The latest record industry stats – three reasons for optimism, three reasons for gloom

The International Federation Of The Phonographic Industry last week published its annual stats report, rounding up the financial performance of the global record industry in 2016. There were few surprises – in either the stats or the IFPI's response to them – though they are worth considering all the same.

The record industry does seem to be at something of a turning point, as it increasingly shifts over to a subscription-based business model. But, as recorded music revenues slowly increase once again, should the record industry – and the wider music business – be optimistic or pessimistic about what is likely to happen next?

KEY FIGURES & TRENDS

We already knew the key record industry trends for 2016 based on the figures put out by national trade bodies around the world since the start of the year, and what the record companies themselves had already told us. And in the main, the key trends of 2016 simply replicated those of 2015, only more so.

Those key trends are as follows: streaming is booming, compensating for tanking download sales and the continued slower decline of the CD. Vinyl sales are also up, as is income from broadcast and public performance, though it is the streams that are taking the recorded music market back into growth.

Worldwide, that growth in 2016 was 5.9%. Streaming revenues rose by 60.4%, while download income fell by 20.5% and total physical revenues were down 7.6%. Sync was up 2.8%, while broadcast and public performance revenues were up 7%.

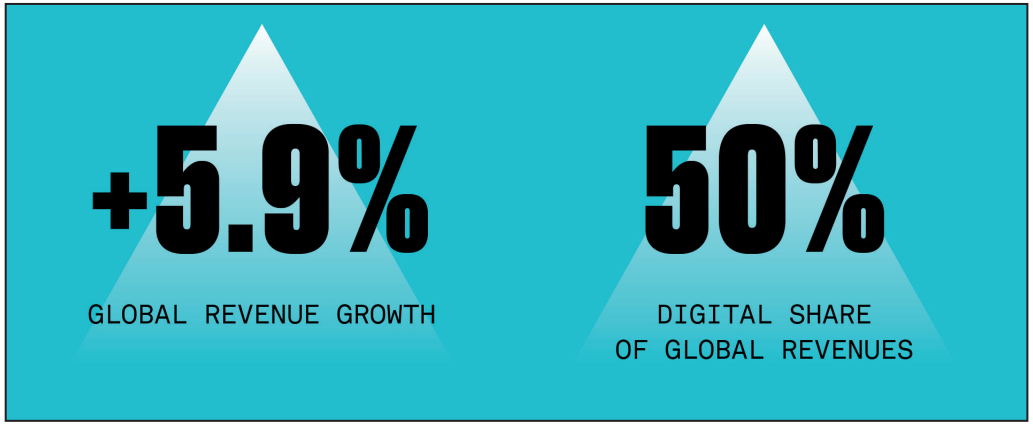
In terms of how the $15.7 billion of total revenue broke down, 50% of that income came from digital for the first time. Of the digital income, 59% came from streaming. The other 50% of the record industry's income breaks down as 34% coming from physical product, 14% from public performance and 2% from sync.

Streaming is really booming because of the paid-for subscription services, with the ad-funded set-ups generally paying much more modest sums over to the record industry. The IFPI reckons that by the end of 2016 there were 97 million people paying to stream music, and with a portion of those being multi-user subscriptions – usually family plans – that meant 112 million people were now using premium services.

Although in its report the IFPI was keen to talk about an increasingly competitive marketplace helping to drive the boom in premium streaming, the market-leading streaming platform – Spotify – accounted for nearly half the world's paying users at the end of 2016, and the second biggest – Apple Music – a significant slice of the remaining number.

True, established companies like Amazon, Pandora and iHeart have only just really entered the premium streaming game, and there are some strong additional players in some emerging markets. Though Spotify and Apple still dominate the global streaming business, and look set to do so for at least the near future.

Commenting on 2016's figures, the major record companies were generally united in expressing cautious optimism about the



Figures from IFPI's Global Music Report 2017

future. Such caution is sensible of course. As the majors all acknowledged, there is still a long way to go before the record industry returns to the kinds of revenues achieved at the peak of the CD boom in the late 1990s, and it will take a few more years of solid growth to be certain this is truly a sector in revival.

For the IFPI, constrained optimism is also required as it seeks political support to close the so called 'value gap'. The music industry continues to claim that services like YouTube are exploiting the copyright safe harbour to reduce their royalty payments. The argument goes that the value gap is hindering the record industry's return to growth, and therefore labels need to be at least a little bit disappointed with that 5.9% figure to persuade law-makers that they must do something about safe harbour.

But should we be optimistic at all about the future of the recorded music market? Probably, though there are both reasons to be optimistic and pessimistic, from both a label and wider music community perspective.

REASONS TO BE CHEERFUL

1. Streaming sign-ups continue to boom

Paid-for streaming is driving the growth, and the paid-for services – especially Apple Music and Spotify – continue to grow at a significant rate. 97 million paying users may sound impressive, but globally speaking that is still a relatively small number of subscribers, meaning there is still plenty of room for further growth.

