Record Sales and the Music Industry

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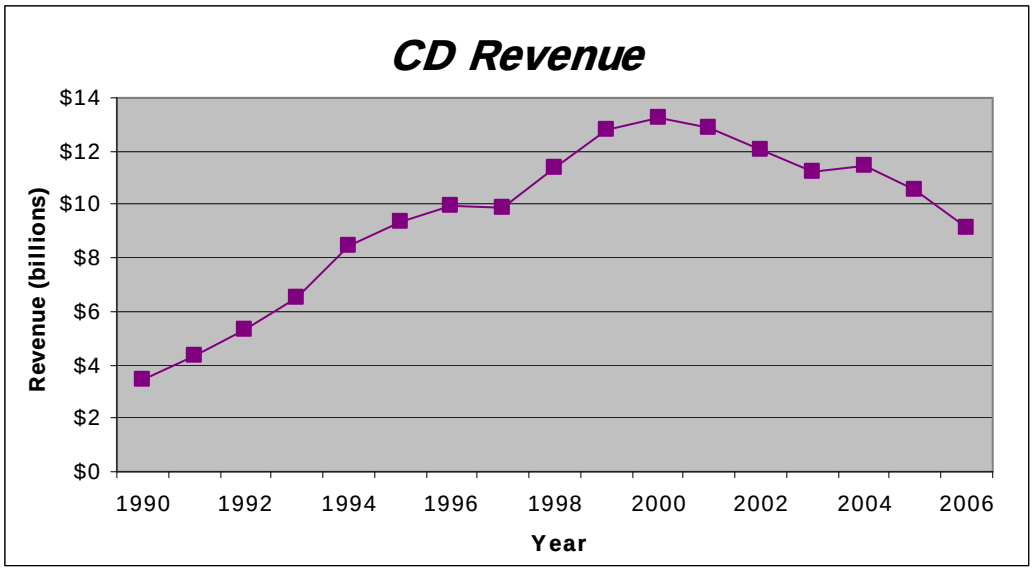
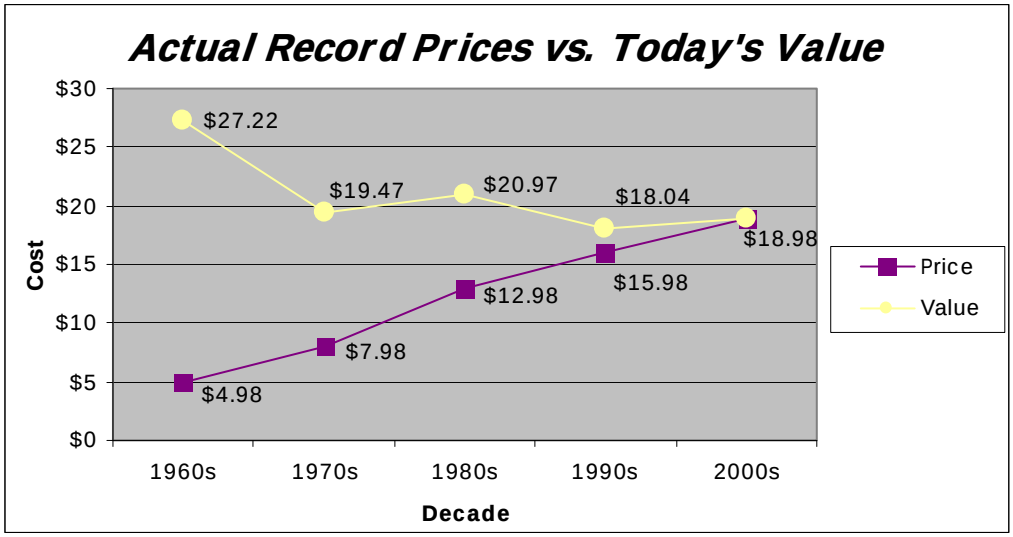
Much has changed in the recording industry in recent years. The widespread use of personal computers has had a large impact, both positive and negative, on everyone involved in the music business. Artists and recording companies most often blame internet piracy for the declining sales of compact discs, but some people have different opinions. The price and quality will affect sales, as will the spending habits of consumers. The music industry has realized that they will need to make some changes to continue to make a profit, so they have started offering online downloads for a fee, as well as using other revenue sources such as concerts and merchandising. Each of these changes will be studied to determine what, if any, affect it has had on the artists and companies involved in the music business.

