Chapter 4

An Overview of the US. Recording Industry

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THE GROWTH IN THE U.S. RECORDING INDUSTRY

The U.S. recording industry is a multibillion-dollar industry that has experienced a cyclical series of gains and losses (table 4-1). For the past several years, however, the recording industry has been experiencing an increase in revenues: the industry's dollar volume in 1987 was $5.57 billion in manufacturers' shipments (based on the suggested list price), an increase of 19.7 percent over 1986 figures,[1] and the 1988 volume was a record $6.25 billion, a 12.2-percent increase over 1987.[2] The number of records, tapes, and CDs shipped, net after returns from retailers, increased 8 percent to reach an all-time high of 761.9 million[3] (table 4-l). The Harry Fox Agency, the music licensing agency, reports that 65,525 licenses were issued in 1988, a 13.6-percent increase over 1987. Of these, 25,380 (38.7 percent) were first-time licensed songs, compared with 15,088 first-time licenses in 1987.[4]

Although revenues for the recording industry are expected to grow at an average annual rate of about 6 percent through 1993,[5] industry spokesmen are adamant that current growth does *not* indicate that the effects of home audiotaping are negligible. On the contrary, they assert that revenue growth would have been even larger, if not for home audiotaping.[6]

A large part of the recent increase in revenues can be attributed to the introduction of several new formats, especially compact discs (CDs). Introduced in 1983, CDs accounted for a third of the industry's total dollar volume in 1988 (table 4-l). Sales of cassette singles reached $57.3 million since their introduction in 1987, and sales of yet another new format, the 3-inch CD single amounted to nearly $9.8 million (table 4-l).

Meanwhile, the proliferation of portable cassette players, Walkman-type stereos, audiocassette decks, etc., has increased the popularity of cassettes, which are now the predominant format or "carrier" for prerecorded music. Cassette sales accounted for 54 percent of all dollars spent on prerecorded music for 1988, while unit sales increased 10 percent in 1988 to a value of $3.38 billion[7] (table 4-l).

The sales value of LPs declined to $532.3 million, continuing a decline that began in 1980. Unit sales of disk singles also declined 11 percent in 1988 (table 4-l).

RECORDING COMPANIES[8]

The U.S. recording industry has six dominant record companies (the "majors"), each with several affiliated labels. They are:

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[1] RIAA Market, Research Committee, Recording Industry Association of America, Inc., 1989.

[2] H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 1.

[3] RIAA Market Research Committee, Recording Industry Association of America, Inc., 1989.

[4] Edward P. Murphy, President, National Music Publishers' Association, Inc. and the I-Larry Fox Agency, Inc., letter to OTA, Feb. 28, 1989,

[5] U.S Department of Commerce, ***U.S. Industrial Out look, 1989,*** p. 57-4.

[6] U.S. Congress, Senate Judiciary Committee, ***Video and Audio Home Taping,*** hearings before the Subcommittee on Patents, Copyrights, and Trademarks, Serial No. J-98-75, Oct. 25, 19&3; and U.S. Congress, Senate Judiciary Committee, ***Home Audio Recording Act***, hearings before the Subcommittee on Patents, Copyrights and Trademarks, Serial No. J-99-69, Oct. 30,1985, Mar. 25 and Aug. 4,1986.

[7] H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 2.

[8] The following is a general overview of the U.S. record industry, and is in no way meant to be a comprehensive discussion Of how recording companies function. It is not an attempt to fully explain all aspects of the recording industry, but rather highlights some of the major characteristics and distinctions of its operation.

