

11 Views of independent record companies

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Introduction

11.1. We sent a questionnaire to four of the largest independent record companies, MCA, Pickwick, Beggars Banquet and Telstar, and a rather shorter questionnaire to a sample of other independents. The questionnaires sought information about these record companies' businesses and invited any views they wanted the MMC to take into account. In this chapter we record the views expressed by the four large independents, and by nearly 60 other independent companies which responded to our questionnaire or which separately wrote to us. These companies are listed in Appendix 11.1. Many independent companies, as well as the majors, are represented by the BPI but a number of others are represented by Umbrella, a separate association recently set up to represent their interests. Umbrella made written representations and attended a hearing.

11.2. This chapter records the views of all these parties. The independent record companies generally took a position which was not dissimilar to that of the majors. Umbrella, and one of the companies, Tring International Plc, however, took rather different positions from the other independents and their evidence is dealt with separately at the end of the chapter.

MCA Records Ltd

11.3. MCA, whose ultimate parent is Matsushita of Japan, said that it saw itself as a relatively small player in the UK market and was a price follower rather than a price setter. It had its own quite modest repertoire of UK artists and acted as the UK licensee of its US parent. It was reliant upon one of the majors, BMG, for the manufacture and distribution of its product in the UK.

11.4. MCA said that the UK music business was highly competitive, with vigorous competition from the majors and the independents. MCA priced its products with a view to increasing sales; in view of its size and the nature of its repertoire, it did not have sufficient market power to set prices. MCA considered it very important that copyright protection for recorded music was maintained at its current level.

11.5. MCA said that it faced competition from other record companies in the UK at three main levels: the acquisition of contracts with recording artists, the promotion and marketing of its artists and the sale of its records to retailers. First, as to competition for artists, MCA told us that it took a significant risk when it signed an artist, in view of the unknown chances of the success of a recording, even for an artist with an established reputation. The terms on which it offered a recording contract represented a balance between that level of advance necessary to persuade the artist to accept the offer in preference to a rival record company, and a prudent maximum, given the unpredictability of an artist's reception in the market. There was keen competition to sign up artists, and in negotiations artists and their managers tended to play off one record company against another in order to maximize the terms of an offer.

11.6. Secondly, MCA faced fierce competition for media exposure and retail promotion of its records from both major and independent companies. In MCA's experience, entry to the charts compiled by retailers and displayed at the point of sale depended upon whether those retailers were prepared to promote the product and what a record company was prepared to pay to have the recording featured in retailers' chart lists in their outlets.

11.7. Thirdly, there was intense competition for sales to retailers, and this was compounded by the considerable market power exercised by the large retail chains. That power was reflected in aggressive, permanent discount purchasing from MCA. In addition, major retailers almost always sought a marketing contribution from MCA.

11.8. Turning to the question of parallel importation of records, MCA said that the 20 or so cases in which it had exercised its right to prevent parallel imports in the last three years had generally related to instances where the release date of the record in the USA had been earlier than that scheduled for the UK. MCA had had a legitimate interest in seeking to protect its marketing campaign in respect of those records in the UK. It accordingly endorsed the arguments which had been submitted by the BPI and the IFPI to the MMC in support of the current restriction on parallel imports into the UK.

11.9. MCA considered that the UK music industry made a major contribution to the British economy in terms of the level of turnover generated, the employment created and the consumer demand that was satisfied. It also stimulated developments in a wide variety of related markets such as fashion, publishing and radio and television broadcasting; these in turn created a favourable response to British cultural products on world markets. The music business was almost unique amongst cultural sectors in the UK (such as opera, film and theatre) in that it received no Government subsidy whatsoever. Nor did it receive any indirect support comparable to the pricing support enjoyed by the book publishing industry under the Net Book Agreement.

Pickwick Group Ltd

11.10. Pickwick Group Ltd (Pickwick), a subsidiary of Carlton Communications plc, told us that the majority of its records were retailed at budget prices; they were sold in traditional record outlets and also in supermarkets, garage forecourts and airports, and by mail order. Pickwick's main competitors were other budget labels, such as those produced by PolyGram and EMI and by independents such as Tring and Castle.

