

Part II

Background and evidence

3 Background to the reference

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The recorded music industry

3.1. The music industry is primarily concerned with the discovery, development and commercial exploitation of musical talent in the shape of composers and recording artists, and the continued commercial exploitation of the works of existing composers and artists. Although the record buyer purchases a physical sound carrier (referred to as a record 'format'-see paragraphs 3.26 to 3.37), such as a CD or cassette, the 'product' which the industry is actually promoting is the artist or sound recording of the composition captured in that format. In the future, new formats and the development of electronically transmitted recordings may alter the way music is purchased and consumed, but the product will remain the same.

3.2. Various intellectual property rights attach to the recording of a musical work, and these underpin the relationships, processes, and commercial and legal arrangements in the recorded music industry. Such rights are based on the concept of copyrights; national laws define the extent of these rights and the national regimes are linked by international copyright treaties or conventions. Within this framework of copyright law and international convention, the trade in recorded music is conducted. An account of these rights, their exploitation, and the relevant UK and international laws and conventions governing the UK music industry is contained in Chapter 4.

3.3. In this chapter, we briefly describe the overall structure of the industry and recent developments both in the UK and overseas which led to the referral of the supply of recorded music in the UK to the MMC.

Structure of the industry

3.4. The recorded music industry is both complex and diverse, carrying out many interconnected activities from the creation and production of original pieces of music and the manufacture and distribution of recordings to the final sale to consumers.

3.5. The most important participants in the industry include the record companies, the composers, the artists, the publishing companies, all those individuals and companies involved in the creation of sound recordings and the music retailers. The functions of each of these participants are briefly summarized in the following paragraphs. They are discussed at greater length in subsequent chapters.

The record companies

3.6. Record companies have a wide range of functions and occupy the pivotal role in the industry. Their principal activities are: finding and developing new artists; recording music, which will involve hiring studios, sound engineers, technicians, producers and equipment; releasing recordings and marketing and promoting them in the UK and in the international market-place; obtaining licences for the repertoire of overseas companies and selling it in the UK; and making royalty payments to artists, music publishers and others out of the proceeds of record sales.

3.7. The five largest UK record companies are usually referred to as 'the majors', by virtue of their international operations and the fact that they own and operate national distribution systems, distributing their own and third-party sound recordings to retailers, wholesalers and smaller distributors. Several of the majors also own and operate their own manufacturing plants, where cassettes, CDs and vinyl records are manufactured. The five majors are BMG, EMI, PolyGram, Sony and Warner.

3.8. There are some 600 independent record companies in the UK. They carry out a more limited range of activities than the majors, centred around the production of a recording. In terms of size, they vary from significant operations such as MCA and Mute Records Ltd to very small businesses issuing only a handful of recordings a year. Independent record companies make an important contribution to the discovery and development of new talent, particularly (although by no means exclusively) in niche areas of musical taste such as dance, jazz, modern classical music or early music. They may also specialize, for example, in the licensing-in of music originated by other record companies to create compilations or in the budget end of the classical sector. Some independent record companies have become very successful, for example Virgin before its sale to EMI.

Artists

3.9. The artists involved in the recorded music industry comprise all those individuals who compose material or who perform as recording artists, or who carry out both activities. Recording artists often write their own material, particularly so far as contemporary popular music is concerned. There are also a large number of musicians who are contracted for particular recordings and who are known as 'session musicians'.

The music publishing companies

3.10. The printing and selling of sheet music is now only a very small part of a music publisher's activities. Music publishers today play an important role in developing the careers of writers (both composers and lyricists), promoting those writers' works, and administering and collecting income from exploitation of the rights in those works. Most record companies, whether majors or independents, have an associated publishing arm. In the case of the majors, these are managed independently.

Studios and others involved in the recording process

3.11. Those who run studios where material is recorded, musical and technical equipment suppliers, producers and sound engineers are all an integral part of the process of making a recording.

Manufacturers

3.12. The manufacturing of records is carried out both by independent manufacturers and by companies which are vertically integrated into the major multinational record company groups. While the manufacturing arms of the majors mainly manufacture only for their own group requirements, the independent manufacturers serve both independent record companies and the majors, particularly when the latter require extra production capacity.

Distributors

3.13. The major record companies each operate centralized distribution systems in the UK, serving both their own record labels and third parties. The recorded music market also supports independent distributors who are closely tied both to the independent record companies and to the smaller, independent retailers. Wholesalers (such as Entertainment UK Ltd (EUK) and TBD) also play an important role in this market.

Promoters

3.14. Promoters of live performances organize venues, concert halls and support services. Live performances play an important part in the marketing by the record companies of individual groups and artists.