Table 4-1.—Annual Shipments

Manufacturers' unit shipments (millions net after returns)

	'74	'75	'76	'77	'78	'79	'80	'81	'82	'83	'84	'85	'86	'87	'88	% Chg. '87-'88
Disc singles	204.0	164.0	190.0	190.0	190.0	195.5	164.3	154.7	137.2	124.8	131.5	120.7	93.9	82.0	65.6	-20%
LP's/EP's	276.0	257.0	273.0	344.0	341.3	318.3	322.8	295.2	243.9	209.6	204.6	167.0	125.2	107.0	72.4	-32%
CD's	–	–	–	–	–	–	–	–	–	0.8[a]	5.8	22.6	53.0	102.1	149.7	+47%
Cassettes	15.3	16.2	21.8	36.9	61.3	82.8	110.2	137.0	182.3	236.8	332.0	339.1	344.5	410.0	450.1	+10%
CD singles	–	–	–	–	–	–	–	–	–	–	–	–	–	–	1.6[a]	NA
Cassette singles	–	–	–	–	–	–	–	–	–	–	–	–	–	5.1[a]	22.5	+341.%
Total[b]	592.0	531.8	590.9	698.2	726.2	701.1	683.7	635.4	577.7	578.0	679.8	653.0	618.3	706.8	761.9	+8%

Manufacturers' dollar value ($ millions at suggested list price)

	'74	'75	'76	'77	'78	'79	'80	'81	'82	'83	'84	'85	'86	'87	'88	% Chg. '87-'88
Disc singles	194.0	211.5	245.1	245.1	260.3	275.4	269.3	256.4	283.0	269.3	298.7	281.0	228.1	203.3	180.4	-11%
LP's/EP's	1,356.0	1,485.0	1,663.0	2,195.1	2,473.3	2,136.0	2,290.3	2,341.7	1,925.1	1,689.0	1,548.8	1,280.5	983.0	793.1	532.3	-33%
CD's	–	–	–	–	–	–	–	–	–	17.2[a]	103.3	389.5	930.1	1593.6	2089.9	+31%
Cassettes	87.2	98.8	145.7	249.6	449.8	604.6	776.4	1,062.8	1,384.5	1,810.9	2,383.9	2,411.5	2,499.5	2,959.7	3,385.1	+14%
CD singles	–	–	–	–	–	–	–	–	–	–	–	–	–	–	9.8[a]	NA
Cassette singles	–	–	–	–	–	–	–	–	–	–	–	–	–	14.3[a]	57.3	+301%
Total[b]	2,186.4	2,378.3	2,732.0	3,500.8	4,131.4	3,685.4	3,862.4	3,969.9	3,641.6	3,814.3	4,370.4	4,387.8	4,651.1	5,567.5	6,254.8	+12%

SOURCE: RIAA Market Research Committee, 1989

[a] Format introduced. 1987 sales for cassette singles are for only 6 months.
[b] RIAA totals include 8-track tapes.

1. CBS Records Group, which owns, among others, the Columbia, Epic, and Portrait labels;
2. Warner Communications, Inc., which owns, among others, Warner Brothers, Elektra/Asylum/Nonesuch Records, and Atlantic Records;
3. RCA Records Group, which along with Arista is a subsidiary of Bertelsmann Music Group (BMG) of West Germany,
4. Capitol Industries-EMI, Inc., which owns Capitol Records, EMI America, Angel, Manhattan, and Blue Note labels;
5. MCA, Inc.; and
6. Polygram, which includes the Mercury, Polydor, Phillips, London, and Deutsche Gramophone labels.

For the most part, the majors have historically grown in size by the acquisition of smaller competitors.[9] For example, each of the affiliated labels of Warner Communications, Inc., was at one time an independent company, and MCA, Inc., just recently acquired Motown records.

