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The Future of Music and the Music Business

Lesson 3: How Money Flows in the Music Business

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There are complex business structures and relationships through which money flows between artists, writers, and music fans—with many hands in the pie. The big profits for musicians are in writing, or better still, a combination of writing, recording, and performing. In this lesson, we will focus on the way money flows to artists and writers and some of the issues for the future. Who is really making money and why?

There are many ways for artists and writers to make money, including product endorsements, appearances, brand extensions like Puff Daddy's clothing line, and other licensing avenues, some of which we will look at in a later lesson on future business models. However, in this lesson we are going to focus on how money flows in the recording and publishing parts of the music business. We'll assume for the moment that people are going to continue to purchase more recorded music than they steal or trade. It's not just the record labels and RIAA that suffer when fans stop buying music. Writers and artists, as well as their publishers, managers, producers, and a whole supporting cast of talented people suffer, too. What parts of the past are going to continue to be important in the future?

Objectives

At the end of the lesson, you will be able to:

- identify the different ways that artists and writers can make money
- identify the various types of licenses issued by publishers and current sources of income
- identify how the existing model works for legitimate digital downloading
- identify safe areas of the current business model, including areas that may improve with technological advances

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Workshop: Money Flow in the Industry

In the diagram below, you can see the relationships of the different parts of the music business and the way money flows among them. Take a look at this flow between the parties and how they are compensated.

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Writers have the potential to make money from...

...Licensing rights to use their music generally through a music publisher:

- Mechanical royalties paid by a record company for use of a song
- Performance royalties paid by radio, TV, clubs, etc. for playing the song
- Synchronization royalties paid by a film, TV, or video company to use a song
- Print royalties paid by a print publisher for the right to print the music notation and lyrics for a song

Writers and publishers can make a great deal of money over time from licensing their songs. Indeed, it can be said that between artists and writers, writers are far more likely to earn big money from working in the music business over the long haul, unless the artists get to be “stars.” Writers are usually behind the scenes in the music business, and quite often, unless they are also artists, they end up quietly collecting their checks for years. A good example of what I mean is writer Bernie Taupin, who has co-written many hugely popular songs with Elton John. Another is Dianne Warren, who has written mega-hits of the recent past for lots of artists including Aerosmith, Gloria Estefan, and Michael Bolton. Both Taupin and Warren are fabulously wealthy writers, but hardly receive the publicity and limelight of the artists that they work with.

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When a writer writes a song, they own 100% of the copyright in that song. Typically when a writer enters into a publishing deal, they transfer 50% of the earning potential to the music publisher, with 50% remaining as the “writer’s share” and 50% as the “publisher’s share.” Songwriters who do not wish to sign their copyrights away may wish to set up their own publishing company, for example, Your Name Publishing Co. This means that they will receive both the writer’s and the publisher’s share, thus 100% of their income, as opposed to 50%.

Songwriters can also enter into a co-publishing deal with the publisher. In monetary terms, co-publishing means that the songwriter collects the songwriter’s share (50%) and also half of the publisher’s share (half of the other 50%), for a total of 75% of their income. Co-publishing is a good approach if you want to keep your rights and maximize the money you get. However, if you don’t have a good publisher pushing your songs, there might not be very much money for you to keep.

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...Recordings—selling and licensing recordings generally through a record label:

- Royalties paid by record label based on the list price minus a lot of deductions
- Royalties paid by a film, TV, or video company to use a song in a production

...Touring—performing live at clubs, concert venues, and private events:

- A percentage of proceeds from ticket sales or fees

...Merchandise—selling merchandise at clubs, concert venues, etc.

- A percentage of gross sales or net profits

Artists have a greater variety of methods in which to make money in music. Generally, these depend on their ability to play, perform, and entertain, as well as their ability to exploit their personality and the “brand name” of their band or act that they record and perform under. Artists are up-front in the music business, and their brands are what people recognize and search for when seeking out music. Think of the value that has been built up in popular brands like “Sting” or “Madonna” or “Prince.” Artists, unless they are also writers, generally must continually stay active, recording and performing music, in order to begin to hope for the same kind of financial success that writers can enjoy. A writer writes a song once and collects forever. An artist has to play that song forever to collect forever.

