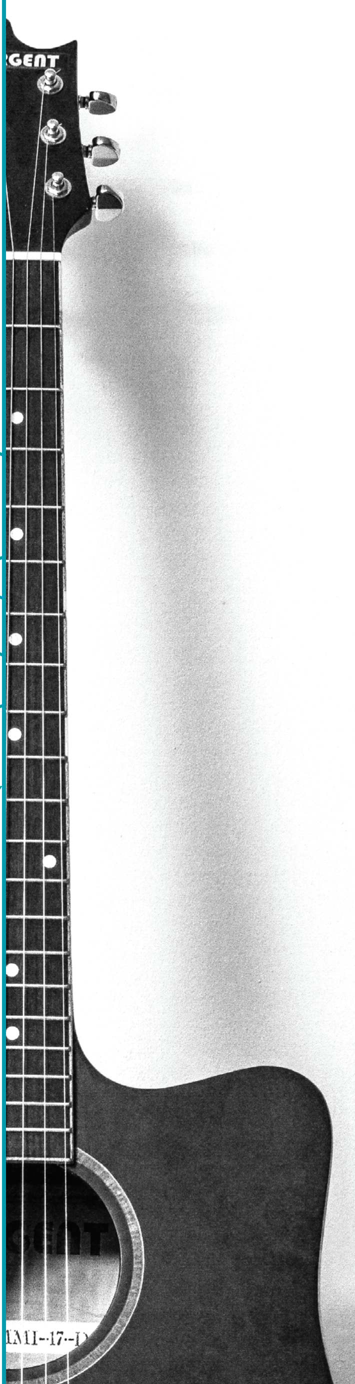
KANTAR FUTURES

FUTURE PERSPECTIVE

MUSIC LESSONS

FOUR THINGS BRANDS CAN LEARN FROM THE DIGITAL DISRUPTION OF THE MUSIC INDUSTRY



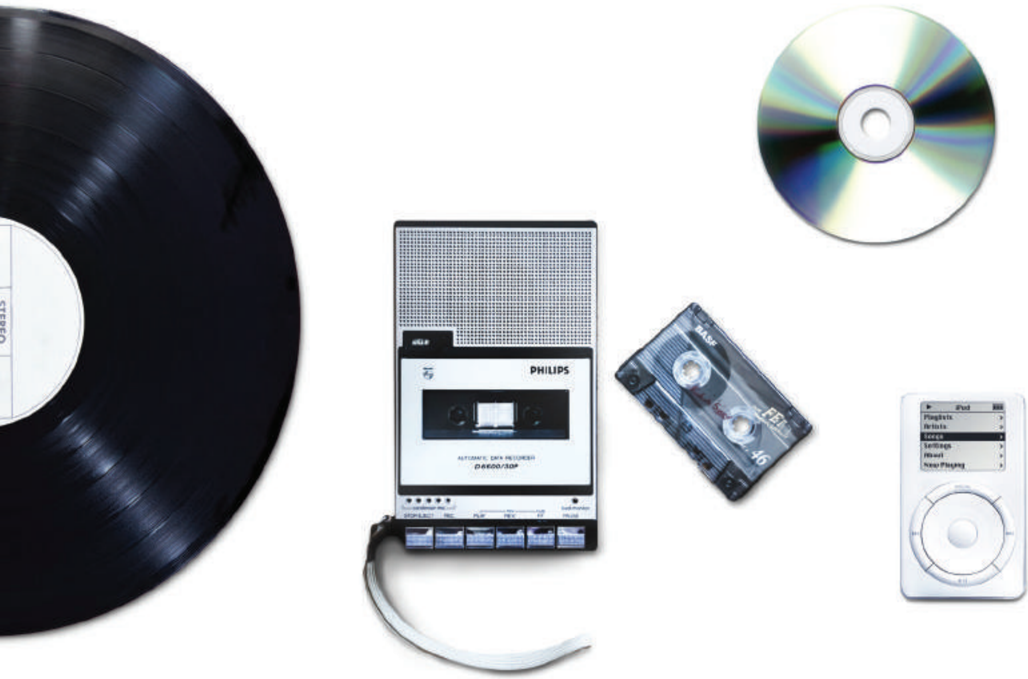
Future Perspectives are thought pieces with concise, focused insights into important issues of interest to marketing and business strategists.

