<u>A MUSIC COMPANY 2</u>

CMA – Music & Streaming Market Study

response to questions outlined in Statement of Scope document.

February 2022

General questions

1. What have been the main changes in the music industry as part of the shift to music streaming, including any changes to:

a. business models;

This is a hugely broad question. Some high level observations would be:

- The ‘industry’ and its associated agencies, service providers, creatives, production houses, tech platforms, analytics providers, media outlets, record labels, managers, DIY artists, publishers, sync and ancillary rights management services are more varied and dynamic than at any other point in the last 20 years. ‘Streaming’ and the readily available access to routes to market has touched every aspect of our business.
- In non-Covid times, the share of revenue derived by an artist from the sale of physical or digital products was typically eclipsed by revenues derived from live performance, merchandise, publishing and other ancillaries. The investment costs, most of which are ‘up front’ (i.e. in advance of a product release) however, fall mainly on the record company.
- In the last 3-5 years there has been a sizeable increase in the number of investment funds and financial institutions playing a role in both rights ownership and creation and funding of tech/digital focussed companies. They see such investments as a having a relatively secure, annuity like profile. The effect of this liquidity has typically inflated the cost of repertoire acquisition, made commercial terms more aggressive and increased the cost bases of incumbent record and service companies (e.g. due to inflated staff salary expectations).

b. the cost structure of the industry (eg costs of music companies, costs recouped from music creators; and costs of music streaming services);

- *Investment costs for record labels remain familiar and relatively high (see below), from sourcing talent, nurturing creation, to all aspects of building awareness, discovery and taking products to market. Music streaming revenues typically have had a longer tail in terms of the time period it takes to establish an ROI. In the physical world, as a generalisation, 80% of product sales might be generated in the initial 3-6 months of a campaign post the initial release date. This is not necessarily the case for streaming, which often has an elongated ‘consumption curve’. Investment costs in artists remain relatively high with varied levels of assured return. The speculative/risk profile of the business remains significant.*
- *Investment in digital expertise, supply chains, content creation and reporting have been significant for record companies and remain so.*

- *Costs of physical manufacturing (vinyl)*

c. risks that music companies and music streaming services take on; and

- The music industry, and especially record labels, remains a business built upon identifying and supporting creative talent. This is not without risk. The nature of the creative process and establishing of rights/products that can later generate a return on investment is by definition 'front loaded'. That is to say that much of the costs of bringing and artist and their repertoire to market are incurred prior to rather than after any success has been established. Streaming does not alleviate this risk. In fact, the prolific and increased volume of artists and releases made available in the market through such services has made standing out from the crowd and building ongoing returns all the more challenging. Hence, often, the need for the investment, experience and expertise offered to artists by labels and service companies. It should be noted that, generally speaking, the investment surrounding the recording and bringing of products to market rests primarily with the record companies (as opposed to the publishers, live agents or managers). This cannot be said to be the same when it comes to revenue generation – notably that significant (often the majority) share of an artists revenue streams will derive from non product based incomes. That is to say that pre and post Covid (which significantly impacted the live and ancillary rights sector), the revenues most artists derive from live performance, merchandise and other ancillary incomes would be significantly greater than those secured from physical and digital consumption.

d. the way firms compete at different levels in the music streaming value chain?

- As noted above, the varied and dynamic nature of todays business, coupled with a low barrier to entry (in terms of making releases available) and multiple types of services meeting the needs of different stages of an artist or labels development result in an incredibly competitive market with a variety of options and choices of services and partners available to artists.

2. To what extent do costs change, if at all, as music streaming revenues grow, and if so, what drives any changes in costs (eg see paragraph 88), for:

a. Music companies;

Record companies (i.e. "Labels") continue to have essentially the same range, type and magnitude of costs associated with the development, support, creation, marketing, distribution and exploitation of artist repertoire. Investments in A&R, the recording processes, creation of artwork, video content and other rich media collateral all remain. In some aspects these costs have increased. For example (i) increased sales of physical vinyl continue to play an important role in mix of formats made available but the associated production costs has increased significantly in recent years and (ii) the evolution of digital consumption trends, social media platforms and Digital Service Providers (for example Spotify, YouTube, Apple Music etc, "DSPs") features has resulted in significant increase in content creation (videos, visual assets etc) and an elongated marketing plan to encourage discovery and consumption of releases

b. Music streaming services?