Beggars Banquet Records Ltd

11.11. Beggars Banquet told us that its records were sold primarily in independent retail outlets; however, the more successful records were also available in the multiple retail stores. Beggars Banquet said that it competed with all other record companies, including the majors, on a range of industry activities including signing artists, promotion, marketing and price, and believed the market was intensely competitive. It kept its dealer prices a little lower than those of the majors for similar products and was prepared to experiment with pricing, for example by offering a major release at a reduced price to gain initial orders. The problem was that this reduction in dealer price might not be reflected in the retail price, since retailers tended to operate price categories.

11.12. Beggars Banquet said that it also ran some retail shops and from its perspective both as record company and retailer said that to its knowledge neither sector made unreasonably high profits. As to copyright law in the recorded music area, any lessening of the current protection would be disastrous for the industry.

Telstar Records plc

11.13. Telstar Records plc (Telstar) said that it licensed product from repertoire owners and sold its records in high street retailers, multiple chains and specialist stores. Its records were marketed largely through television advertising. Because of the high costs of such promotion, most of its records were sold at full price. Telstar said that it was in direct competition with the major record companies; moreover, competition from non-music products such as videos and computer games was increasing.

11.14. Telstar told us that, from its experience both in Europe and the USA, the UK market was the most competitive and the one where it was most difficult to succeed. The recent concentration in power of the retail chains was having an increasing effect on dealer prices and as the market share of the chains increased, so Telstar's margins decreased. These retailers achieved large discounts off the dealer price and exercised complete control over the retail price of records.

Other independent record companies

11.15. While individual companies generally commented on only one or two aspects of our inquiry, many made the same points and in this section we summarize the main points made by one or more of the companies listed in Appendix 11.1.

Need for the inquiry

11.16. A number of the companies thought that the industry should not have been referred to the MMC for investigation. Some took the view that the continuing adverse publicity could only damage a successful industry with good export earnings. Others said that it was wrong for the MMC to be asked to investigate the prices of luxury products like CDs which involved discretionary spending by consumers. Many of the necessities of life were supplied by highly profitable monopolists and these were more appropriate areas for investigation.

The price of CDs

11.17. Many companies claimed that the price of CDs was not high by international standards; indeed, records were more expensive in virtually every major market in the world than in the UK. It was true that records were generally cheaper in the USA, but so were most other products. This was because the USA had a totally different economic, political and social structure, with lower operating and manufacturing costs than the UK and other European markets. Retail margins were generally higher on UK than US goods; in particular, the major UK record chains demanded high levels of discount, which kept UK dealer prices high. A comparison of UK prices with those of other European countries was more appropriate, and this showed that UK prices were generally lower.

11.18. The companies said that it was important to remember, in comparing the price of products as between the UK and other countries such as the USA, that the level of the exchange rate at any particular time could affect the relative prices considerably. Thus, the data which the NHC had published about the prices of records in the USA had been collected at a time when the exchange rate was approaching \$2:£1. After 'Black Wednesday' the rate had moved to \$1.50:£1, a rate at which UK prices, although still higher than US prices, had moved considerably closer to their US counterparts.

11.19. One classical record company said that it was also important to remember, in looking at comparative CD prices in the UK and the USA, that consumers often failed to take into account the VAT which was charged on records in the UK. Prices in the USA were always quoted ex-sales tax and this gave a misleading impression of the price actually paid by the customer at the till. This company pointed out that there were strong parallels between the classical record industry and the publishing industry, and that consideration was being given in Europe to a joint VAT level for publishing and classical CDs-5.5 per cent in the case of France. A lower VAT level of, say, 8 per cent on both classical CDs and print might be a solution which would contribute to Treasury revenues but would be seen as giving back something to the consumer and to an unfairly vilified industry. It would also make US and UK prices broadly comparable.

11.20. Some companies said that there was no evidence that cheaper records would lead to an overall increase in record sales. Moreover, there was at present a wide variety of different prices for consumers to choose from within each format.