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Money Flow between Artist and Label**Recordings—Selling and Licensing Recordings via a Record Label**






How does the “recording” get from the studio to the ears of the listener and the hands of the buyer? The major labels work on a 1/10 ratio (at best)—for every ten artists they sign, only one of those ever achieves any positive level of financial success. They are placing bets across a stable of records. If we look at the way in which a major label does business, it tests a set of records and then uses a vast amount of money and influence to buy what it perceives to be the winning records’ way onto the charts and onto the radio. Most major labels have a great deal at risk with each record, and they direct their promotional efforts based on the early success or failure of an album’s release, to ensure that at least one in ten of their bets break even. Sound unfair? This is the record business.

If you are chosen to be that lucky one of the batch, the label will exercise everything in its power to back you to success. This starts with independent promotion. The labels employ several key promoters who are in tight with the radio/MTV programmers and DJs. This means payola: whether directly or indirectly, they buy their way to the top. Pulling the right strings here and pushing the right buttons there ensures that your single will be on top-40 heavy rotation in no time. Getting the CDs on the shelves is more of a straightforward retail process, but they still pay to play. While major labels manage their own pressing and distribution, independent labels will usually have to establish a distribution deal with a major label company, or one of the few remaining independent distributors. Distributors typically keep 15–20% of the wholesale price of a CD. If the records have been successfully promoted, the stores will want to stock them.


The labels employ various methods to grease the wheels and get your records into retail. “Free goods” are a time-honored method of giving retailers extra margin. Labels will often flat-out give dealers up to 15% of the records that the dealers purchase, as part of the transaction. Essentially this means that the retailer gets 100% of CDs that they might sell, but the label only has to pay the artist royalties on 85% of them. This is yet another way that artist royalties are reduced.

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Money Flow between Artist and Label**Recordings: Royalties Paid by a Film, TV, or Video Company for a Song**

Just as the writer receives income from a TV, movie, or advertising company for the use of a song in a movie, TV show, or commercial, artists can earn, as well. The record label collects the money and gives the artist their share, according to the contract. Unlike publishing deals, a 50/50 split is not necessarily a given in all record contracts. Nevertheless, licenses are part of recording contracts and will be a potent source of income for artists in the future.

Touring: Performing Live at Clubs, Concert Venues, and Private Events

One of the most reliable income streams for an artist is live performing, in which they get a percentage of proceeds from ticket sales or fees. I say "reliable," because live performance is more in the control of the artist than most of the rest of their career.





Early in their careers, touring is a great way for an artist to get exposure and build a following through touring. It is never a big money maker in the beginning. Although at first an artist could face running at a loss, the more established they become and the more tickets they sell, the more money they make. Touring is a great way to directly connect with fans, and savvy artists make the most of touring to maximize their income and marketing potential.

As an artist gets established, their income can increase to tens of thousands of dollars, and sometimes even higher. Promoters control the bulk of the concert business in the U.S., and the artist either splits the ticket proceeds with them, or receive a guaranteed fee. Sometimes, they get a combination of both. Splits vary widely, generally running from 50% to 85% of gross sales or net profits, depending on the deal. A manager earns his keep in the music business by squeezing as much income out of touring as possible.

After time, if an artist can find some success and can build a following, touring when coupled with record sales and promotion can really fuel a career. Apart from various booking, promotion, crew and equipment fees, the artist gets to keep a lot of the earned money, if costs can be controlled.