Retailers

3.15. Music retailing can be divided into a number of categories in the UK market: specialist music chains, such as HMV, Our Price and Virgin; non-specialist chains, such as W H Smith and Woolworths; and independent specialists, either small chains or single outlets. 'Non-traditional' outlets such as supermarkets, petrol stations and convenience stores also sell a limited selection of records.

3.16. The largest record retailers in terms of overall sales of records are W H Smith, with its subsidiary, Our Price; HMV, which is owned by THORN EMI plc; and Woolworths, which is part of the Kingfisher group. W H Smith also has a 50 per cent shareholding in Virgin Retail which is a joint venture with the Virgin Retail Group Ltd.¹

3.17. The direct mail selling of sound recordings has increased in importance in recent years. Record clubs, of which Britannia Music Company Ltd (Britannia) and BCA are the largest, supply their members from a select list of titles. Mail order companies are much smaller in terms of the volume and range of orders. Some, such as Readers' Digest, market their own compilations.

Ancillary activities

3.18. There are a number of other organizations and activities which are important to the functioning of the music industry. These include:

- radio stations, clubs, pubs and discos, which play records and generate revenues for composers, performers and record companies in the form of royalties;
- trade organizations-there are a large number involved in the music industry, including the British Phonographic Industry Ltd (BPI), which represents record companies and manufacturers, and the British Association of Record Dealers (BARD), which represents retailers;
- the Musicians' Union, which represents many performers;
- collective licensing bodies-these represent copyright holders in negotiations with licensees over royalty payments and undertake the collection and distribution of these payments. Those collective licensing bodies which are important in the recorded music industry are described in Chapter 4;
- the music press; and
- a large miscellaneous services and support sector including lawyers, accountants, managers, graphic designers, public relations companies and advertising agencies.

¹On 2 March 1994 W H Smith announced a proposed merger between Our Price and Virgin Retail to form a new company in which W H Smith will have a shareholding of 75 per cent and the Virgin Retail Group Ltd the remaining 25 per cent.

Size of the industry

3.19. A diagram showing the constituent parts of the UK record industry is given in Figure 3.1, together with an estimate of the total numbers employed in each sector in 1992.



Source: BPI Surveys and estimates.

The international nature of the UK music industry

3.20. Since the emergence of The Beatles in the early 1960s, music originating from UK songwriters and performers has secured a share of world music sales disproportionately larger than would be expected given the size of the UK market. The breadth and diversity of UK talent continues to be reflected in the supply of UK repertoire to the global music market. For although sales to UK consumers account for only 7 per cent of the world total, it is estimated by the BPI that a larger proportion of world sales, about 18 per cent, are from recordings involving UK artists.

3.21. UK record companies regard the international exploitation and success of their recordings as of fundamental importance, believing that many of them would not be profitable on the basis of domestic sales of their repertoire alone. The UK music industry has over the past 30 years been a significant source of export earnings and contributed to the country's balance of payments. Income to the UK from the licensing of recordings overseas exceeds £400 million per annum.

The music scene

3.22. A further characteristic of the UK music scene is its diversity. Although there is no universally accepted categorization, the BPI analyses music sales into the following categories: classical, country/folk, jazz, pop, rock, dance/soul/reggae, middle-of-the-road (MOR) and other. However, the music scene is even more diverse than this analysis would suggest, including punk, rap, heavy metal, acid-house, techno-rave, grunge and swing-beat; and new genres are constantly emerging. Accordingly, musical styles are not readily categorized.

3.23. Of the generally accepted categories mentioned above, pop and rock taken together accounted for nearly 60 per cent of album sales in 1992. Classical music accounted for a little over 9 per cent. The record companies report an accelerating trend towards fragmentation of musical genres and taste and an increased rate at which styles of music and individual releases become popular with consumers and then decline.

3.24. Certain artists and songs, however, can remain popular for many years, for example Cliff Richard or The Beatles. Classical music has enjoyed a growth in popularity in recent years. In 1982 classical music accounted for only 6.2 per cent of all albums, as measured by the BPI. In 1990 this peaked at 11.1 per cent, boosted by the popularity of such recordings as *Nessun Dorma* performed by Pavarotti and used as the theme tune for the 1990 World Cup on BBC television, but has since fallen back to 9.2 per cent in 1992.

3.25. It is the changing taste of consumers which drives the relative popularity of different types of music and this in turn has dictated the wider range of music offered by record companies. Demographic trends have also affected the demand for recorded music, particularly in terms of the volume and type of music purchased by an ageing population, while younger consumers have become increasingly attracted by alternative entertainment such as videos and computer games.

The different formats

3.26. Recordings may be physically carried on a number of different formats, a term which we use to refer both to the physical medium on to which the music has been recorded (the 'sound carrier') and to the amount of music contained on that sound carrier (ie single or album). Each sound carrier requires appropriate hardware on which it can be played, and many households will have several different items of hardware, for example the integrated stereo system, the car cassette player, the radio/cassette player and the 'Walkman'.