MUSIC LESSONS

The digital disruption of the music industry is largely misunderstood.[1] It has been widely touted as the toppling of major labels by digital insurgents, yet major labels remain at the center of the industry. What digital has done is different, and much more radical. It is the **transformation of music from a product into a service**.

This is happening in all industries, not just music. From food to fashion, digital technologies are enabling challengers to contest incumbents with new business models that bypass the centrality of a product in creating value and growth. What's happening in music offers guidance for every category.

This Future Perspective will discuss how digital has changed the music industry and then outline four critical lessons learned about how to succeed in a marketplace transformed by digital disruption. In particular, the experience of the music industry makes it clear that **success in the future of consumption will require new business models**, not just new products.



THE WANING OF MUSIC AS A PRODUCT

The Third Age of Consumption is at hand. As discussed in our work on the future of consumption, the era now unfolding will be one in which cognitive, economic and resource capacities will no longer permit brands to realize value and growth in the same old ways. Business models based on accumulation, possession and ownership will give way to new models rooted in experiences, relationships and algorithms. This is exactly what digital disruption has meant for the music industry, making music a bellwether for the future of the marketplace as a whole.

From its earliest days, the recorded music industry revolved around a product. Originally, this was sheet music and cylinders. In recent decades, it was records, then CDs, and eventually downloads. The product format changed over time but the economics of the industry was always tied to selling a product.

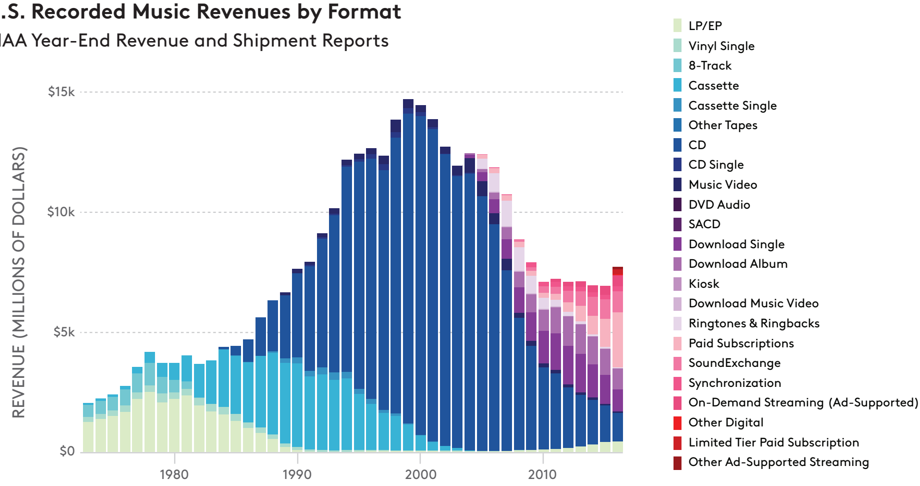
Major label companies dominated this product-centric ecosystem. As is true of any product sold at scale, sizable financial resources were required to develop, record, produce, distribute and market the product. Only labels could afford the necessary investments. Labels had a vested interest in limiting the number of artists to increase scale and profitability through higher prices to consumers.

Napster dealt the first digital blow to this product-centric ecosystem by enabling people to freely share their music libraries. Consumers no longer had to buy or own a music product in order to listen. Major labels took legal action to shutter Napster and other file-sharing services, even prosecuting their own customers. But the impact of file-sharing services could not be outlawed. As seen in Recording Industry Association of America figures, U.S. recorded music revenues peaked in 1999, the year Napster launched.[2]

FIGURE 1

U.S. Recorded Music Revenues by Format

RIAA Year-End Revenue and Shipment Reports



Confused markets create opportunities. Steve Jobs seized these opportunities with the introduction of iTunes and the iPod in 2001, followed by the iTunes Store and the 99-cent download in 2003. But even downloads have been unable to check the decline of music product sales. Nevertheless, Apple's innovation created the institutional innovation of a legal digital market that changed expectations and laid the groundwork for the transformative digital disruption that followed.