11.21. One company pointed to the fact that it had to pay royalty rates for licensed-in US repertoire that were at least double those paid by its competitors in the USA; those had to be covered in the prices it charged. Another said that any lowering of CD prices without a corresponding reduction in manufacturing costs could have the effect of damaging many independent labels. These had been very successful in the UK, many occupying niche markets. The independent classical sector had done particularly well in the UK.

11.22. Moreover, in real terms, CD prices had come down over the years. By the end of the 1970s, inflation had left vinyl LP prices far below their true level and the record industry was having difficulty in surviving in view of the inadequate returns. Since that time, record prices had not kept pace with inflation and were now in reality too low. At the same time, artists and collecting societies acting on behalf of rights owners had been pressing for, and often obtaining, higher royalty rates, and this had put an extra burden on the independent sector.

11.23. One company told us that it had tried, without success, to release CDs containing recordings by some of its best-known artists at budget prices in the hope of stimulating increased sales. This company considered that the budget area of the market had been swamped by pirate CDs imported from the EC; these provided their importers, distributors and retailers with margins that legitimate record companies could not match.

Value for money of CDs

11.24. Many companies expressed surprise that a high-quality product such as a CD should be expected to cost no more than the inferior formats which had preceded it. Just as a hardback book commanded a higher price than a paperback, so CDs justified higher prices than vinyls or cassettes. They offered a considerably higher sound quality than either or those formats, a total playing time of up to nearly 80 minutes, and a virtually indestructible format. To that extent, a CD offered better value than many more ephemeral forms of entertainment. Consumers were willing to pay for a quality product. On the classical music side in particular, consumers were abandoning cassettes in favour of CDs because of the superior sound quality of the newer format.

11.25. One of the classical record companies told us that, while it was true that the manufacturing costs of CDs had fallen over the past few years, the savings in manufacture were more than outweighed by the extra costs involved in producing a longer and technically more sophisticated product. Typically, half a dozen sessions would be required in order to take full advantage of the format, and further costs were involved in editing. Another classical record company said that it cost about twice as much to record a CD, typically 70 minutes long, as a 40-minute vinyl LP. The consumer was routinely receiving twice as much music on the CD format and it would therefore be fairer to start from the assumption that a classical CD should cost the same as two LPs.

Profitability

11.26. The 20 or so companies which directly addressed the question of profitability in the independent sector said that it was clear that they were not making large profits. Some stressed the precariousness of the record business and said that they barely succeeded in remaining in a profit-making position. Such companies typically survived only by finding a niche audience, exploiting it skilfully and keeping overheads to a minimum. Sometimes a small company did produce a record with mass appeal, and it might then become profitable for a time, but such success was usually short-lived. A significant number of independent record companies went out of business each year, mainly because they had had a run of loss-making releases, a position that could not be sustained indefinitely. Because of the higher costs of manufacturing CDs, as opposed to other formats, the losses which occurred when a recording failed to achieve sales were correspondingly all the greater.

11.27. A number of these companies said that a price reduction of £2 on a record would have very serious implications for their businesses and might force them to close. The effects on the industry would also be serious: the smaller companies were the creative seedbed for the industry in terms of new talent and if they did not survive, the overall music scene would be impoverished and the public offered a far narrower range of music than was currently the case. There would also be serious employment implications throughout the industry, already affected by the recession.

11.28. Several companies stressed the vitally important role which the independent companies played in fostering contemporary classical composers and artists. The costs of producing contemporary classical orchestral or operatic repertoire were high and were sometimes only made possible by public funding, and yet the numbers of records sold were often tiny. In these circumstances, and at a time when further subsidies were threatened, a reduction in the current dealer price would have serious implications for the future of such companies.

Research and development

11.29. A number of the companies stressed the vital importance of being able to continue investing in new artists. Investment was needed to sustain the creative cycle, developing new, successful artists who would produce recordings ultimately forming part of a company's back catalogue, which would in turn generate the money to fund the next round of new artists. It was only by being able to control the pricing of their records that companies could generate sufficient funds to invest in this way. Any measures that threatened this capacity to invest would have the effect of upsetting the whole cycle of development of new music and artists.