First, it is necessary to examine the trends in music sales. The following graph presents the revenue from CDs from 1990 until 2006. In 1990, the CD revenue was approximately $3.45 billion, while revenue from cassettes was still slightly higher, at $3.47 billion. One year later, CDs would begin to bring in more revenue than cassettes, but cassette tapes were still purchased more often. Cassette tape units and revenue began to die out, while CD sales began to soar, finally reaching its peak in 2000, earning a revenue of over $13 billion dollars. Since that time, CD sales have declined, and in 2006, revenue was at approximately $9 billion dollars; sales had not been this low since 11 years previous.



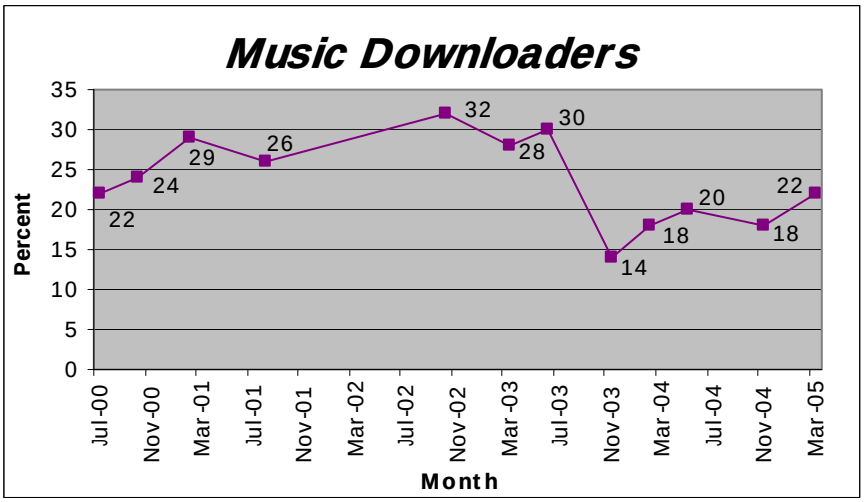
Some people argue that rising album prices are to blame for this decline. In the 1960s, an album would cost $4.98 on average, whereas today, the same album would cost the consumer $18.98. However,

when a comparison is made between the prices and values compared to today's dollar, it is evident that while prices are rising, it is technically costing less. That $4.98 album from the 1960s was actually costing the buyer $27.22; over $8 more than an album from today. This would indicate that rising prices are not to blame for the decrease in CD sales.

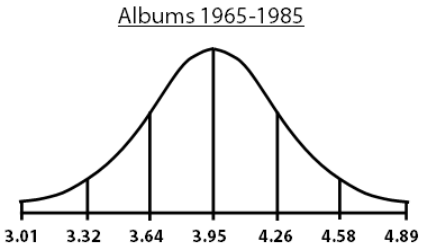


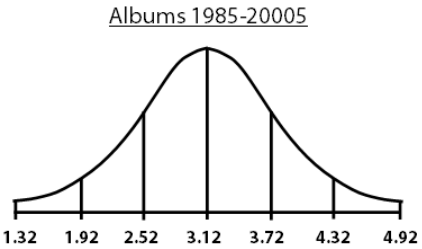
Another possibility, and the music industry's favoured reason, is the introduction of illegal downloading programs. A survey was conducted from 2000 until 2005 about usage of the internet, including one question that asked if the respondent had ever downloaded music. As shown in the graph below, the percentage of respondents who answered "yes" generally rose up until July 2003, after which there was a sharp drop in affirmative responses. The reason for this decline is that the Recording Industry Association of America (RIAA) announced that they would begin suing people who downloaded music illegally, which caused many users of these illegal programs to stop. Since this decrease, however, numbers have begun to rise again. This is probably due to the increasing popularity of legal download sites that have arose as an alternative to illegal programs. The percentage of people who said "yes" is back to 22%, as it was in the first year of the survey. Although respondents were not asked to specify whether they legally or illegally downloaded music, it can be assumed that in recent years the growth in affirmative responses was due to legal downloads. In February 2004, five of the top illegal downloading programs had 30 million unique users, while a year later, there were only 19 million. At the same time, five popular legal downloading

websites grew from 21 million in 2004 to 22 million in 2005, surpassing the users of illegal downloading programs. From this information, it is likely that illegal downloads were a cause of CD sale decline, but this is not the major cause any more.