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Money Flow between Artist and Label**Selling Merchandise at Clubs, Concert Venues, through Merchandisers and Online**

Performance venues are also the perfect stage to sell merchandise from. Some well-managed acts make a significant portion of their total income from merchandising. Sometimes a label will ask the artist for their merchandising rights, i.e., the right to display their name and likeness on shirts, stickers, and other items. Most artists keep these rights for themselves or enter into a deal with a merchandiser such as Winterland, Brockum, or Sony Signatures. If they sign a deal, then the label or company could pay a royalty to the artist of 28%–60% of the gross merchandising income. Sometimes the splits are based on net profits; the artist can receive up to 85% of net.





If an artist decides to retain merchandising rights, they can perhaps make more. To do so requires expertise in design, printing, and sales—and this is something that most artists do not want to take on.

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Money Flow between Artist and Label

Here we see a different look at the flow of money from fans to artists and how some of those streams are distributed. Roll over the connections between the entities to see the relationships.

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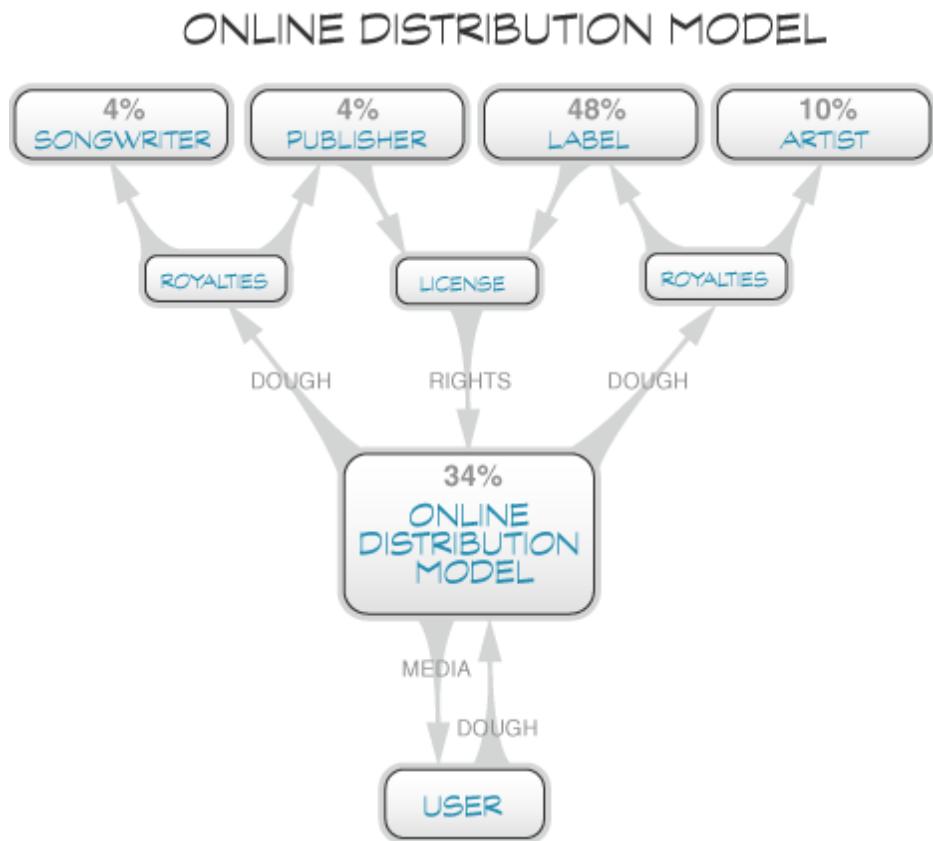
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Legitimate Digital Downloading



For a long time no one was sure how to handle the problem of selling music online. All entities held out to get the best deal. Most notable were the labels who refused to license their catalogs to the early entrants into the digital space. The labels wanted to control the action because it was, after all, their recordings that were being downloaded. The publishers took the opportunity to get their fair share out of the new revenue when it finally started to happen. Left in the lurch, as usual, was the artist. iTunes, Listen.com, and others are all testing the waters of legitimate digital distribution, sailing on a ship of singles.