The major recording companies have experienced tremendous growth over the current upswing. In 1988, both CBS and BMG Records experienced their biggest selling year.[10] Similarly, Warner Communications achieved its highest operating income in the first half of 1988, netting $143 million.[11] MCA, Inc., hit an all-time high mark of **$41 million in 1987, a 21-percent** increase over the previous year.[12]

Currently, there are two large independent recording companies, A&M, which contracts with BMG for its manufacturing and distribution, and Chrysalis, which contracts with CBS. Motown Records, previously another large independent company, was recently sold to MCA which had handled its manufacturing and distribution, and to MCA's investment partner, Boston Ventures, for $61 million.[13] These large independent labels have maintained at least 1 percent of the market share over a period of years, and with the exception of distribution, they perform all of the functions of a major recording company.[14] There are numerous other independent labels. MTS, Inc., the company that runs Tower Records, for example, carries over 2,600 listings of independent labels.[15] These firms vary in size from A&M and Chrysalis to a label owned by just one artist.[16] Most are small firms that in the aggregate maintain a market share of less than 1 percent.[17]

[9]David E. Kronemyer and J. Gregory Sidak, "The Structure and Performance of the U.S. Record Industry," *1986 Entertainment, Publishing and the Arts Handbook*, by John David Viera and Robert Thorne (eds.) (New York, NY: Clark Boardman Co. Ltd., 1986), p. 266.

[10]David Lieberman, "Now Playing: The Sound of Money: The Record Industry's Platinum Success Is Spawning Multimedia Empires," *Business Week, No. 306586-90,* Aug. 15, 198S, pp. 86-87.

[11] Mark Mehler, "WCI Music Nets $143 Mil Income in Record 1st Half," *Billboard*, vol. 100, No. 31, July 30, 1988, p. 5.

[12]Lieberman, op. cit., footnote 10, p. 86.

[13]See Mark Potts, "Grapevine's Right: Motown Sold: As Rumored, MCA Inc. To Buy Record Company," *The Washington Post*, June 29, 1988, pp. G8G9.

[14]United States of America before Federal Trade Commission, Docket No. 9174, In the matter of Warner Communications, Inc., Warner Bros. Records, Inc., Chappell & Co., Inc., and Polygram Records, Inc., Trial Brief of Counsel Supporting the Complaint, Aug. 17, 1987, p. 9.

[15]Russell M. Solomon, President, Tower Records, letter to OTA, May 2, 1989.

[16]Kronemyer and Sidak, op. cit., footnote 9, p. 270; FTC hearings, op. cit., footnote 14, pp. 8-9.

"FTC hearings, op. cit., footnote 14, pp. 8-9.

Record Company Functions

The production and sale of prerecorded music in the United States comprise three major functions: production, manufacturing, and distribution. Production entails selecting and recruiting artists and material for the artist to record, securing the arrangement, financially managing the recording, and recording the material. Manufacturing involves reproducing and packaging the recordings onto cassettes, LPs, singles, CDs, etc. Distribution includes marketing, advertising, promotion, and the orderly release of the product, as well as managing sales, inventory, collection, and wholesale pricing.[18] While exact data were not available to OTA, interviews with recording company executives suggest that manufacturing, packaging, and royalty costs are about $2.50 to $2.75 for a typical LP/cassette, and $3.50 to $4.00 for CDs. Of the wholesale price (approximately $5.00 for an LP or cassette), perhaps $1.00 will go to the artist and another $0.55 will go to the music publisher and songwriter.[19]

Differences Between Majors and Independents

Whereas all of the major labels are typically minor subsidiaries of diversified corporations,[20] independent labels are generally involved only in the business of producing records.[21] The major record companies also differ from the independents in that they are vertically integrated into the production and distribution of prerecorded music on a national or international scale.[22] Thus, they can produce, manufacture, and distribute their products. Independents, on the other hand, do not have this capacity, and must either subcontract with a major recording company or rely on an independent firm to manufacture and distribute their products. Independent distributors are limited to distributing products on a regional basis.[23]

Subcontracting arrangements can be beneficial to the majors as well as the independents.[24] Major recording companies have developed extensive manufacturing and distribution networks to take advantage of large economies of scale. These networks require an adequate flow of sound recordings to operate at optimal efficiency. The WEA (Warner/Elektra/Asylum) distribution network, for example, employs over 1,000 people in four regional distribution centers, and in 1987, it tracked over 1,500 line items.[25] By subcontracting its facilities to independents, the majors are able to operate at maximum efficiency, and, in return, the independents are able to price their products competitively.[26]

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[18] Ibid., p. 7.