3.27. Over the past 25 years or so, recorded music has been available to the consumer on three principal sound carriers, the vinyl record, the music cassette (cassette) and, most recently, the CD.

Vinyl

3.28. When the pop industry took off in the 1960s, vinyl recordings dominated the market, having taken over from the brittle 78 rpm records in the late 1950s. Vinyl records were available as 7-inch singles or 12-inch long-players (LPs). Vinyl LP sales reached their high point in 1975, after which they began to decline, largely because consumers were switching to cassette. Vinyl records are generally held to produce a better sound quality than cassettes, and a small number of listeners (particularly of older jazz recordings) believe the sound reproduction on vinyl is more authentic even than that of a digital (CD) recording. But vinyl records are less easily transportable and are more easily damaged than cassettes, and the latter are very convenient for playing in cars and on personal stereo systems.

3.29. Since 1988, vinyl sales have declined more sharply. Demand for vinyl is now largely confined to fans of specific music genres such as heavy metal and dance, those who believe that the sound quality of analogue recordings is closer to that of a live performance than digital recordings, and those who prefer the traditional turntable to its modern replacements.

Cassette

3.30. Cassettes were introduced in 1967 but were slow to achieve popularity. As noted above, cassettes then grew at the expense of vinyl and continued to grow strongly even after the introduction of CDs in 1983. This was because their transportability and the low cost of the hardware on which they could be played offset some of the advantages of the CD, namely its durability and the fact that, unlike the cassette, the sound quality does not deteriorate over time.

3.31. One of the key characteristics of the cassette format was that for the first time consumers had the means to copy recordings, whether these were on vinyl or on pre-recorded cassette, on to a blank cassette and thus build up a music library of recordings at a fraction of the price at which recorded music was on sale.

3.32. In 1984 there was a rapid expansion of cassette sales as the result of improvements in the sound quality of tapes and the growing importance of portability in consumers' choice of formats as in-car players and personal stereos had become common. Cassette sales reached a peak in 1989. The subsequent downturn in sales from 1990 coincided with the onset of the recent recession but also reflected the increasing consumer preference for CDs.

Compact disc

3.33. The introduction of the CD in 1983 was followed by considerable investment by the industry in promoting this format which is held to offer unsurpassed sound quality and convenience to the consumer, as well as durability. The demand for CDs has steadily increased since 1983 at the expense of both vinyl and cassette. In 1992 total sales of CDs exceeded those of cassettes for the first time.

3.34. Vinyl records, cassettes and CDs are available in two formats, either 'singles' or 'albums'. Singles consist of either one title or up to 25 minutes' playing time. Albums consist of at least four tracks and, in the case of CDs, can play up to about 80 minutes of music.

New sound carriers

3.35. Two new sound carriers, the digital compact cassette (DCC) and the MiniDisc, were introduced in 1992. The DCC, developed by Philips, looks similar to a conventional cassette. It is said to combine the digital sound quality achieved by the CD with the ability to make a perfect copy of a digital recording. DCC hardware is also compatible with analogue cassettes, so that users can play their existing analogue cassette collections on their new DCC machines.

3.36. The MiniDisc, developed by the Sony Corporation, looks like a small CD in a protective cartridge. It is said to offer quick random access to tracks, high sound quality and durability. It is also available in blank form and can be used to make digital copies of pre-recorded music.

3.37. Sales of these formats have so far been low and it is not yet clear how successful they will prove to be. In the past, attempts to introduce new formats have sometimes failed. For example, after stereo LPs had become established in the late 1960s, record companies tried to introduce quadrophonic LPs but these did not develop the wide public appeal necessary to establish them in the market. Again, four- and then eight-track tape cartridges had become available in the mid to late 1960s, but although eight-track cartridges seemed at one time to be on the point of gaining wide support, their sales peaked in 1974 at just under 8 million units.

Origins of the MMC reference

3.38. In 1990 Consumers' Association (CA) had argued in its publication *Which?* that the price of CDs in the shops was too high. When they were introduced in 1983, CDs had cost £10. Since that time, CA said, full-price pop CDs had become only marginally cheaper in real terms, selling at £11 and sometimes £12. The price of classical CDs had not come down at all. Yet during this period, the cost of manufacturing a CD had more than halved and the demand for CDs had grown, so that a reduction in price would have been expected.

3.39. During 1991/92 the Office of Fair Trading (OFT) undertook an investigation into the recorded music market with particular reference to the price of CDs. The OFT's conclusions were summarized by the Minister for Corporate Affairs at the Department of Trade and Industry, in response to a written Question in May 1992. The OFT, he said, had found:

that no producer or retailer had a market share in excess of 25 per cent ... and that there was no evidence of collusion between recorded music producers or retailers, or between producers and retailers. It concluded that prices of compact discs had settled at the level which the market was willing to bear. There was no evidence that the profits of the record producers were excessive. In the absence of any evidence of collusion or anti-competitive conduct the Director General of Fair Trading concluded that no action under the competition legislation was appropriate but the OFT proposes to keep the market under review.