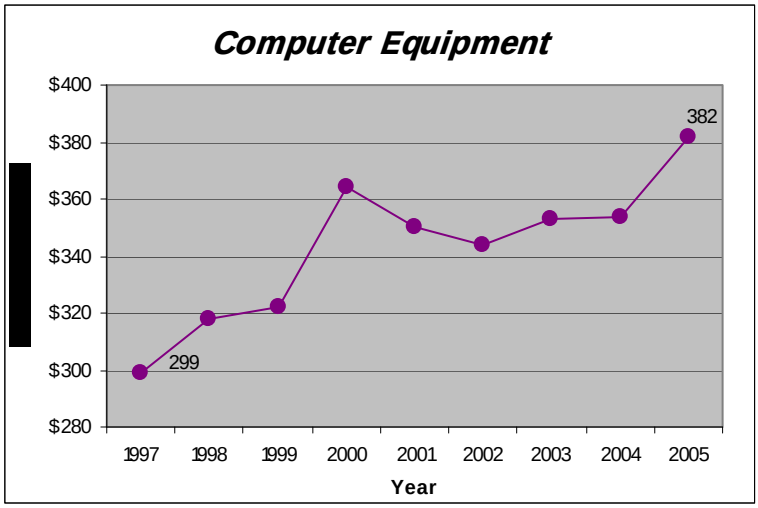


Other consumers blame the decreasing quality of music for the loss in revenue. Forty albums, one from each year of 1965 to 2005 that remained in the number one position of the Billboard charts for the longest time, were selected. The quality of each album was examined by comparing ratings from buyers. When looking at albums from the first twenty years, the average rating was 3.95, while albums in the last twenty years were only given an average rating of 3.12. When the standard deviation for each group of years is also calculated (0.313 for the earlier years and 0.6 for the later years), it is evident that most albums from the sixties, seventies, and eighties, would be rated between 3.64 and 4.26, while hardly any would receive a rating less than 3.01. Looking at the eighties and on, however, most albums fall between a rating of 2.52 and 3.72, while a rating in the 1 or 2 range is more likely. This would indicate that albums have indeed decreased in quality, and although these numbers are simply opinions and are definitely biased, they are one of the only measures of quality that is possible for such a large range of music.



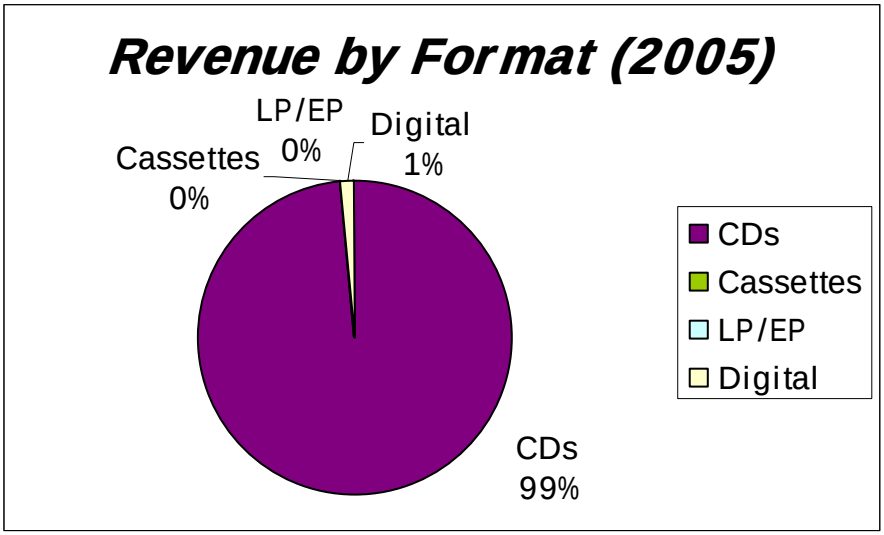


The final factor to be examined is consumer spending habits, which change often. Only in recent years have people been able to purchase computer hardware and software and video games, for example, as well as many other new gadgets. If people are spending more money on these products, they will not be able to continue spending the same amount of money on music. The graph below shows the trend in computer equipment purchasing habits. In 1997, a Canadian household would spend about $299 on computers and $31 on video games. Over the years, both of these areas have seen an increase in spending; in 2005, a household would spend $382 on computers and $51 on video games. This is the most likely cause for the decrease in CD sales, because unless people begin earning more money, they will not be able to dedicate as high a percentage of their income to music.

