canadian music artists and entrepreneurs have the skills and means to succeed in a global and digital environment.”

Policy Considerations	Possible Action
To develop skills you need projects. To develop projects you need capital and partnerships.	<ul style="list-style-type: none"> ▪ Ensure that there are incentives in place to engage capital for content and technology projects. Secure a framework where digital media for promotion and distribution can thrive ▪ Assure some pool of capital for projects with difficulty in attracting private capital
There are a number of regional markets that “succeed” to varying degrees but the greater opportunities are global in nature.	<ul style="list-style-type: none"> ▪ Support marketing with an export orientation
To succeed globally, market intelligence is needed.	<ul style="list-style-type: none"> ▪ Support market intelligence projects that benefit music trade groups
There is a need for research into the Canadian marketplace for digital media.	<ul style="list-style-type: none"> ▪ Support behavioural research into how Canadians use the Internet and media generally.

“World markets want Much’s content not because it looks American but because it’s *not* American.”

Roma Khanna, VP CHUM-TV

7 Conclusion

"I've never seen a space change more quickly. This business is astonishing in the way it's migrating. It's not necessarily on any game plan or master plan, a lot of the time it feels like it's being made up as it goes along and that the ultimate business model is not determined or settled in the marketplace."

- John Jones, VP Business Development, Musicnet

Change precipitated by digital technologies and an evolution of consumer consumption habits will continue to be persistent and have profound implications for the future of all media in Canada. Music will appear to become a pervasive commodity for consumers. It will be available everywhere through increasingly portable and invisible technologies. Business models will evolve into extensive partnerships that will include consumer brands and where music industry stakeholders take an increasingly smaller portion of many more transactional arrangements.

Paramount will be catering to consumer demand as, "It is now the audience that is becoming more important", as Roma Khanna of CHUM-TV put it. This situation has been brought about through the introduction of choices in how consumers choose to engage music. With digital distribution both the package and the places it is acquired have been changed forever. With digital marketing the determining factor in sales will be to draw audience to product and those already commanding other consumer consumption experiences are poised to enter the music business. A classic case of digital disintermediation where the degree that traditional middle men get written out of the revenue equation is directly dependent on their adaptability to new market conditions.

Near term there are some much needed legal clarifications regarding copyright law that have to be made. The industry has significant "Hearts and Minds" issues with consumers around education related to file sharing. There are some delicate negotiations to occur and settle around revenue models. And there are new developments in digital music distribution, digital marketing of music and the business of music almost every other day. All of these things will shape the long term outlook for the music business in Canada. It will likely be unsettled for some time.

With all of these forces effecting changes it is a matter of "when" they will occur not "if". The industry is in the midst of them occurring. Where there are challenges there are opportunities for those with imagination. This is a bit of a cliché in the new media business but it has never been truer particularly with something so important to life with media as Music. There is a great deal at stake and this merely fuels the fires of change. It is a great time to be a music consumer. For the other stakeholders in the music industry these amount to increasingly "interesting times".

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About the Author

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Appendices

1 List of Interviewees

Interviewees

FAD Research wishes to thank all of the study participants who were very generous with their time, their views, and their referrals.

Ric Arboit	President	Nettwerk Productions	Vancouver
Ted Boyd	President	Iceberg Media	Toronto
Rob Brooks	VP Marketing	EMI Music Canada	Toronto
Brian Chater	President	CIRPA	Toronto
Alan Chumley	Associate Director	Bell Canada	Toronto
Ted Cohen	VP	EMI	Hollywood, CA
Rik Emmett	Artist	Artist	Toronto
Earl Ferns	President	Desi Records	Toronto
Terry Flood	VP	Le Groupe DKD	Montreal
Laura Goldberg	Senior VP	Napster	New York, NY
Wojtec Hoch	CTO	Musicrypt	Toronto
John Jones	VP	Musicnet	New York, NY
Roma Khanna	VP	CHUM -TV	Toronto
Philippe Le Roux	Associé	V(DL)2 Inc.	Montreal
Andy Maize	Artist/Principal	Maple Music	Toronto
Duncan McKie	President	Pollara	Toronto
Patrick McLean	Director	Bell Canada	Toronto
Norman Miller	VP	BMG Canada	Toronto
Alistair Mitchell	CEO	Puretracks/Moontaxi	Toronto
Kristine Murphy	COO	OMDC	Toronto
Blair Packham	Artist	Blair Music	Toronto
Brian Robertson	President	CRIA	Toronto
Len Pendergast	Director	OMDC	Toronto
Willi Powell	Strategic Development Mgr	Apple Computer	Toronto
Kelli Richards	President	Brainstorm Marketing	Cupertino, CA
Shelley Stein-Sacks	Director, MEP	Telefilm Canada	Montreal
Olivier Trudeau	President	eWorldmusic	Montreal
Jennifer Walsh	National Marketing Mgr	EMI Music Canada	Toronto

Thanks to:

Catherine Allison	Consultant	The Mercury Group	Ottawa
Susanna Cluff-Clyburne	Director Gov't Relations	Bell Canada	Ottawa
Peter Diemer	VP	Musicrypt	Vancouver
William W. Fisher	Professor	Harvard Law School	Cambridge, MA
Nancy Lyzaniwski	Senior Policy Analyst	OMDC	Toronto
Donna Murphy	Government Relations	CIRPA	Toronto
Michael O'Brien	Artist/Member	NARAS	Albuquerque, NM
Annie Provencher	Regulatory Affairs	L'ADISQ	Montreal
Paul Spurgeon	Lead Counsel	SOCAN	Toronto
Mary Vrantsidis	Int'l Trade Shows	CIRPA	Toronto

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FAD Research contacted a number of additional organizations that we had hoped could participate in this study. These included the CMRRA (Canadian Musical Rights Reproduction Agency), Archambault Music, Galaxie and Rogers' Media. Unfortunately we were unable to schedule their participation within our allotted timeframe.

Finally FAD Research would like to thank Lynn Buffone and the support of the Sound Recording Policy and Programs Directorate at the Department of Canadian Heritage whose support and guidance made this study possible

NOTE:

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