> To some extent, music streaming services benefit from economies of scale as revenues derived from paying subscribers and advertising has increased – i.e. following the logic that if consumption per user remains flat or decreases as the number of subscribers/revenues increase then the cost per user would decrease. However, as popularity of streaming increases, so does consumption. As has the proliferation of repertoire being released and supplied to DSPs (estimated at 60k tracks/day). This huge increase in supply coupled with increasing consumption will in turn increase the DSP cost base.

3. Are there any key technological or other changes anticipated in the music industry, particularly anything that could impact competition in the future, either between music companies or between music streaming services?

The only constant in our business is that the business is constantly changing.

Metaverse (AI/AR); Blockchain/NFTs initiatives; Crypto; Payment models; changes to DSP offers to consumers – these are all going to present opportunities and challenges that the business will respond to.

The continued diversity and complexity of the exploitation of rights will require ongoing investment in expertise, systems and processes in order to aid repertoire/product discovery and meet the demands of the market when it comes to establishing routes to market, the means of supply and friction free remuneration. This may favour those able to makes such investments but we are also confident that service companies will be able to offer solutions to smaller operations and meet market needs in the future much as they do today.

4. Are there areas within the stated scope of the market study that the CMA should particularly focus on, or any important areas it has missed?

Look at the ways in which music services (DSPs) program and serve repertoire to consumers via 'algorithmic', 'auto play' and voice driven requests versus the commercial terms agreed for such rights. i.e. is there a relationship that means that less expensive repertoire is served more than other repertoire and as such this distorts the market share of rights holders and the payments received.

Look at User Upload Content (UUC) services, such as Tik Tok, and the potential value gap that exists between huge volumes of usage versus comparatively low values derived by rights holders.

Competition between music companies

5. How do recorded music companies compete with each other in:

> *a. the supply of services to music creators to develop and bring their music to market; and*
>
> *b. the supply of music to music streaming services?*

This is a hugely broad topic. Companies compete in a variety of ways, often influenced by market share and levels of resource available. Clearly, larger organisations are often able to afford to spend more on the marketing of an artist or product release, or leverage off greater resource and teams when it comes to promotion and awareness strategies.

Actual supply of music to digital services is relatively standardised in terms of expected processes and standards required. Some companies are better at it than others – not least due to their willingness and capacity to invest in systems, processes and expertise. This features as part of the decision choices considered by artists/managers when working with partners (see 8, a)

6. How well is competition working at present between recorded music companies?

- *As per above, our sense is that competition is as vibrant and dynamic as at any other time. Artists have a wide range of options in respect to how they approach the market – from self-serve platforms to, artist/label service deals to long term licensing partnerships and everything in between. Artists and managers have the option to 'shop around' and there is a wealth of different companies, services and deal types that meet the varied needs and development paths of the artist community.*

7. How, if at all, is competition between recorded music companies likely to change in the future?

- Not hugely. The independent sector represents approx. 25% of the UK market. The self-serve platforms provide a solution to artists at a certain, often more developmental level. The service companies continue to be varied in their offerings and commercial terms. Labels, of various sizes and expertise will seek out and look to sign and support talent and repertoire. Artists will continue to have choice.
- Market developments driven by "metaverse" activities are likely to encourage market entrants and potential fragmentation or hold back of certain rights depending upon whether partners are able to deliver services to artists in these developing areas. Again, the future proofing of record and service companies in this area requires investment prior to any guaranteed return.

8. To what extent can music creators seek better terms for the services they are offered by recorded music companies?

a. What are the key drivers of a music creator's choice of recorded music company? What role do music managers play in this?