[19] OTA staff interview with record company executive, June 22, 1988; H. Rosen, R.I.AA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 8.

[20] Kronemyer and Sidak, op. cit., footnote 9, p. 267.

[21] Dick Weissman, "Record Companies," *The Musk Business: Career Opportunities and Self-Defense* (New York, NY: Crown Publishers, Inc., 1979), p. 36.

[22] FTC hearings, op. cit., footnote 14, p. 8.

[23] Ibid., p. 8.

[24] The following is taken from Kronemyer and Sidak, op. cit., footnote 9, p. 270.

[25] OTA staff interview with WEA executive, June 22, 1988.

[26] Kronemyer and Sidak, op. cit., footnote 9, p. 270.

Relative Advantages and Disadvantages[27]

The majors have comparative advantages over independents in manufacturing and distribution since they can more closely coordinate the release of the product with marketing, promotion, and sales efforts.[28] The independents can, however, incur lower fixed costs of manufacturing and distribution by subcontracting with the majors. Overall manufacturing and distribution costs are higher for major record companies, although the majority of the costs associated with recording music (i. e., studio time, producers' fees, musicians, etc.) remain the same regardless of the size of the recording company.[29]

Because of their stature,[30] and their ability to offer large bonuses and increased royalty rates, the majors are more able to attract well-established artists than are independents. A major label may also better be able to afford to risk a venture on new talent, and, in fact, may view its future in that market.[31] Although many new acts get their first "break" by signing with an independent recording company, the Recording Industry Association of America (RIAA) reports that the major distributors sell most of the new talent on the market and that the vast majority of records released by the major distributors are not by the proven successes.sp Sales from a few new talents may represent huge profits for record companies, since new artists rarely receive the high royalty rates of well-established artists. At the same time, new talent may also represent a substantial loss for a record company since most new recordings fail to make a profit.

Distribution

Distribution involves the sale of the product to retailers, wholesalers, subdistributors, and sometimes, directly to the consumers. It also involves warehousing and inventory control, and tracking of consumer buying habits. Music is "perishable" in the sense that sales depend on closely coordinating advertising, marketing, promotion, and pricing. The bulk of a recording's sales are generated during the short time in which it is a "hit." Thus, it is critical that an adequate supply of the product be available when demand peaks.[33]

The majors distribute over 83 percent of the recording industry's total volume,[34] approximately 10 percent of which is for independent labels.[35] With the exception of recordings the artist sells in conjunction with performances, independent distributors account for the remaining 17 percent. Independent distributors operate regionally in the United States. Most carry products from some of the larger independent labels, in addition to a large number from the smaller ones.

[27]The following is taken from Kronemyer and Sidak, op. cit., footnote 9, pp. 267-270.

[28]Ibid., p. 270.

[29]Ibid.

[30]FTC hearings, Op. cit., footnote 14, p. 10.

[31]H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch 3, p. 7

[32]Ibid.

[33]FTC hearings, op. cit., footnote 14, p. 14.

[34]Ibid., p. 52.

[35]Ibid., p. 19.

All of the majors– with the exception of MCA, which has a foreign distribution contract with Warner Communications, Inc.– distribute their recordings outside of the United States and earn as much as half of their revenue from foreign sales. Foreign markets provide a greater opportunity for recording companies to spread their initial production costs and generate higher revenues.[36]

Retail Sales[37]

Record stores are responsible for over 60 percent in dollar volume sales of prerecorded music. Large-scale outlets are supplied directly by the recording companies; smaller operations purchase their merchandise at a slight markup from subdistributors, known as "one-stops." One-stops stock products from a wide range of labels, especially those of the major recording companies. One-stops offer record retailers the convenience of purchasing most, if not all, of their music from one source. Some one-stops specialize in one particular type of music; others carry a wide range of selections.