11.30. Many of the companies also pointed to the high risks associated with the record business. To achieve chart success, it was necessary only to sell a few thousand records, and so there was intense competition for such success. It was much more difficult and risky for an independent label to promote and market its products than for one of the majors. Rapidly changing consumer tastes also made success less predictable. In effect, the business was akin to gambling, and those companies survived which were able to control and limit the number of loss-making records which they released. It was necessary to have an acute sense of the developments taking place in consumer fashions and how well particular music was selling. While the majors could employ large numbers of people to fulfil these functions, and in any case had their vast back catalogues to sustain any losses, the smaller companies had to rely on becoming familiar with niche genres and markets.

Contribution of record industry to UK economy

11.31. Several companies stressed the major contribution which the independent sector had made and was continuing to make to the UK's balance of payments and to the international standing of the UK in the music field. The industry had also used the power and influence of popular music to make an important contribution to charity work, through such initiatives as Live Aid. Outside interference in a self-sufficient and successful industry was both unnecessary and undesirable.

The pop and classical music sectors

11.32. Several companies stressed the very different economics of running a pop record company on the one hand and a classical label on the other. One company, in the classical field, said that while there would never be as large an audience for classical as for pop music, classical music would always be relatively more expensive to record, not only because of the artists who had to be paid for their skilled services, but because of the immense care and expensive equipment needed at every stage of a modern digital recording. The pop industry was able to recoup its costs with potentially enormous sales, sometimes in the millions; the classical side had to do so with sales typically around one-hundredth of this volume or less. Moreover, while pop artists were frequently paid in the form of royalties which, by definition, diminished if a recording was unsuccessful, classical choirs, orchestras and producers had to be paid in full at the time a recording was made irrespective of its subsequent commercial success or failure.

11.33. By contrast, a company in the pop sector said that it bore all the risks of one of the major record companies, but, unlike the classical company which might be acquiring very cheaply the rights to an old recording or making a recording itself with no artist royalty and without copyright liability, it had to survive on the sales performance of new acts alone and could not escape copyright.

11.34. Another classical independent said that it specialized in world première recordings, and that its costs, which mostly involved major orchestras, more than justified its present prices. A further classical specialist said that it offered an enterprising and diverse range of excellent recordings at a reasonable price and it was one among a number of highly respected labels which had proved that quality and dedication could be more than a match for the economic might of the majors' labels. The real or imagined misdeeds of the majors could hardly be applied to small labels such as these.

Parallel imports

11.35. Several companies expressed concern about the possibility of UK copyright legislation being amended to remove the current restriction on parallel imports. In their view, such a change would pose a real threat to the UK music industry. The UK represented around 7 per cent of the world market and was responsible for nurturing the talent that was responsible for more of the music sold around the world than any other country except possibly the USA.

11.36. Allowing unlimited parallel imports into the UK market was an invitation to companies with a much lower cost base in other countries to flood the UK market with product which was deliberately priced to undercut the UK record companies but which was only viable for such overseas companies because they were not incurring the marketing expenses or other costs involved in developing the products. The additional sales were a bonus to such overseas companies. But the effect in the UK would be to undermine the viability of the record industry here and to threaten its very existence. The only UK beneficiaries would be the major retailers who would set up distribution hubs to deal with the bulk quantities of product which would be needed to offset the shipping costs. This would threaten the independent retailers and further reduce competition in the high street.

11.37. More particularly, UK record companies would suffer at the hands of non-UK licensees, who had the benefit of manufacturing under licence for their local market, at low cost, and without the attendant expense of long-term artist development and recording costs.

Trade barriers in the USA

11.38. One company said that until 1985/86 the UK industry had been responsible for one-third of US domestic sales. It believed the USA had, since then, systematically created disincentives to UK distributors (and in return to UK business) in the USA by erecting trade barriers. Behind this protection, the USA had been able to develop new labels, artists and repertoire for sale to export markets, hitting UK companies in the rest of the world.