THE WAXING OF MUSIC AS A SERVICE

Global recorded music revenues tracked by the International Federation of the Phonographic Industry show physical product revenues down 4.5 percent in 2015 versus 2014, and download revenues down 10.5 percent. But global recorded music revenue in total was up 3.2 percent. This is because streaming was up by 45.2 percent, more than enough to offset declines in music products. In the U.S., the number of streams almost doubled during this period, growing 93 percent.[3]

Streaming is the engine of growth for recorded music, but streaming is not another music product. **Instead, it is a different business model built on service not product, one that uses digital technologies to sell music as a service**. Streaming provides end-users access without ownership. Just as music products created an ecosystem of value tied to products, music as a service is also creating a new ecosystem of value for the music industry, much of it outside of recorded music per se.

A service-based business model enables consumers to access benefits without owning a product. This is not to say that there are no physical assets, only that the benefits provided by these assets for end-users are enjoyed as a service to use rather than as a product to own. In particular, benefits are available on demand. Pricing can be per use or by subscription.

Service-based offerings are not new, but digital technologies have made it possible for such offerings to make inroads into categories that have long been exclusively product-centric.

The two biggest streaming services or platforms are Pandora, launched in 2005, and Spotify, launched in 2008. Pandora provides a personalized radio service. Spotify provides a catalog of music. Both operate on demand

without requiring ownership. Both also employ algorithms to customize playlists and recommendations.

The biggest impact of streaming has been economic. By decoupling listening to music from owning a music product, **the artificial scarcity that labels were able to enforce in a product-centric music ecosystem has been all but eliminated**. More music is now available, and it turns out that consumers like genres and types of music as much as individual artists. If a particular artist's music is not available, consumers are often indifferent to substitution and will happily listen to something similar instead. This has driven down revenues to labels and payments to artists.

As one industry observer has noted, the music industry now has a "payout structure [that] best reflects the 'value' of music in an era of abundant supply," which is to say that " [a]ny song 'hired' to entertain is 'worth' the same as another."[4] Consumers benefit from greater selection and lower prices. But the lost revenue for labels and artists is forcing them to find new models for value and growth.

Digital also has a disruptive effect because often **it lowers traditional barriers to entry**, thus weakening—if not eliminating altogether—the monopoly power of incumbents. The playing field is leveled for new competitors. But barriers to entry don't go away as a force in the marketplace. Once digital challengers are established, they **create new barriers to entry that punish flat-footed incumbents**. This transformation of competitive advantage means that value and growth must be found in new models. Digital disruption puts established companies at a disadvantage twice over, relative both to current ways of doing business and to new ways.

RECONFIGURING THE VALUE CHAIN

Economist John Kay published an influential essay in 1997 about the structure and economics of the media industry.[5] At the time, the received wisdom was that the internet would benefit only large players. Kay argued that this view was based on a misreading of how media markets are structured to create and deliver content.

Kay explained that media markets consist of three parts, each involving different skills, as shown in Figure 2. Talent creates content. Publishers package content into products, find audiences and often underwrite content development. Distribution and retail deliver the product to the audience. Risk is highest at the early stages, while delivery tends to involve the most infrastructure and capital.

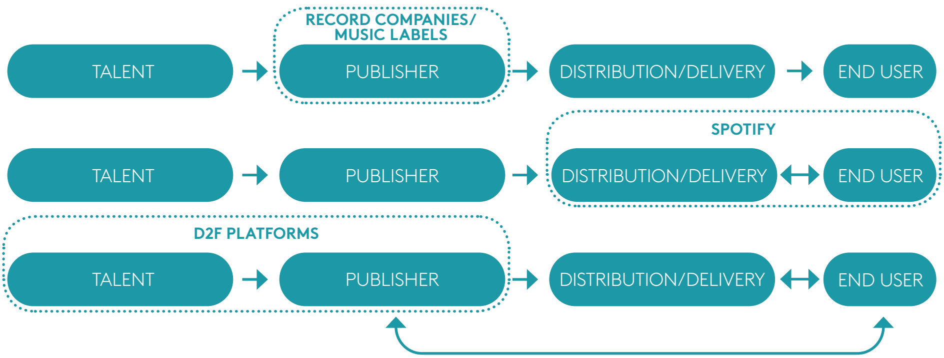
There will always be large companies with cross-media and international capabilities, but Kay argued that the internet would open up opportunities for smaller players whose strengths are based on understanding customers and products in particular niches. **Much of what's new about digital does not reward the traditional centers of power in the marketplace**.