Mass merchandisers, such as department and discount stores, sell a high volume of prerecorded music, particularly hit records. Most mass merchandisers do not buy directly from the recording company, but rather enlist the services of a "rack jobber" to supply their music. Rack jobbers carry a narrow selection of prerecorded music, usually the top albums on the music trade paper charts, and thus limit their selections to current hits. In some cases the rack jobber actually leases the space in the department or discount store and owns as well as operates the record department.[38]

Recording companies also sell their product directly to the consumer via direct mail. Currently, there are two record clubs operated by the major recording companies:[39] the Columbia Record Club, part of Columbia House, a division of CBS, Inc., which distributes music from all the major labels with the exception of RCA; and RCA which distributes its music along with the products of other companies such as A&M, Arista, Capitol, Mercury, and London.[40] Smaller recording companies also operate their own mail order systems, but offer a narrower selection.

RECORDING CONTRACTS

Types of Recording Contracts

Crucial to the recording business are the contracts that define the business arrangements underlying record production and the allocation of revenues from the recorded material. Although there is no one standard recording contract today, recording agreements tend to be negotiated within one of four categories:[41] the exclusive artist recording contract, the "all-in" artist contract, the produc-

[36] Ibid., pp. 30-31.

[37] The following is taken from material incorporated in the FTC hearings; Dick Weissman, "HowRecords Are Sold and Distributed," *TheMusicBusiness: Career Opportunities and Self Defense* (New York, NY: Crown Publishers, Inc., 1979), pp. 60-67, and Adam White (&.), *Inside the Recording Industry: An Introduction to America's Music Business* (Washington, DC: Recording Industry Association of America, 1988).

[38] Weissman, op. cit., footnote 37, p. 62.

[39] H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p.12.

[40] Sidney Shemel and M. William Krasilovsky, *This Business of Music (New* York, NY: Billboard Publications, 1985), with 1987 update, p. 56.

[41] The following is incorporated from Alan H. Bomser and Fred E. Goldring, "Current Trends in Record Deals, " *1984 Entertainment, Publishing, and the Arts Handbook,* Michael Myer and John David Viera (eds.) (New York, NY: Clark Boardman Co. Ltd., 1984), pp. 168- 169; Shemel and Krasilovsky, op. cit., footnote 40, p. 47; Harold Vogel, "The Music Business, " *Entertainment Industry Economics: A Guide For Financial Analysis* (New York, NY: Cambridge University Press, 1986), p. 145; and H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989 (enclosure with comments on draft ch. 3, pp. 12-16).

Photo Credit: Ed Asmus, Courtesy of MTS, Inc.

Cassettes have become the most popular audio format.

tion contract, or the master purchase or master license contract. Under the exclusive artist recording contract, the recording company signs the artist directly to the label, and an in-house or independent producer is assigned to guide the project. Under an "all-in" artist contract, the recording company contracts directly with the artist, who furnishes his own independent producer. The artist is paid a lump sum, and then must pay the producer and other costs.[42] Under the production contract,[43] the recording company contracts with an independent production company representing the artist. The production company need not be a music producer per se, and in some cases may simply be the artist's manager.[44] Under the master purchase or master license contract, the artist provides finished

[42] H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 13.

[43] For a more detailed discussion of production contracts, see Bomser and Goldring, op. cit., footnote 41, PP. 168-169.

[44] H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 12.

master recordings to a production company which then sells or licenses them to a recording company.[45]

Within these categories, specific contract provisions are based on negotiations between the recording company and the individual artist or the production company representing him. These provisions may be contingent on the relative bargaining power of the recording artist – i.e., whether he is a new or well-established artist.