General point: As described in other answers, there is plenty of variation and choice when it comes to an artist choosing the service or partner they want to work with. Once that choice is made, there are usually agreed term lengths as well as commercial and service level provisions. If during the term the artist wants to renegotiate, this is possible but would typically be determined on a case by case and centre around the development and success of the artist versus the return on any investment made by the record company. Broadly, the more successful the artist the more viable a discussion is likely to be about changing an agreement mid-term. Once the term ends, the artist has the capacity to look to the market as well as negotiate with their current partner.

Artists have a broad range of services and types of deal open to them. The choice of partner will be informed by the level of expertise and resource the artist have at their own disposal versus what they would require from a partner in order to meet their aspirations for the project. Factors driving their decision will include (but not be limited to):

- Rights granted – what rights the artist is willing to make available to the partner e.g. digital, physical, sync, other
- A&R and recording costs – guidance and funding around the creation and recording of repertoire
- Release strategies & marketing services – e.g. audience development initiatives, advertising campaigns, promotion services etc

- Access to international markets – the provision of promotion and other solutions across multiple markets
- Manufacturing and Production – CD, Vinyl, Packaging etc
- Sales & Distribution – physical and digital supply and sales with commercial routes to market
- Insights, Accounting, Reporting and Payment Terms
- Commercial terms – royalty rates, advances, other contributions (recording costs, tour support etc)
- Deal Type – license vs service agreement
- Term length – typically informed by commercial terms and deal type

Managers, where hired by an artist, typically lead the commercial discussion with the record company or service.

b. What are the key factors determining the bargaining power of music creators in negotiations with recorded music companies?

- Factors influencing commercial discussions between artists and their managers and labels, include but are not limited to:
    - Size of catalogue (if any)
    - Sales history (if any) by territory, by format
    - New Release commitments
    - Rights available (physical, digital, ancillaries, territories)
    - Investment requirement – e.g. is a contribution required to artists recording costs, artwork, video and other assets
    - Marketing commitments and tour support requests
    - Royalty share for the rights agreed
    - Length of term
    - Advance requests

c. Does the strength of competition between recorded music companies vary for different types of music creator, for example music creators at different stages of their career – and if so, how and why?

- Naturally the commercial terms and the inclusion of bespoke aspects of agreements tend to vary/benefit established artists with a proven track record of sales versus those agreed between an artist and a label at the start of their career. That said, given the level of competition and the range of options available to development artists (e.g. self-serve platforms etc), there is more scope for artists who are relatively early in their careers to secure highly attractive, more nuanced agreements.
- There is often a distinction between the considerations included in agreements done today versus those that have been done in the past.

9. To what extent can music streaming services seek better terms from recorded music companies?

a. What are the key factors determining the bargaining power of music streaming services in negotiations with recorded music companies?

The commercial terms agreed with rights holders by Music Streaming Services (or Digital Service Providers, "DSPs") are typically influenced by the size and market share of the service vs the size and share of the rights holder. Consequently, smaller, independent companies may choose to either (i) deal directly with a service but will typically have 'standard' commercial agreements that do not always contain some of the bespoke features that might be negotiated with other, larger rights holders or (ii) go through the services and terms provided by a distribution partner, such as [Integral] or (iii) access commercial terms through Merlin (www.merlinnetwork.com). This rights agency was set up by a portion of the independent community to negotiate framework agreements with DSPs on behalf of its right holding members. This enables those members to supply products to those services under the terms negotiated by Merlin.

b. What impact, if any, do recorded music companies' links with music publishers have on these negotiations?

- At independent labels or self-produced artists level, there is no connection between the two facets of streaming royalties but rumours are that Majors are contemplating their whole returns (publishing and recording) when signing a deal. It is worth mentioning that CRO are playing a role in some of the publishing negotiations. A CRO, like Sacem, is representing UMG and Warner in some DSP's contracts as well as representing some UK, continental and US independent publishers including all the publishers working together under the agency Impel (a mini Merlin for publishers). The CROs and Merlin positions in the marketplace help de facto to reduce the potential gap of earnings between indies and majors.