For example, digital has made it possible for artists to connect directly to fans, and sell to them, via direct-to-fan (D2F) platforms. This allows talent to replicate the publishing function and capture that value, while leaving delivery to the internet. It also enables artists to harvest value in other ways besides just selling recorded music. **This reliance on a diversity of new sources of revenue is a key effect of the digital disruption of the traditional value chain**.

Without artificial scarcity, music products no longer command a premium price. So digital has forced artists to look for fresh revenue streams, many of which do not involve digital products or delivery. These revenue streams

FIGURE 2

John Kay Model of Media Markets

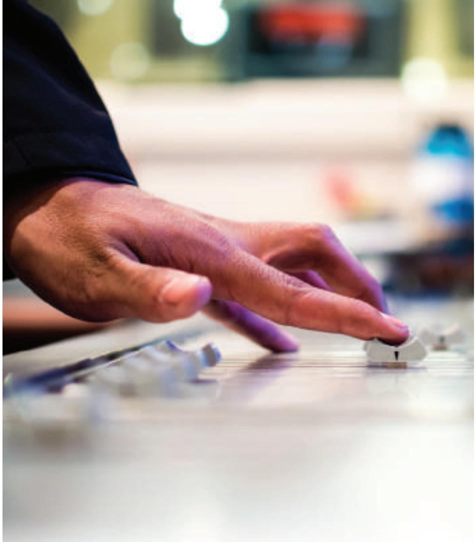


are not available to incumbent players like major labels that continue to rely on traditional business models.

Digital re-channels the flow of industry revenues. Unless incumbents give up old ways of operating, new sources of value and growth will elude them because the new flow of revenue streams does not renew existing streams or automatically redirect new streams to incumbents. In music, much of the innovation and new ways of doing business are being fashioned by artists and platforms, not by labels. So future growth will accrue to the benefit of different players in the music industry ecosystem.

What brands need to learn from this is that **the new sources of value and growth created by digital disruption will bypass existing business models**. Consumers can get the benefits they want in new ways, and the old ways aren't coming back. The momentum of digital is too powerful for labels to resist, so they must go along, even though doing so makes their existing ways of realizing value and growth less valuable and often obsolete. If incumbent brands want to be players in the future, they have to do business in different ways.

Kay was writing before the development of digital streaming platforms like Spotify or Pandora, but the same structural dynamics are at work. Platforms are a constructed relationship with an end-user and they can position themselves at either the publishing or the delivery stage. For example, Spotify is a delivery platform. Music companies are still the publishers and they still own the relationships with some if not all of the talent. The result is that the economics of Spotify



involve a delicate dance around the balance of revenues and margins across its platform, artists and music companies.[6] These economics add to the necessity for artists to diversify their revenue streams.

The fight for control over customer relationships is an ongoing wrestling match, and not just in music. Several companies such as Nike or L'Occitane have extended their brand to retail already by using a small retail footprint as audience development. Yet even these sorts of connections with audiences are not secure. In an era of digital disruption, delivery and distribution, more companies than ever have an easier time securing strong relationships with end-users, making user relationships with incumbents fragile. This is the risk posed by Amazon. Think, too, of the ways in which comparison sites have sucked value from the insurance, electronics and automobile sectors.

There are three priorities for remaking and revitalizing business models in the future of consumption: experiences, relationships and algorithms.[7] So it is no surprise that these are the very ways in which the music industry is remaking itself.

EXPERIENCES DELIVER VALUE & GROWTH

Decoupling the experience of music from a music product is the essence of the digital disruption of music. But this is only the beginning.

As the economics of abundance (instead of scarcity) have lowered the value of songs, particularly as reflected in the extremely small streaming payments paid to artists, musicians have begun to look for ways to tie music to forms where scarcity and exclusivity can still generate high value. This is a doubling down on experiences to create value.

A few years ago, music producer Brian Eno anticipated this. He wrote in *Prospect* magazine that musicians will increasingly "embed that relatively valueless [music] product within a matrix of hard-to-copy (and therefore valuable) artwork. People who won't pay £15 for a CD will pay £150 for the limited edition version with additional artwork, photos, booklet and DVDs. They often already own the music, downloaded—but now they want the art."[8] Eno himself has done this with his 2006 release of *77 Million Paintings*, a DVD that emulates one of Eno's video and music installations.[9]

Some artists now crowdsource funding for studio time to record new music by offering packages of experiences to fans and funders that include things like guitar lessons from the artist or collectible merchandise or a house concert or special editions of the release.