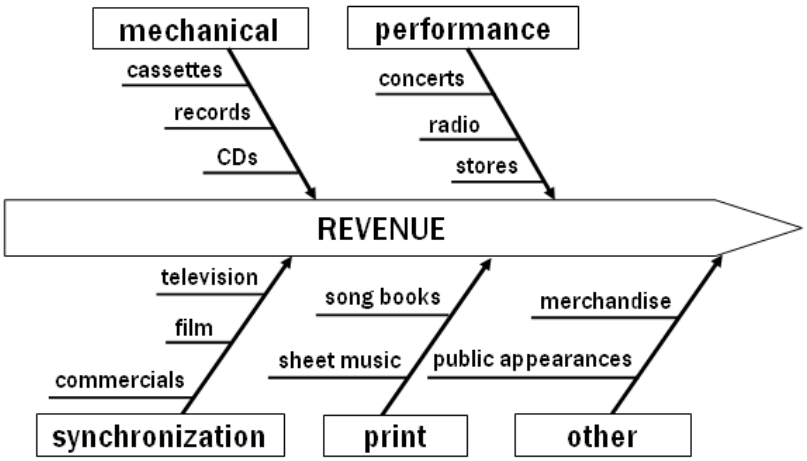


Next, the changes made by the music industry to combat the loss in revenue will be examined. As previously mentioned, legal download websites have began emerging, where users will pay a fee, which goes to the artist and record company, to download a song. In 1995, CDs accounted for 73% of the units sold, while cassettes made up the other 27%. Ten years later, in 2005, CDs were down to 65% while digital downloads were 35%, showing that they are used more often today as a secondary source than cassette tapes were in the 1990s. In 1995, cassettes accounted for 20% of the mechanical revenue, which shows that a cassette would cost less than a CD. Today, digital downloads also cost less, because they are often a single song rather than a whole album, as cassettes and CDs were. Despite the popularity of digital downloads,

they only comprise 1% of the revenue, because they are so inexpensive. Although legal downloads are bringing back buyers, they will not bring revenue back up to the level it was in 2000.

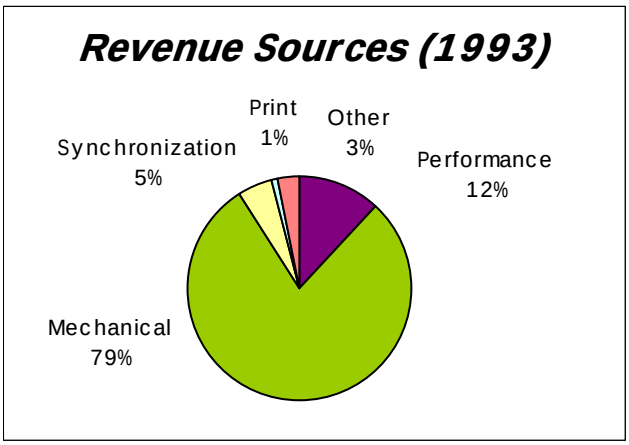


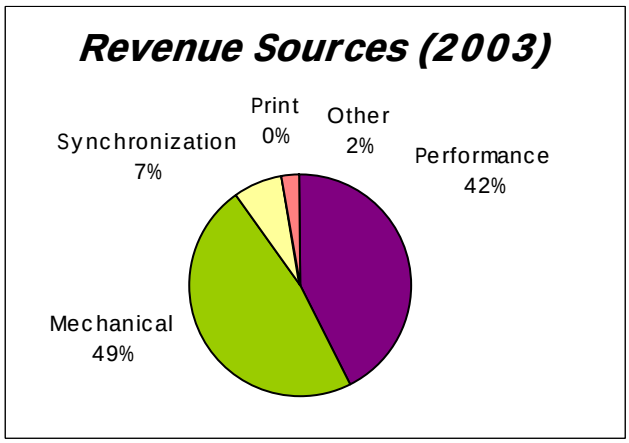
The following diagram shows the main sources of revenue for the music industry. The first is mechanical, which has already been discussed: records, cassettes, CDs, and also digital downloads – the actual album. Concerts and radio plays also bring in revenue, and fall under the category of performance. Synchronization revenue comes from the use of music in television, film, or commercials. Print is another form of distributing music and lyrics: song books and sheet music. Finally, there are many other less prominent ways to make money in the music industry, which includes ways such as selling merchandise and making public appearances.