Retailers

11.39. A number of companies criticized the role of the major retailers in the industry. One referred to comments made to the NHC by the former Chairman of W H Smith to the effect that W H Smith was in favour of reducing CD prices but was thwarted by the high dealer prices charged by the record companies and their distributors. This company said that such comments could only appear hypocritical, since W H Smith's prices for classical recordings were among the highest charged by any retailer, yet the market power of that company allowed it to demand and obtain dealer prices that were among the lowest paid by any retailer. Moreover, W H Smith's staff appeared to have very little knowledge of classical music, which was regarded as just another commodity like pens or envelopes. Of all the record retailers, W H Smith could most benefit from better informed staff and a less predictable and limited range of classical recordings.

11.40. Another company said that the major retailers were seeking lower prices as a desperate short-term measure to improve store traffic. If the UK music industry contracted as a consequence of reduced CD prices, such retailers would readily switch their floor space to computer games if that produced the requisite margin. The UK would then be left with an ever-diminishing music retail sector, concentrated in fewer hands.

11.41. A classical record label said that its trade price had in recent years risen much less than the retail price of its records. In the 1980s its trade price had been £7.29 and the retail price £10.99 to £11.99. In the succeeding years, its trade price had risen to the current level of £7.79, whereas retail prices now ranged from £12.99 to £14.99. It wondered how such retail mark-ups could be justified.

11.42. Another company said that it was concerned about the levels of concentration in the retail market, with too much power in the hands of one group, W H Smith. This retailer extracted large discounts from suppliers and was achieving large profits, even though it took no risks (since it could return product to the suppliers) and was doing no more than passively displaying the product.

11.43. Other companies also referred to the substantial margins achieved by the major retailers, and doubted whether these were really justified in order to cover the overheads and staff costs involved in selling recorded music.

11.44. Finally, one company pointed to the importance of distributors to independent record labels. Artists appearing on smaller labels relied on distributors being prepared to supply their releases to retail outlets, both in the UK and the USA.

Other points

11.45. One company said that national radio and television airplay was still dominated by the majors who could spend significant sums on promotional activities. Referring to the difficulty of getting radio airplay, it said that it had the impression of being shut out from a 'very exclusive club'.

Umbrella Organisation Ltd

11.46. Umbrella, an association of independent record labels with independent distribution, said that its members represented 20 per cent of the value of UK recorded music sales in 1992.

11.47. Umbrella explained that it had originally started as a pressure group to keep the independent charts as free from interference by the majors as possible, but had developed into a more general lobbying body. It hoped that its role would develop further to enable it to influence policy at government level with respect to the industry, not only in the present case, but in the case of the proposed EC-wide blank tape levy and more general copyright harmonization.

11.48. Umbrella did not make a collective submission on behalf of its whole membership, but several individual members submitted views to us separately and we held a hearing with them. One member put the following points to us:

- (a) the price of CDs for major popular artists was probably too high;
- (b) CD prices were kept high by the retailers; attempts by one of the majors (Warner) to start a discounting policy had failed because the retailers failed to pass on the discount to the customer;
- (c) the major record companies and the major retail chains had an affinity of interest to maintain CD prices at their current levels;
- (d) vinyl record prices were too low;
- (e) it was in the interests of major international record companies to force vinyl as a music carrier out of the market, and keeping vinyl prices (and hence margins) low helped achieve that; and
- (f) parallel importing would cause problems for independent record companies. This was because most independents were forced to license to majors in the USA, and at today's prices US exports to the UK would undercut UK independent record companies and further squeeze their margins. In addition, overstocks could be dumped on the UK market and have the effect of distorting the UK record industry.

11.49. He suggested the following action to make the market more competitive:

- (a) the majors should be made to divest themselves of record company acquisitions of past years and to demerge the different labels they operated in order to reduce their dominance of the market and allow more competition;
- (b) the majors should be made to divest themselves of ancillary interests in the music industry including music publishing and record distribution;
- (c) collective licensing bodies such as PPL and VPL should be made more independent of the control and influence of the majors by the restructuring and opening up of their governing bodies to representatives of recording artists, consumers and smaller record companies;
- (d) the majors should not be allowed to own more than 20 per cent of any engineering, technological or manufacturing concern which was directly concerned with the reproduction of sound recordings; and
- (e) the major retailers should be broken up to remove their dominance of the market and to encourage more price competition.