A bigger opportunity is building value from live concert experiences. Instead of using concerts to promote music products like records, CDs or downloads, the product is used to sell the shows. Streaming has sparked a revival of live performances, with the bulk of these revenues accruing to artists, promoters and venues, not labels.

U.S. revenue from concerts and events has grown by an average of 5.1 percent annually since 2012.[10] U.S. ticket sales are projected to grow from $1.94 billion in 2012 to $2.44 billion in 2021, and sponsorships from $6.78 billion to $9.55 billion over that same period of time.[11] Mintel estimates that the U.K. live music industry grew by nearly 50 percent from 2010 to 2015.[12] TechNavio projects 6.92 percent year-on-year growth for global live music ticket revenues through 2021.[13]

Music festivals have become a worldwide cultural phenomenon, to the point that observers now worry about "peak festival."[14] The number of festivals in the U.K. listed on the eFestival Web site jumped from 496 in 2007 to 1,070 in 2015.[15] In the U.S., Eventbrite reports a 51 percent increase from 2014 to 2015 in the number of festival attendees.[16]

Festivals and concerts are only a part of live music. Clubs, live streaming, awards show events, and house concerts are also an element in the change in music from a product-centric industry to a service-based experience. Live music is also buoying up an interrelated ecosystem of auxiliary revenue streams and ancillary businesses such as food, transportation, lodging, clothing and other merchandise. Brands that get involved as sponsors or vendors can also reap the benefit of being embedded in an experience.

The service-based business model of live concerts offers value and growth that music products can no longer command. Historically, music ticket prices have risen faster than inflation.[17] This continues today, even as the value of recorded music products is falling. In 2015, the average live music ticket price hit an all-time high.[18] Technological innovation with things like virtual reality and augmented reality will create even more immersive live experiences.

As in music, brands in all categories can build new value and growth by adding an experiential layer to a product. Often, this is a new experience not typically associated with a brand. This could entail a number of things, such as:

- Personal curation or concierges
- Instruction
- Collaboration
- Technology enhancements during usage or purchasing
- Association with events and activities
- Prizes and promotions
- Membership or loyalty rewards
- Insider access
- Cross-product or cross-category tie-ins

The emotional benefit of a brand can be decoupled and provided instead through an experience that can generate a new, growing revenue stream. This is true for many functional benefits as well.

Even low-involvement products that are purchased habitually are bought and consumed in moments that can include experiences. The focal point for value and growth is to frame innovation in terms of experiences rather than products.
In other words, don't begin by asking how to improve the product. Rather, **begin by asking how to use experiences to build more value into the brand**.

LESSONS LEARNED #2

RELATIONSHIPS OVER BRANDS

The shared experience of music has always been a powerful driver of success. As industry insider and culture critic Bob Lefsetz wrote about the huge appeal of Adele's *25* tour in an era supposedly defined by the long tail of demand: "Everybody wants to go where everybody else does ... Of course we want to dig down deep into our personal interests. But don't confuse that with what we desire to consume as a community. Only a few people want to be alone, the rest want to belong." As he put it in all caps, "PEOPLE WANT TO BELONG."[19]

Music is not the only thing that people want to share. People rely upon social guideposts for everything. But the social dynamic is bigger in music. However, digital disruption puts all categories on a more equal footing with respect to relationships because social elements become much more important, as evidenced in music.

Artists are using digital tools to tap into the power of relationships. D2F Web sites like NoiseTrade, Topspin, Bandcamp, StereoLoad, ToneDen, SoundHost, Nimbit, PledgeMusic, Sandbag, Music Glue and others offer an extensive range of services for artists.[20] There is nothing that labels have done historically that can't be done by artists themselves with the resources and applications available at D2F websites. Special emphasis is given to tools that strengthen ties between artists and fans such as gamifying releases, gathering feedback, getting input and votes on artwork or track lists, and hosting communities. Relationships are the key to the success of D2F business models.