Check out the following model based on the iTunes license. This model replaces traditional distribution with online distribution and keeps the record label at center stage, with the artist stuck in a deal from the twentieth century.



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When consumers purchase a download from iTunes, they are actually “licensing” the song for playback within certain boundaries. According to many label contracts, licenses are to be treated as splits, perhaps split 50/50 between artist and label. This is not the case with the current iTunes model. Someone surely is going to test this in court.

The current iTunes model is a bad deal for artists. Same old record company tactics. The track downloads are treated as sales, not licenses. The artist is screwed once again. The labels are choosing to account for the download as if a download was the same as the sale of a single, using the existing contract language to define the payments. Some labels are even trying to discount the royalty further by deducting a percentage for “new technology” fees. Enough is enough.

Publishing and licensing will be the only way out for artists and writers. If songwriters and artists band together, they can leverage the licensing provisions in their existing contracts to extract their fair share of the digital revenue to come. New contracts and constructs need to approach the transaction from a licensing point of view, and artists should not stand for being dominated by a record label that no longer performs the same essential functions as they did before this new digital age. Labels have the upper hand when it comes to their catalogs. But artists and writer have the upper hand when it comes to new music.

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The new legitimate music downloading services like iTunes and Listen.com have enormous potential to evolve into a substantial revenue generator. The question is, who will make the money? When distribution shifts from physical to digital, the role of the labels needs to shift, as well. Labels no longer control distribution the way that they did, and radio seems like it is going to become even more irrelevant in a digitally networked era. Although legitimate digital distribution services are currently faced with incredible competition from free P2P networks, everything must start from somewhere, and this model will be given the opportunity to grow and stabilize. If the labels remain in control of the licensing decisions and splits, then the artist is likely to have to rely on other sources of income once again to support their craft. Or perhaps a model for digital distribution will emerge that is even more favorable to artists and writers alike.

Publishing

The business model in which royalties are collected and administered on behalf of the songwriter still has a firm place in the future, so long as people elect to spend money for music. Although methods of distribution are uncertain, it remains the duty of the publisher to ensure that a writer's work be heard and that they be paid for it. While mechanical income from the sale of CDs will drop, there is potential for it to be replaced through the legitimate download model.

The digital network itself could benefit writers and artists because sales are easier to report accurately. Royalties paid to the publishers from online radio and downloading could be 100% accurate, as they would be digitally monitored. Current performing rights organizations rely on human evaluation, averaging, and sampling. Today, the royalties paid on music played in restaurants is based on radio airplay, but no consideration is given for the more likely ethnic diversity of music played in restaurants. Digital technologies give us much more accurate and fair means of tracking actual usage, which can help improve on existing systems and make the industry more transparent and fair.

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Independent and smaller labels are usually structured so that they can survive and profit on lower sales and niche marketing, and are therefore are not as threatened as larger labels are. In the past, the independent labels were agreeable to licensing their catalogs to legitimate music download services when major labels stalled. Smaller labels are also will help them to focus on the careers of their artists. Their smaller size also will help them to remain flexible, with the ability to adapt and re-tool their business models when necessary in the future.

Live Performance and Touring

It is true that concert tickets are increasing in price to compensate for a lack of CD sales, but there stands to be little reduction in the popularity of live shows. Classical and jazz musicians are not in danger of losing revenue during the current CD slump, as most of their money comes from live performances. Live performance will continue to be a medium for a direct connection between the artist and the fan. As the use of sophisticated audio/visual technology increases, so will the entertainment value of a live performance .

Merchandising

Artist merchandising stands only to benefit from the digital transformation of the music business. Direct marketing is where it is at, online. Selling materials directly to a fan from an artist's Web site is not only easier than having them wait in line at a show but also helps to form a richer and more direct consumer relationship. There may be a lot of other things to sell direct in the future.

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Recap

We have seen how artists and writers have separate and independent ways to make money via recording, touring, publishing, merchandising, and other means. We have also taken a look at some digital music business models. Next, we will look at the way music is marketed.

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