Contract Provisions

Length of Contract

In the past, a recording artist's contract typically ran for 1 year, with the recording company having the option to extend the contract period for up to four additional l-year periods. Now, however, recording contracts usually specify the number of albums to be delivered, with options for an additional number of albums to be delivered in the future.@ During this contract period, the artist is obligated to record exclusively for that recording company. This provision protects the recording company from having its artist start recording for another company after the original company has invested a great deal of time and money in developing that artist's career.[47] Although the contracts usually bind the record company to record the artist, they do not require that the recordings actually be released. Contract negotiations might stipulate that the artist is free of contractual obligations if the recording company fails to release the artist's work after a specified period (e.g., 6 months).

Other issues that the artist and the production company or recording company negotiate include default clauses, conditions under which a contract can be reassigned to another person or company, foreign release commitments, ownership of publishing rights, and the artist's right to audit the recording company's books.[48]

Ownership and Use of Masters[49]

Since a recording agreement is a contract for employment between the recording artist and the recording company, the company owns the recorded product as a "work-made-for-hire" under the U.S. copyright laws, unless otherwise provided.[50] Contract negotiations determine whether the masters and the copyrights of the sound recording would revert to the artist after a certain period. Most contracts also contain language addressing release, remastering, reissues, etc.

Recording Costs and Advances

In the United States, as in all countries but France,[51] all costs of recording and producing a musical work are recoupable out of an artist's royalties. It can cost from $100,000 to $500,000 or more to record and produce an album.[52] The initial investment for a new artist is usually over $200,000, excluding the costs of marketing, advertising, and producing a pro-

[45] Bomser and Goldring, op, cit., footnote 41, p. 168; Vogel, op. cit., footnote 41, p. 145.

[46] Bomser and Goldring, op. cit., footnote 41, p. 172.

[47] Shemel and Krasilovsky, op. cit., footnote 40, p. 10.

[48] Vogel, op. cit., footnote 41, pp. 153-154.

[49] Material taken from Bomser and Goldring, op. cit., footnote 41, p. 172; Shemel and Krasilovsky, op. cit., footnote 40, pp. 12-13.

[50] Bomser & Goldring, op. cit., footnote 41, p. 172; Shemel and Krasilovsky, op. cit., footnote 40) p. 12.

[51] H. Rosen, RIAA, letter t. J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 18.

[52] H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 18.

Photo Credit: Capitol Records, Inc

Mastering room

motional video. Music videos have production costs of approximately $50,000 to $80,000 for new artists, and around $130,000 to $250,000 or more[53] for well-established artists. Overall, the costs of recording, manufacturing, advertising, producing a video, and promoting an album can run anywhere from $300,000 to $750,000 or more.[54]

The artist does not normally receive income from the sale of his recordings until all recording and some other costs are recovered.[55] Therefore, an artist, especially one who is just beginning, may need financial assistance to cover expenses. The recording company will often advance payments to the artist to assist with initial expenses. The size of an advance varies with each artist and each situation. In principle, these advances are recoupable from future royalties, but according to RIAA, artists are seldom forced to repay the advance if a

[53] H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 19.

[54] H. Rosen, RIAA, letter t. J, Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 18.

[55] In addition t. recording costs, the record company may be able to recover partial artwork, promotion], packaging, and/or advertising fees.

recording does not sell.[56] Many albums do fail to recoup their recording costs; the recording industry estimates that 85 percent of all pop albums and 95 percent of all classical titles fail to recover their costs.[57]

In addition, some contracts may allow the recording company to recover its costs for all prior recordings made by the artist. In other words, if the artist had recorded three previous albums for which the recording company had been unable to recoup costs, the company might be able to recoup all losses before paying out any of the royalties made from the last and only successful album. Whether this is the case depends on contract negotiations and the relative bargaining power of the artist; according to the RIAA it seldom occurs.[58]

[56] H. Rosen, RIAA, letter to J. Winston, OTA, May 2, 1989. Enclosure with comments on draft ch. 3, p. 20.
[57] White, op. cit., fOOtnOte 3', p. 35.
[58] M. Cover, Recording Industry Association of America, telephone conversation with D. Wong, OTA, May 11, 1989.