In 2016, D2F site Bandcamp reported its sales of digital albums up 20 percent, digital tracks up 23 percent and merchandise up 34 percent. Its sales of vinyl albums were up 48 percent, CDs up 14 percent and cassettes up 58 percent. By contrast, for the industry as a whole, digital albums were down 20 percent, digital tracks were down 25 percent and vinyl albums were down 14 percent. Since its founding, Bandcamp has paid artists an aggregate of nearly $200 million.[21]

Social recommendations play a bigger part than ever in directing fans to music. The primary ways in which people discover music nowadays are friends, trusted curators, charts, viral hits and algorithms, along with old-fashioned serendipity.[22] All of these rely on the power of social relationships, even algorithms that utilize recommendation engines to do look-alike matching.

There is also a lot of experimentation going on in ways for fans to invest directly in artists. Some artists now use crowdfunding or other specialized platforms and financial instruments for fans to make an investment for an equity stake in a recording, tour or music catalog.[23]

Building closer, stronger relationships with customers is critical for brands that want to compete for experiences. If they don't, Amazon will. In the world of digital platforms, it's all about winning the competition for relationships, which is why Amazon has a soup-to-nuts ecosystem of customer engagement. As Amazon has made clear through its acquisition of Whole Foods, it is intent on fulfilling its ambition of being "the everything store." Amazon uses brands to build its own relationship with customers rather than make its retail platform available for brands to strengthen their customer relationships.

In short, **relationships trump branding**. No brand is safe unless it secures its own relationships. Value and growth will follow relationships in every category.

LESSONS LEARNED #3

SMALL BRANDS HAVE A BIGGER OPPORTUNITY THAN EVER

The consensus about digital is that it is winner-take-all. The prevailing narrative is that, very quickly, one company emerges from the gold rush of digital start-ups to dominate the marketplace. This has been borne out many times. Investor and internet pioneer Marc Andreessen described the phenomenon he has lived through in an oft-quoted answer to a question put to him in a Q&A with *TechCrunch*: "[I]n normal markets you can have Pepsi and Coke. In technology markets in the long run you tend to only have one, or rather the number one company ... The big companies ... in technology tend to have 90 percent market share. So we think that generally these are winner-take-all markets ... Number two is going to get like 10 percent of the profits, and numbers three through 10 are going to get nothing."[24]

Network effects are the reason for this phenomenon. They create natural monopolies.[25] The more people in a network, the more value it has to people. So people migrate to the biggest networks, which makes them even bigger and thus even more valuable, which in turn, attracts even more people. Pretty soon, almost everybody is in one network. A digital firm that can get to a critical mass of people first will acquire a self-propelling momentum that will vault it into a position of winner-take-all dominance.[26]

In some cases, the same sorts of network effects have proven true for infrastructure. In the case of search, for example, if the best functionality requires copying the entire internet onto proprietary servers, then the first search firm to do that will enjoy winner-take-all network effects. And so forth.

In fact, digital network effects are similar to the scale advantages that dominant businesses have always relied upon to create barriers to entry and to manage pricing. The key difference with digital is not scale per se, although scale is important, but the self-reinforcing, positive feedback loop of a network that binds customers to it.

But network effects matter only when networks are essential to the value of the product or service. While this is essential for some businesses, this is not the case for most brands. Indeed, music demonstrates that network effects are not true in every single category. In music, digital disruption has opened up the industry rather than narrowing it down to a winner-take-all industry.

Obviously, only investment at scale can create platforms like Spotify and Pandora. So streaming has evolved as a winner-take-all phenomenon. But the industry had even more of a winner-take-all character when music was a product. Labels used their central position to develop a few big artists who could generate the vast majority of revenues and profits. Lesser artists were on one-sided contracts just promising enough to encourage them to try to break through, which restricted the number of artists who could earn enough to make a living. Complaints by artists about labels and promoters are rooted in this historical winner-take-all business model. Digital has changed this.

More artists, not fewer, can get a share of the business nowadays. In 2000, the top 100 tours commanded almost 90 percent of annual concert revenues. In 2014, this figure was halved to 44 percent. As one industry observer has noted, "[I]ndependents—the vast majority of whom never generated significant revenue from physical sales—are making considerably more from concerts than at any point in recent history ... and capturing an increased share of what recorded sales remain."[27]

Certainly, the biggest artists still command the lion's share of revenues from music product sales and streaming. But the music ecosystem that has flourished due to digital disruption has created more winners not fewer. Artists are more likely nowadays to see opportunities to build a steady, long-term career in music rather than having just one long shot at success.