So from which of these sources is the new revenue coming from? By comparing revenue sources in 1993 and 2003, it is evident that mechanical revenue was the main source of income in both cases. However,

mechanical revenue has decreased 30% in the ten years in between, for the reasons discussed previously. The area that has gained the most is performance, which is up by 30%. Synchronization has also increased, but only by a slight margin of 2%. Print is down 1% and other sources, such as merchandising, have also decreased by 1%. Mechanical revenue remains the leading source, but because of the decline in recent years, concert ticket prices have increased and more concerts have been taking place to contribute to the performance revenue.





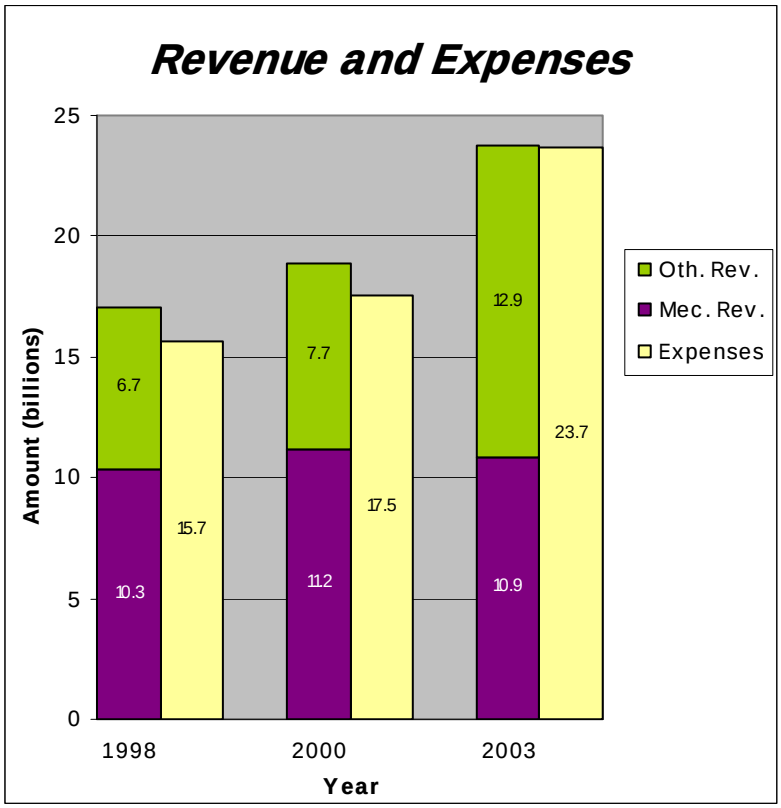
To determine the dollar value for each of these sources, the non-mechanical revenue percentages are adjusted and placed in a matrix. In 2003, the mechanical revenue was approximately $10.87 billion and all other revenue combined was $12.89 billion. Multiplying each of these adjusted percentages by the latter number will show the estimated amount of money earned from each source.

$$\begin{array}{r} \text{mechanical} \\ \text{performance} \\ \text{synchronization} \\ \text{print} \\ \text{other} \end{array} \begin{bmatrix} 100\% \\ 82\% \\ 14\% \\ 0\% \\ 4\% \end{bmatrix} \times \begin{bmatrix} \$10.87 & \$12.89 & \$12.89 & \$12.89 & \$12.89 \end{bmatrix} = \begin{bmatrix} \$10.87 \\ \$10.56 \\ \$1.81 \\ \$0 \\ \$0.52 \end{bmatrix}$$

(in billions)

Until this point, revenue has been examined rather than profit. Looking at the revenue and expenses from 1998, 2000, and 2003 will show trends and changes in profit. In these three years, the mechanical revenue stayed within a range of $10-12 billion dollars; not a very large change. The other revenue however

increased significantly: up $6.2 billion in only five years. However, at the same time, the expenses increased as well. To calculate the profit, subtract the expenses from the revenue; this area is represented on the graph below by the area between the tops of the two bars. As shown by the graph, the overall profit remains the same in the first two years at about $1.4 billion. By 2003, however, the expenses have increased so much that the profit is down to only $100 million.



This shows that although mechanical revenue has decreased, total revenue is actually increasing. What has gone down, however, is the profit. The most likely reason for the decrease in mechanical revenue is the changes in technology that encourage consumers to buy different and new products, rather than things like music, which has been around for such a long time. Illegal downloads and declining quality also have an impact, but it is less evident than the impact from the spending habit changes. The music industry is keeping their profit margin by turning to other sources, mainly performance and to a lesser degree, synchronization. If the music industry is able to continue using these different sources for revenue and to decrease expenses, they should continue to make a profit for many years to come.

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