10.What scope is there for smaller recorded music companies (including DIY platforms) or music streaming services to compete with the major music groups?

Independent companies are by their very nature managed by innovative, passionate and tenacious entrepreneurs. They absolutely have the capacity to compete with major groups in some aspects of their offering (development, creative ideas, credibility/reputation, marketing skills etc). However, costs associated with content creation, marketing and other resources afforded and available to major labels can put them in a position of advantage.

11. What barriers, if any, are there to:

a. entry and/or expansion in services offered by recorded music companies; and

b. innovation in relation to these services?

There is often a tension between the desire to broaden services or add expertise with the associated investment required to do so in advance of a meaningful return on that investment. Therefor, size and scale often does have an impact on the ability of companies to diversify or invest in enhanced offerings.

12. What, if any, issues are there that limit competition between music companies, either in the supply of services to music creators or in the supply of music to music streaming services (see paragraph 95 and 100 above for examples of the types of possible issues the CMA intends to explore)?

Generally speaking there is a highly dynamic and varied array of services, choice and competition available to music creators at all levels of an artists evolutionary journey.

13. How can competition between music companies be strengthened in the supply of services to music creators and/or in the supply of music to music streaming services?

Generally speaking there is a highly dynamic and varied array of services available to music creators at all levels of an artists evolutionary journey.

Competition in music streaming services

14. How do music streaming services compete with each other for consumers?

Typically through:

i) Discounts and Trials – Free 30 day and 3 month trial discounts are typically used to acquire new customers. This results in a reduced payback to the rights holder during the trail period. The DPS focusses on customer retention, post trial, at which point the price point and payback typically reverts to 'full price'.

ii) DSPs initiating Third Party Partnerships – e.g. mobile phone, broadband and other brand collaborations that bundle the music service alongside other offers. These partnerships typically result in a discounted revenue per user being paid back to rights holders by the DSP in lieu of growing the customer base and the retention of paying customers after the initial period of partnership/discount granted.

iii) Direct to consumer offers – through advertising incentives direct to consumers; by bundling the music service alongside other offers from the parent company (e.g. Apple bundle the music service into a wider entertainment package; Amazon make music available as part of their 'Prime' service)

iv) Product differentiation – previous USPs included the volume of tracks available on the service or territory availability. Today, USPs tend to focus more around product features (e.g. sticky visual or content providing added context) added value services (e.g. podcasts) or enhanced features (e.g. Spatial Audio)

It should be noted that some larger DSPs have claimed in the last 3 years that a) the cost of customer acquisition for them has increased as they compete with other entertainment offers available in the market (e.g. Netflix/Disney+) and b) testimonials suggest that once a consumer has 'invested' time and effort in familiarising themselves with a service, it is not easy to convince them to move.

15. How well is competition in the supply of music streaming services working at present?

There are a range of options available to artists – from self-serve tech platforms, to service companies and record companies that take on the responsibility of managing the supply of repertoire to routes to market. This is a relatively established and evolved space and, generally speaking, there is a low barrier to entry in respect to being able to make repertoire available on music services. That said, some companies are more adept and supportive in processes associated with the supply of products and there are certainly ways in which aspects of the supply of timely and accurate meta data to DSPs can be improved.

Note that the retail price charged to consumers by music services has remained static almost from inception (e.g. £9.99/month for a single user subscription) and as such, in real terms, the value of revenue being shared amongst rights holders has been eroded over time. We believe that such an erosion is detrimental to the short, mid and long term investment in artists, services and streaming offerings, and that prices should be increased – this seems unlikely to occur unless all services choose to do so. When certain services have wider interests (hardware, online stores etc) than a pure play music offering, the willingness to increase prices appears limited.