While network effects are real, the transformation of categories by digital has shaken loose a lot of new opportunities for brands and companies willing and able to pursue value and growth in **uncomfortable places**. Growth is coming from segments and slices, not from the big middle that dominated in the past. These sources of growth consist of pockets that are smaller than many brands are used to, and thus they are pockets of opportunity where brands often lack the knowledge, the processes, the skills and even the confidence to win. It is often smaller brands that are willing to look in these uncomfortable places.[28]

In other categories besides music, gains by smaller brands in a world of digital disruption can be seen. In the global Kantar Worldpanel tracking of 200+ FMCG categories across 44 countries that make up one billion households and 76 percent of global GDP, CPG/FMCG growth in 2015 was 4.7 percent. But local brands grew 6.2 percent while global brands grew just 3.4 percent. This was the third year in a row that local brands outpaced global brands. Fifty-eight percent of total CPG/FMCG growth in 2015 was captured by local brands.[29]

There are many reasons for the superior performance of these local CPG/FMCG brands. Lower barriers to entry, closer relationships with consumers, and weakened incumbents are a perfect storm of opportunities for smaller brands. Scale and existing assets are no longer enough to defend incumbent positions. Incumbents need a view of the marketplace that looks for opportunities in the uncomfortable places that are being unlocked by digital disruption.

Uncomfortable Places

The idea of uncomfortable places refers to growth opportunities that are alien to the ways in which brands have traditionally been built and managed to generate value and growth. Broadly speaking, brands are comfortable with large mass market opportunities (albeit, often marketed to by segments) that are easily scalable and that grow in conjunction with overall economic growth. But these kinds of markets present significant challenges going forward, so brands will have to get comfortable with the uncomfortable places they have avoided in years past. That is, pockets of growth opportunities that are smaller than many brands are used to and where brands often lack the knowledge, the processes, the skills and even the confidence to do business.

LESSONS LEARNED **#4**

GET OUTSIDE THE DATA

The rise of algorithms is perhaps the biggest change that digital is bringing to the music industry. Streaming services and other digital music platforms use algorithms to classify people's tastes and then predict what people might like to hear. These predictions can be for playlists of songs with which people are familiar already or, most importantly, for new music to introduce to people. These learning algorithms, often augmented by tastemakers and curators, adapt over time as people, others like them, and their friends react to what they hear.

Such algorithms are not unique to music. Recommendation engines of various sorts are commonplace. But the future of marketing is going to be determined more and more by algorithms guiding and supporting decisions made by both individuals and influentials. This has been discussed elsewhere as the pivot to passive digital[30] or the rise of programmatic consumption.[31] It represents a marketplace in which consumers hand off a big chunk of shopping, browsing and buying to algorithms that have learned people's tastes and preferences.

As this future unfolds, marketers will have to advertise to algorithms instead of consumers because algorithms, not consumers, will be scanning and processing information and advertising. Consideration sets will matter much less, if at all, because algorithms will make limited, even single recommendations about what to buy. The task of marketers will be getting into people's preference profiles, not getting into people's consideration sets. As algorithms close off the buying process, the usage or consumption process will become more important as the only unmediated opportunity for marketers to connect with consumers.

This future of algorithms already exists in music. Spotify and Pandora rely on algorithms to determine what music to push to people. Preference profiles are derived from lots of information that is regularly updated. Music that matches is pushed to people.

One criticism of algorithms is that they lock people into echo chambers of existing tastes, thereby shutting people off from new or different things (although algorithms have been developed recently that address this by recommending "adjacent" rather than identical options[32]). Brands fear that they will lack opportunities to connect directly with consumers or reach new consumers. In fact, this is exactly what digital delivery and distribution platforms are trying to achieve. They want consumers to be more committed to their platforms than to brands. Spotify wants to own customer relationships. So does Amazon. In this world, all brands are challenger brands. To survive, brands need to get outside of the data.

This is **the paradox of the digital era**. Old-timey analog or non-digital connections are more not less important. **Analog is critical to mastering digital**.