It varies from market-to-market, but across the board subscription streaming is yet to go truly mainstream. High profile new entrants into the market, like Pandora and iHeart in the US, and Amazon globally, could all help to further promote the concept of paying a monthly fee to access 40 million odd tracks on-demand.

Spotify has always claimed that Apple's move into streaming actually helped rather than hindered its growth. Although a major new competitor with big pockets and major ad spend had entered the market, having the market-leading download seller launch a streaming service was a big news story, and that made a whole new audience aware that subscription streaming was an option. Some of whom then signed up to Spotify rather than Apple.

Having other major media and web brands go fully into subscription streaming could have a similar effect. Especially when those new services can be up-sold to existing mainstream customers – like the millions of free users of Pandora and iHeart's personalised radio services, or the listeners of iHeart's US-wide network of AM/FM radio stations, or Amazon's massive global customer base.

As with the impact Apple Music's launch had on Spotify, having these big brands talking up subscription streaming could also help existing players in the market. Which means the streaming music business at large could also benefit, even if the new services from Pandora, iHeart, Amazon et al are not, in themselves, successful.

Of course, there is an argument that the £10 a month subscription package (or the economic equivalent elsewhere in the world) that has become standard will only ever appeal to a minority audience, and that the music industry needs to start offering mid-price options to truly appeal to the mass market.

That's probably true. The challenge remains of identifying what those mid-price services might look like, and how they can be launched without resulting in large numbers of existing subscribers down-grading and spending less each month. Though if that challenge can be met, and the mass market truly cracked, then streaming could continue to see significant growth for the foreseeable future.

2. The power of the platforms is yet to be fully realised

The music industry is only just realising the power of the data that floods in from the streaming platforms each month. There is still much work to be done in how that data is crunched, presented, analysed and shared between different stakeholders, but this information can be used to reduce risk, plan marketing, and inform many aspects of an artist's business.

Beyond the data, there is also the fact that the streaming platforms have a direct-to-fan relationship with music consumers – and knowledge of where they live and what music they consume – which is yet to be fully realised as a marketing and upsell platform.

That's partly because of an understandable concern on the platforms' part not to swamp their customers – especially paying customers – with too many promotional messages from the music industry. And partly because the platforms' primary business partners are the record labels, which aren't necessarily interested in upselling an artists' tickets, merch and other products.

Savvy artists and managers recognise the potential value of these direct-to-fan relationships. And the streaming services are also experimenting in this space, in some cases as a way of placating artists who complain about the royalties they personally receive from streams, and in some cases to drive new revenues.

In addition to allowing artists to use their platforms to upsell tickets and t-shirts – revenue streams in which the label may or may not share – those streaming platforms with free user bases will also likely start upselling digital content on a 'bite-sized' basis. This will enable the platforms, and artists and labels, to earn new income from those free streamers who are never likely to be persuaded to commit to ten pounds a month every month.

Quite who will lead on all this – and how the resulting income will be shared – isn't yet clear, though the streaming platforms have the potential to deliver significant revenues to the wider music community beyond the existing subscription revenue stream.

3. Emerging markets will increasingly deliver the goods

Digital is slowly turning certain markets where income from physical music products was always negligible into decent earners for the record industry. This provides new opportunities for both local talent and global artists.

In the IFPI's figures, Latin America saw the highest growth in 2016, up 12%, compared to 7.9% in North America, 5.1% in Asia and 4% in Europe. Meanwhile, when commenting on the record industry's figures, Spotify cited Brazil and Mexico in particular as markets that are becoming key for its business.

The streaming firm's Will Page said: "Spotify's success story has expanded beyond established markets, with Brazil and Mexico now making up two of our top four countries worldwide by reach. Back when the industry peaked in 2000, Brazil and Mexico were seventh and eighth biggest markets in the world respectively. A combination of increasing smartphone adoption – reaching far more users than CDs ever did – and Spotify's success makes the potential for these emerging markets to 're-emerge' and to exceed previous peaks".

Optimism also remains about the potential of big markets like China, which have become more much friendly to copyright owners in recent years, and where local streaming platforms are starting to sign up significant numbers of users. Although it remains early days, if markets like China really could mature for the record industry, that would prove to be very lucrative for the global business.

REASONS FOR GLOOM

1. The subscription streaming business model is not yet proven
The single biggest reason to be pessimistic is that the record industry is increasingly reliant on a small number of global services – Spotify and Apple Music in particular – none of which are as yet profitable.

While streaming is proving lucrative for the record companies, that is not true for the platforms. That's partly because the global services are pursuing aggressive growth strategies that are expensive. But it also because – while the deals between labels and streaming platforms are revenue share arrangements at their heart – the record companies also demand upfront advances and minimum guarantees.

The streaming services hope that, once they reach a certain scale, revenue share payments will start to always outperform the minimum guarantees, and the 30% of revenues they get to keep each month will more than cover ongoing running costs.

The two crucial questions are: what scale do the services need to reach to become viable businesses and can they reach that scale? Which is to say, how many paying users do Spotify and Apple Music each need to be viable businesses long-term? And how many paying users does the record industry need for streaming to sustain the business once downloads are more or less gone and physical is a niche product?

