

# **The supply of recorded music**

A report on the supply in the UK of pre-recorded  
compact discs, vinyl discs and tapes containing music



MONOPOLIES AND MERGERS COMMISSION

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**Presented to Parliament by the Secretary of State for Trade and Industry by Command of Her Majesty  
June 1994**

## Members of the Monopolies and Mergers Commission as at 14 April 1994

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Mr D P Thomson<sup>1</sup>  
Mrs C Tritton QC  
Professor G Whittington

Mr A J Nieduszynski (*Secretary*)

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<sup>1</sup>These members formed the group which was responsible for this report under the chairmanship of Mr Graeme Odgers.

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Part I

# **Summary and Conclusions**

# 1 Summary

1.1. The UK record industry is large and internationally important. Retail sales in the UK amount to over £1 billion per annum and UK employment associated with the industry exceeds 48,000. The industry earns considerable income from licensing its recordings overseas. UK sales represent 7 per cent of the world market, but it is estimated that a larger proportion of world sales (about 18 per cent) are recordings involving UK artists.

1.2. Our inquiry has looked at both the record companies and the retailers of recorded music in the UK.<sup>1</sup> On the record companies side five multinational companies, known as 'the majors', account for about 70 per cent of the market. These companies are EMI, PolyGram, Sony, Warner and BMG. We find that a complex monopoly situation exists in their favour by reason of their pricing practices, arrangements on parallel imports<sup>2</sup> and terms of contract with artists. The remainder of the market is made up of some 600 other companies known as independents, many of which are small and specialize in particular genres of music, eg dance or jazz. Many of these companies engage in similar practices to the majors but lack the majors' market presence both in the UK and internationally. Across the UK industry the great bulk of sales are of popular records, with classical music accounting for only 9 per cent of sales.

1.3. On the retail side W H Smith, through its own shops and through its subsidiary Our Price, supplies 26.6 per cent by value of the market. Since this amounts to more than 25 per cent, this group of companies has a scale monopoly. Other significant retailers are Woolworths (15 per cent), HMV (13.5 per cent), Virgin Retail (4.2 per cent), Boots (3 per cent) and Tower Records (2 per cent). There are also some 1,100 independent specialist record shops and a growing number of 'non-traditional' outlets such as petrol stations and supermarkets. In addition, mail order and record clubs account for some 12 per cent of the market.

1.4. Copyright is central to the operations of the record industry, both in the UK and internationally. It allows record companies to invest money and enterprise in creating commercial recordings which can be exploited in both the home and overseas markets knowing that they have legal protection against unauthorized reproduction. Copyright is also important in ensuring that the talents of successful artists and songwriters are rewarded.

1.5. The MMC inquiry was prompted by concern about the prices of compact discs (CDs), and particularly the fact that prices appeared to be significantly higher in the UK than in the USA. Much of the apparent difference relates to different tax arrangements. Sales taxes in the USA are considerably lower than the UK's 17.5 per cent rate of VAT. Moreover, record prices are displayed without sales tax in the USA, whereas shelf prices in the UK include VAT.

1.6. We commissioned our own survey of comparative UK/US prices and found that the real price differentials were considerably lower than is often supposed. The survey showed that, when tax is

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<sup>1</sup>The terms of reference are set out in Appendix 1.1.

<sup>2</sup>See the Glossary for definition.

excluded, the prices of full-price popular CDs are on average 7 to 9 per cent higher in the UK than in the USA at an exchange rate of \$1.50 to the pound. The differential for full-price classical CDs is greater at about 25 per cent. However, some 55 per cent of classical CDs sold in the UK are in the mid-price or budget categories and there are strong indications that the price differentials covering the complete range of full-price, mid-price and budget CDs are on average lower than the differentials for full-price CDs.

1.7. These price comparisons are based on an exchange rate of \$1.50 to the pound, which was the average for the second half of 1993. Variations in exchange rates will lead to changes in the measured US/UK price differentials. We sought to check whether record price differentials were out of line with those existing in other low- to medium- priced manufactured goods associated with leisure activities. We found that they were not. This suggests that the price differentials for CDs are not the result of circumstances specific to the record industry.

1.8. Apart from the influence of particular exchange rate levels it was argued that the much larger size of the US market (resulting in longer manufacturing runs and the ability to recover the high initial cost of a recording over a greater number of sales) and the generally lower US retailing costs (relating particularly to lower premises costs and higher labour productivity) lead to price levels being generally lower in the USA. It has not been possible to quantify the effect of these factors but we believe the arguments have force and apply both to CDs and to a wider range of manufactured products.

1.9. We also compared record prices with those in a number of other industrialized countries and found that UK prices are generally lower. Thus it appears that the UK is not experiencing systematically higher prices for recorded music.

1.10. It was suggested to us that the differential with the USA could be eliminated if the record companies' ability to control parallel imports were removed. We do not believe this would be the case. Such a move would in any event be contrary to the EC Rental Directive and could be damaging because of the increased risk of piracy and the general weakening of copyright protection, which is territorially based.

1.11. We found that the major record companies compete vigorously amongst themselves and with the independent sector. New entrants are a pronounced feature of the industry. The major record companies' strength in the market-place is balanced by powerful retailing groups. The major companies are not therefore able to exercise market power to the disadvantage of consumers and we conclude that prices are set at competitive levels in the UK market. The major record companies are not making excessive profits.

1.12. Record retailing is also a competitive market. There is no evidence that the scale monopoly of W H Smith enables it to exploit its position. Its profits on record retailing are not excessive.

1.13. The record industry is a high-risk business. The great majority of recordings do not sell enough copies to recoup their initial investment. Record prices must therefore be set so that the earnings on successful records will cover losses on the failures. It would not be sensible for the record companies to price CDs, cassettes and vinyl records strictly in relation to manufacturing costs, which make up only a small proportion of the total costs. Instead record companies have developed pricing structures for different recordings and different formats which reflect consumers' perceptions of quality and value and hence willingness to pay. Given the strong competition in the market we believe this pricing policy is justified.

1.14. During our inquiry a number of issues were raised in connection with the contracts between artists and record companies. We found that the record companies compete actively in securing the services of new and established artists. Terms of contract have generally moved in the artists' favour

over the last 20 years. Artists are normally professionally advised in their commercial negotiations with the record companies about contract terms, both at the time of the initial contract negotiations and at subsequent renegotiations. Ownership and control of copyright for a significant period is essential to a record company that has made a large initial investment in recordings and in an artist's career. We see no case for any change in the contractual or copyright framework governing the relationship between artist and record company. The proper forum for the resolution of particular disputes between artists and record companies is the court.

1.15. We had some concern about the record companies' practice of giving free singles to retailers as a means of promoting new releases. However, on balance we think no change is required in connection with this practice because it forms part of the competitive process and benefits the independent retailers, who do not receive discounts and other promotional support to the same extent as large retailers.

1.16. Finally, we also felt some concern that consumers might be misled by the practice of some major retailers in displaying charts which show the retailers' predictions of future sales rather than actual sales as recorded in the national charts. Where retailers do this we consider that they should make clear the basis on which the charts have been compiled.

1.17. Although we have found two monopoly situations to exist, we have not found that they operate against the public interest.