16. How, if at all, is competition in the supply of music streaming services likely to change in the future?

New services and offerings from tech partners (e.g. metaverse etc) will require specific supply and commercial solutions. New market entrants are likely.

17.How do consumers make decisions about which music streaming services to use? What barriers are there, if any, to consumers switching between services?

There are limited barriers to consumers changing from service to service. Consumers are most notably driven by price first, product features second. Demographic profiles inform typical DSP usage profiles. Free services often skew younger and act as a gateway. Family and student plans encourage introduction to subscription features. Casual non-avid users are happy to move from service to service based upon price and/or whether they get music as part of a wider bundle (e.g. Amazon Prime). Some consumers will be tied into fixed length agreements through their service forming part of a mobile or hardware bundle offer. This does not stop them choosing an additional service during the same period. For the more enthusiastic user, competition amounts DSPs is fierce around becoming the 'first service' choice for the more discerning consumer as they invest more time in the curation of their playlist etc and are often less likely to move from service to service.

It should be noted that headline price points for subscription services have remained almost static for 10+ years across all services. So in real terms, the value of music has decreased. There is a strong argument that as markets mature (in this case the UK) the price point for accessing subscription streaming services should increase. Note that other similar services (e.g. Netflix) have increased prices whereas music services have not.

18.How do consumers use music streaming services and to what extent is their usage influenced by playlists or recommendations?

Passive use or 'lean back' use of services is prolific amongst many users. The use of playlists and then the subsequent 'auto play' and 'artist radio' features generate a significant proportion of use. Such features are curated by the music services. Certain features (for example 'Discovery Mode' on Spotify) will deliberately feature certain tracks in the users experience because the rights holder has agreed to take a reduction in the royalty it receives in return for such inclusion. This 'payola' model is something that should be resisted as it distorts the user experience and has a detrimental impact on the revenues inclusion and presentation of repertoire not participating in the discount. This obviously favours those benefitting from or able to afford discounts. For example, some service companies revenue models are based upon one-time fees rather than being tied to 'sales' revenues. As a consequence these companies do not care as much about discounting royalties due. Such repertoire has the capacity to be favoured by Spotify as it is 'cheaper' to them whilst disadvantaging those not participating.

Voice driven activations (e.g. "play me something calming") are controlled by the music services. The selection process for what is served to a consumer following such a request is far from clear and could well be open to any number of influencing factors.

19. What barriers, if any, are there to:

a. entry and/or expansion in music streaming services; and

b. innovation in music streaming services?

Scale is certainly a factor when looking to compete in the ‘traditional’ sense of being a music streaming service. Pure play ‘music only’ services that do not have the benefit and leverage of a wider portfolio of interests (e.g. social media platform, hardware sales, e-commerce platform etc) will struggle to succeed in the ‘traditional’ music streaming service space.

There is significant opportunity for smaller entities to develop in the burgeoning metaverse/NFT/Blockchain environment but we would expect those to be most successful to be targeted for acquisition by incumbent services and platforms as they evolve.

20.What, if any, competition or consumer issues are there in the supply of music streaming (see paragraphs 98, 100(c) and 103 above for examples of the types of possible issues the CMA intends to explore)?

21.How can competition in music streaming services be strengthened?

22. How can better outcomes for consumers be achieved in music streaming?

Consumer are the primary beneficiaries of a highly dynamic market. The question implies there are currently poor outcomes, which we believe is not the case. Consumers will continue to benefit from a highly competitive and innovative market featuring new product developments/innovations, discounts and bundle offers will remain a key acquisition lever; relatively low price points and the relative ease in ability to move between services and all consumer benefits.

Agreements and inter-relationships between music companies and music streaming services

23. What impact, if any, do equity cross holdings and agreements between music companies and music streaming services have on: a. competition between music companies; and b. competition and innovation in music streaming services?

24.What impact, if any, is there on competition in the music streaming value chain from any softer forms of influence or control that music companies and music streaming services may have over each other (for example related to back catalogue rights or playlists/recommendations)?