For the labels, there are two causes for concern here.

First, it seems inevitable that the streaming firms will ultimately seek to move to true revenue share arrangements, removing advances and minimum guarantees from the deal. What impact would that have on the income the labels are currently seeing?

Second, what if the big services were to conclude that their current business models just don't work? Could they successfully pivot, and quite what would they want from the labels to help make that happen?

Of course, let's not forget our earlier optimism: Spotify and Apple Music continue to sign up impressive numbers of new subscribers; mid-price services could open up streaming to a whole new consumer base; and we are yet to fully exploit the upsell potential of both free and premium streaming platforms.

But for all the pessimists out there, it's certainly true that the streaming business is still in its experimental phase. There could be some shocks ahead.

2. The labels will have to share more of the pie
Even if the streaming business ultimately works – in its current form or otherwise – and becomes profitable for the platforms, and therefore sustainable long term, will it remain as lucrative for the record companies?

In a recent interview with the FT, the boss of BMG – Hartwig Masuch – said "I believe there will be some wake-up calls – I am very cynical about the view that the good days have returned". His reason for this caution was that, "every renegotiation [with an artist] will cut down massively on the margin".

There has been much debate in recent years over how streaming income is shared between platforms, labels, publishers, artists and songwriters. About 70% is usually passed to the music industry: 55-60% usually being allocated to the recording rights (label and artist) and 10-15% to the publishing rights (publisher and writer).

The big music publishers have been slowly pushing up the cut of the money they and the songwriters receive in recent years closer to the higher end of the 10-15% bracket. Which was one of the reasons Spotify had to try to negotiate the labels down a few per cent, the platforms being adamant that a 30% share is the absolute minimum they can operate on in order to be viable businesses.

It remains to be seen if the streaming firms push for a bigger cut down the line, or whether they seek to add to their cut of the income by starting to charge the music industry to access certain premium data or marketing channels.

Though Masuch was talking about how the income that comes into the record industry is shared with the artist. This depends on record contract. Artists on classic record deals are likely receiving under 20% of streaming income, inline with the way monies were shared when CDs and downloads were sold.

+17.7%
DIGITAL REVENUE GROWTH

+60.4%
GROWTH IN STREAMING REVENUE

Figures from IFPI's Global Music Report 2017

Many artists and managers have argued that labels cannot justify taking a similar cut of streaming income compared to CD, because there are none of the costs and risks associated with physical product.

Meanwhile some heritage acts argue that streaming has provided labels with a very cost efficient way of exploiting catalogue, which often stems from old record deals that pay tiny royalties to artists, and which were agreed at a time when no one foresaw the ease with which old music would be monetised in the future.

Labels could be ultimately forced to share more of their streaming income with heritage artists through a change in copyright law. Though with newer talent, labels could argue that if artists aren't happy with the royalties on offer, they shouldn't do the deal. Yet new acts continue to sign to traditional labels – major and indie – suggesting that record companies do still ultimately deliver value in the digital age.

Though companies like BMG and Kobalt are offering artists other options, with a services approach where the label invests less, and management usually delivers more, and the artist routinely sees more than 70% of income. If that services model is sustainable, and more artists go that route, so that they don't take the traditional record deal that's on the table, that could put commercial pressure on all labels to pay a higher royalty.

Arguably, with established acts, that is already happening. But traditional labels still arguably have the edge when it comes to breaking new talent, and for the time being new acts that need a label's money and infrastructure may continue to reluctantly sign-up to deals that pay out less than 20% of streaming income. Though some new artists are breaking that mould too, and things could ultimately shift even with new talent deals.

3. The labels will have to learn to live with free

Many in the record industry – and the wider music community – remain uneasy with the amount of free streaming that is available, partly because of the nominal royalty free streams generally pay; partly because of a feeling that the availability of free streaming is slowing the growth of paid-for streaming; and partly because its felt people should pay to access at least the latest releases.

YouTube, of course, is the biggest free music streaming platform in the world, and the music industry feels that its presence prevents any crackdown on free streams elsewhere. The labels can't crackdown on YouTube because of the safe harbours, hence the IFPI's lobbying to have safe harbour rules rewritten.

But – even if it gets its way on safe harbour – realistically the music industry will have to learn to live with free streams long term, as will most of the media and entertainment industries. Which is to say, it seems inevitable that online the majority will freeload, while a minority will fund the business. The challenge is how to turn free users onto paid-for services, and how to sell other stuff to those who will never sign-up to a monthly subscription.

In many ways, with music, it was always so, in that most people got most of their music for free via the radio, which paid nominal royalties to the industry, while some people got some of their music via CD, which generated the big bucks. The difference online is that the free services and the paid for services are so similar.

But either way, it seems likely that free streams are going to be part of the online music experience for the foreseeable future. The challenge is how to generate revenues around and despite all that free content. And, of course, learning to live with the fact that some consumers, and some services, seem to be getting something of a free ride. Though the music industry will likely do just that if it can continue to achieve decent growth for many years to come ■