11.50. Another member of Umbrella said that in his view, pricing in the industry was led by the larger record companies and the larger retailers, and in the absence of retail price maintenance the smaller companies had to follow the lead or they would simply pass their profits to the large retailers. There was a degree of implicit collusion between the large retailers and the large record companies. Record companies wanted to sell as many units as possible in as short a time as possible in order to obtain a high chart position and benefit from the resulting media exposure. To maximize sales, the record company needed its recordings to be prominently displayed in the large retail outlets.

11.51. This put the large retailers in a commanding position. They could demand large discounts off dealer price, sale-or-return deals, and that advertising and promotion must be paid for by the record company. These retailers could then choose either to pass the discounts on to the public by undercutting smaller rivals or taking the extra profit. This had the effect of squeezing the record company's margins, especially on titles which did not sell well, with the result that they in turn set dealer prices as high as the market would bear in order to maximize their profit.

11.52. Smaller retailers were unable to compete with the larger chains in this situation and were forced to concentrate on selling non-chart, niche items and to seek trade through their greater knowledge of the industry and personal customer service. Similarly, the smaller record companies could not secure the sort of promotion of their records which the majors were able to purchase and in their turn concentrated on selling into the independent specialist shops.

11.53. The power of the large retailers had been most apparent in the rapid loss of sales experienced by the vinyl format. These retailers could stock larger quantities of CDs and sell them at a higher price than their vinyl equivalents, so they had simply stopped stocking vinyl. Once this happened, it became uneconomic for the record companies to manufacture vinyl and it declined, notwithstanding that 90 per cent of households still had a turntable and did not want to be forced to purchase a CD player.

11.54. The final point made by this Umbrella member was that very careful thought should be given to any proposal to amend the current copyright law. The protection afforded by UK copyright legislation was vital, not least for the thousands of unsuccessful artists and musicians in the industry who were unlikely ever to become highly successful.

Tring International Plc

11.55. Tring said that its marketing approach was very different from that of the majors and most of the independents. It was cost-based, and aimed to provide very low-priced CDs and cassettes. Price was the determining factor. Tring thought it could sell any product at the right price and in the right outlets.

11.56. Tring said that it did not seek to record new acts; in fact it very rarely signed new artists. When it did take on new acts or artists, it signed them up for one-off productions rather than attempting to form a long-term relationship with them. Tring said that it had a large current catalogue of products, larger even than was typical of the major record companies. It had some 800 lines available at the moment.

11.57. Explaining its cost structures, Tring said that these allowed it profitably to sell good-quality CDs and cassettes to the market at £2.99 and £1.99 respectively.

11.58. Tring said that it had an excellent relationship with the MCPS. Since it was very much involved with signing acts for the purpose of re-recording material which had already been recorded in the past, it had to be particularly careful that copyright was not infringed. Tring had found that marketable catalogue was tending increasingly to return to the artist's ownership; ie that rights were reverting from the record companies or management to artists.

11.59. An important aspect of Tring's philosophy was to give value for money. It therefore tried, so far as possible, to market CDs which contained the maximum playing time. This was good business sense, since it cost the same to manufacture 73 minutes of music as it did 7 minutes.

11.60. Tring was confident that the BPI handbook considerably understated its market share; no doubt this was also true of other companies which sold other than through traditional outlets. Tring said that it did not supply Boots, John Menzies, WH Smith or Woolworths, ie the very outlets from which the BPI predominantly collected its data.

11.61. Unlike the majors, Tring was not selling predominantly to a 15- to 24-year-old market. Its target market was mainly the 30 to 55 age group, ie a market not only with a larger disposable income, but one which tended to appreciate more than the young market the repertoire which Tring produced. The majors had traditionally relied on the chart market, which appealed mainly to the younger age group, to establish an artist. Tring considered that the majors could only make profits on their album sales, not on their singles, which were being sold to an ever-diminishing youth market.