

MP3s: It's Time to Join 'Em

New business models are the way of the sonic future

By Derrek S. Lennox

It's an understatement to say the music industry is concerned about the MP3 phenomenon. Software tools such as Napster and consumer devices such as CD burners and MP3 players enable anyone to buy a CD, create MP3 files and give them away over the Internet. To defend their territory, record labels have filed lawsuits to combat the viral momentum of MP3 file sharing, but successful litigation against MP3.com and ongoing litigation against Napster haven't stopped it yet. Labels also are suing the manufacturers of MP3 players, which, in certain instances – such as Sony – pit one hand (Sony Records) against the other (Sony Electronics).

In the long run, the armies of lawyers for recording labels and the Recording Industry Association of America (RIAA) won't be able to prevent the spread of MP3s. Instead of waging a fruitless battle, labels should adopt the technology and develop new business models to capitalize on it. Consumers must be convinced that it is easier and “cooler” to buy music than it is to pirate it. The traditional model, the MP3.com model, and the EMusic.com model hold the germ of a new model.

Broken record

Traditionally, an artist signs with a record to make one or more sets of recordings, with contingencies for singles. The label pays for recording; sound mastering; manufacturing the CDs, records, or tapes; and marketing. It sells the music product to distributors. They, in turn, sell to record stores, who sell to the consumer. The music store offers the consumer selection, convenience, and some genre classification. The distributor offers a single channel through which stores get products. The record labels create value by finding and promoting the talent, and—with the help of agents—finding other channels (such as concerts) to increase exposure and profits. The consumer provides research (finding songs he or she likes), word-of-mouth promotion (telling others), and self-delivery (hand-picking a product from a store). Record stores recently have added Internet ordering, which transfers product delivery from the consumer to the post office, and in-store music kiosks, which assist the consumer in finding more to buy.

MP3.com and others are changing the model. Here, artists produce and pay for recording, sound mastering, and converting to an MP3 file, then post their work on MP3.com; consumers can download MP3 files or buy CDs. The consumer – assisted by MP3.com tools – can find new music she likes and obtain it directly from home. MP3.com pays the artist a royalty for CDs sold and for songs played and downloaded through a “payback for playback” option. Custom CDs can be tailor-made and mailed to the customer, as in EZCD.com's model. Value is in the “buy from home” experience, the ease of access to new music, and the ability to listen at home before buying.

The EMusic.com model allows consumers to buy song files in MP3 format. They can search a well-classified selection of products sorted by artist, labels and genre.

Problems with the MP3.com, EMusic, and EZCD models include cumbersome research processes that can lead to hours of unproductive listening. MP3.com and EZCD have perhaps too many obscure artists. EMusic has more recognizable talent, but tends to overstock choices from much older albums no longer in production.

How it plays

In the next model, the artist – possibly in conjunction with an agent – will pay to record and master demo songs and independent releases, then distribute them through MP3.com-like storefronts in CD and electronic file formats. Consumers will pay for CDs or buy electronic music files by the song or via monthly subscriptions.

Artists will earn royalties on CDs bought, songs listened to, and songs bought and downloaded. Smaller, independent artists would be better able to make a profit. Some artists could use this model to attract attention and representation from a traditional record label. The demo tape could become obsolete as artists send MP3 mini-CDs or email Web links to agents and producers.

Once an artist signed with a record label, the label will provide promotion, bundling, archiving, mastering, recording, radio airtime and perks – just as they do now. They will license the rights to distribute music through CDs, custom products, and electronically to the Internet and retail companies. The label will provide genre classifications by the song, rather than by the artist. Cross-genre listing also will be available.

The customer will obtain music several ways. At a retail store, she can buy a selection of pre-made CDs, create custom CDs, buy music files, and buy devices to store the music files. She could also do these online. Stores and related Internet sites will keep her profile, knowledgeable salespeople can give her song recommendations based on her past enjoyment patterns. When she hears a cool song, she will use a handheld device to buy the song as either a file or as an email attachment. Listeners also will have the option to add the song to a custom CD list. Music suggestions will be made via kiosk by analyzing song samples – the computer will provide a list of similar sounding songs based on the construction of the music, not just on a list of genres. Order statistics and pop-chart standing for each song will help her make choices.

Radio stations will still assist impulse buying. A listener will use his PDA or computer to look up the current playlist on a radio station's Website. From there, he will have the choice of buying the song, adding it to a custom CD song list, or purchasing a ready-made CD featuring the artist, the disc jockey, or the genre of music.

The logo for dsics, featuring the lowercase letters 'dsics' in a white, serif font against a yellow-to-orange gradient background.

Derrek S. Lennox Consulting Services

Helping medium-sized companies
grow and compete

Popularity will determine the price. Song prices will tend to be higher when recordings are first release, and will drop as its popularity drops. When nostalgia or a movie soundtrack reignites interest in the song, its price will briefly rise again. A song can have an indefinite life – with perpetual sales ensuring that the artist gets perpetual royalties.

As mass-produced CDs give way to custom CDs and to music file storage and play devices, inventory requirement at each store decreases. When stores sell music files both online and from a physical location, selection can be unlimited. As production and transportation costs fall, the need to bundle bad or boring songs with popular songs will disappear. As customization increases, so does value to the customer, so the occurrence of piracy and the need for over-litigation will diminish.

As with all industries facing the Internet revolution, the companies that will survive will be the ones that provide value. That's just good business.

Derrek S. Lennox is a strategy consultant with Digital 4sight, an e-business research and strategy firm.