Artists are facing this challenge in the shift of value to platforms. The imperative they face is to escape the algorithms that lock them into tiny payments from streaming. One way to do so is live concert shows. They not only generate additional income for artists, they create interest in artists that can override algorithms. In a similar vein, some artists try to create interest with free samples or free downloads to expose people to their music.

Artists are also looking in uncomfortable places, or what *The Guardian* referred to as "unthinkable places." Coffee shops are now popular venues for aspiring artists, both live shows and background music during the day. As one musician calculated, "15 minutes a day in 350 Caffè Nero shops, 'so you can reckon that 15,000 people every day are hearing it'." Starbucks operated a record label for several years that included releases by Paul McCartney, Joni Mitchell and Carly Simon. Red Bull has a label. So does Mountain Dew. So does *Adult Swim*.

These efforts are just one piece of the puzzle, but they illustrate the ways in which digital disruption has forced artists to get outside the data. Brands in all categories have to think in these ways as well. Brands want to drive algorithms rather than be driven over by them. The good news is that brands have many options for doing this, some of which are already familiar to marketers:

- Traditional media, and also direct mail
- Non-store venues for merchandise and promotions
- Sponsorships of live events or activities
- Partnerships with digital games or virtual reality
- Placements in movies, TV shows and videos
- Apps or wearables
- Tie-ins with sampling or subscription services
- Opinion leaders
- Kiosks
- Street displays or solicitations

There is little that is new in this list. The point is that digital makes these more important not less as it ushers in an era of algorithms. Brands must find ways to escape the commoditizing pull of algorithmic modeling.

Prince showed the power of non-traditional exposure when he released his *Planet Earth* CD in 2007 as a free CD in the July 15, 2007 edition of the *The Mail on Sunday*. His decision was fiercely criticized by retail music stores in the U.K. because it cut them out of a recorded music product revenue stream. Prince did it anyway and sold out all 21 shows of his concert run at London's O2 Arena. Product sales were helped not hurt. The CD eventually peaked at number 3 on the U.S. Billboard 200 chart.[34] Prince was ahead of his time. The lesson learned applies even more in a future of music as a service. Marketers need to follow his example and get outside the data in order to get people asking algorithms about their brands.

The business choice for brands is simple: Either establish an identity that acts as a meaningful attractor or become commoditized. If brands do not create a group of customers that will seek it out in the digital noise and actively choose it, then they will wind up as high-volume, low-margin suppliers to a delivery and distribution company.

PRACTICING YOUR SCALES

The music industry is learning as it goes. Artists, labels, distributors and promoters are all still figuring out how to play the game. The marketplace of music as a service is a work in progress, but it is the future.

Brands in all categories are rethinking their propositions and business models. Music offers some lessons and guidance, but brands must approach the digital future with both **a willingness to experiment and a commitment to reinvention**. As every musician can attest, perfection takes lots of practice. That is perhaps the biggest lesson music has to teach brands.

ENDNOTES

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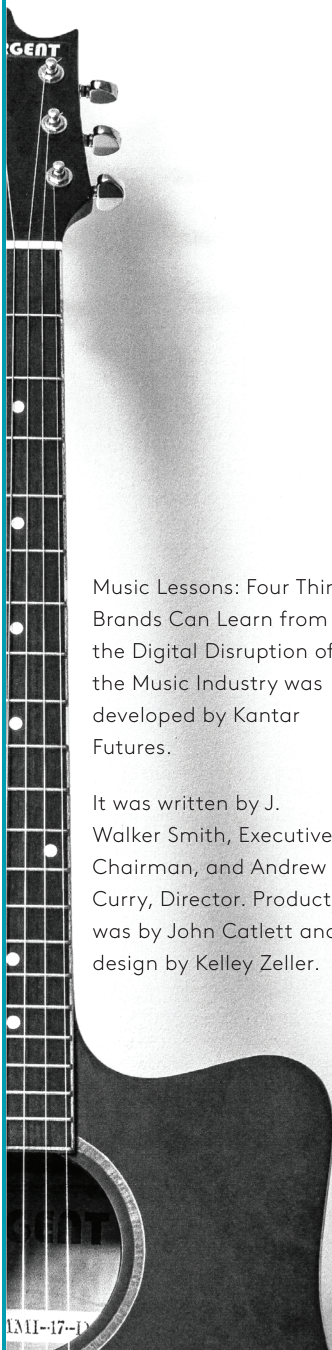

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