3.40. The OFT continued, however, to receive representations and in July 1992 a new Director General announced that he had decided to open a further inquiry. The inquiry had three objectives:

- (a) to update the information in the earlier inquiry on market structure at both the record company and the retail levels;
- (b) to examine the impact upon competition in the UK market for CDs of the copyright legislation and of restrictions on the importation of CDs offered for sale in the USA; and
- (c) in the light of the above, to decide whether any action would be appropriate under the Director General's competition powers.

3.41. Before the OFT had completed its further inquiry, the National Heritage Committee of the House of Commons (NHC) announced in December 1992 its intention to conduct an inquiry into the price of CDs in the UK. The NHC's report was published in May 1993.¹

3.42. The NHC stated (paragraph 1 of its report) that when the Committee decided to conduct this inquiry, it was looking for an answer to what seemed a very simple question. Why do compact discs cost quite a lot more in the United Kingdom than they do in the United States?

3.43. In its conclusions, the NHC said that it welcomed the examination by the OFT of possible restrictions on international trade represented by legislation governing parallel imports and that even if the result should not prove a reliable basis for a complex monopoly finding, the Committee believed that the operation of the 1988 Copyright Act as it related to parallel imports could work against the public interest. (The 1988 Copyright Act gives copyright owners or their licensees the right to prevent the import of records from another country, even where these records have been produced with the permission of the copyright owner in that particular country—see paragraphs 4.22 to 4.29.)

3.44. The NHC accordingly recommended that the Department of Trade and Industry re-examine current legislation on copyright with particular reference to its anti-competitive effects in the recorded music industry. It was essential, however, the NHC said, that any relaxation of the law relating to parallel imports in the UK should not be used to place the UK at a disadvantage compared with other countries. The NHC concluded by stating that 'It is now time for consumers to show that they will no longer bear the prices currently charged for full-price compact discs'.

¹ See paragraph 2.2.

3.45. On 14 May 1993 the Director General of Fair Trading referred the supply of recorded music to the MMC. In the press release which accompanied the reference, the Director General said:

Compact disc prices remain relatively high when compared with the cost of other formats and with prices in the US. I have not been satisfied by the arguments that have been put forward to explain this phenomenon. I am concerned that the record companies' use of copyright law, to restrict parallel imports of CDs at a lower cost, may be frustrating competition It will now be for the MMC to undertake a full study of this market and form a view as to whether or not any practices of the industry operate against the public interest. I hope they will consider in particular whether copyright, which is a reward for innovation and creativity, is being used in such a way as to restrict, distort or prevent competition.

3.46. The price of records had also been the subject of scrutiny in Australia over this period. The Prices Surveillance Authority (PSA) was asked by the Australian Government in February 1990 to conduct an inquiry into the prices of sound recordings in that country, looking at competition and efficiency, and the operation of the copyright law, as well as issues such as piracy, the health of the Australian music industry, and the introduction of new technologies. The final report¹ was published on 13 December 1990.

3.47. The PSA concluded that record prices in Australia were excessive and recommended a series of measures designed to benefit consumers, ensure recognition of the rights of Australian artists and assist the development of the Australian music industry.

3.48. The key recommendation on prices was the removal of import restrictions to promote competition in the Australian sound recordings market which was, the PSA said, dominated by the international record companies. Prices of vinyl records, cassettes and CDs had been consistently much higher than in overseas retail markets for many years, the PSA said. Record company profits had been exceptionally high, even ignoring high transfer payments to overseas parent companies. A substantial fall in prices would occur if records (except pirate records which should remain illegal) released on overseas markets could enter the country. The PSA Chairman said:

Import restrictions effectively allow the major record companies to control imports into Australia. These companies can import from their international parent companies who own much of the copyright but this access is generally not available to other suppliers in the industry. This limits competition in the record market. Dominance of the record market's supply by a few companies, underpinned by import restrictions, keeps prices high The most direct and appropriate way to deal with the problem of high prices, and claims of restricted record availability, is to abolish the importation provisions of the Copyright Act regarding non-pirated recordings.

3.49. The PSA report was published some three years ago. Early in 1993 the Australian Government introduced a Bill which provided for the removal of import restrictions affecting records coming from the USA, some EC countries and New Zealand and released after 1 July 1994. That Bill lapsed following the announcement of the March 1993 Federal election. There is opposition to the proposal to remove import restrictions both from the industry itself and from some Ministers, and the whole matter is still under consideration by the Australian Government.

¹*Inquiry into the Prices of Sound Recordings: Report No 35, Prices Surveillance Authority, Canberra, December 1990.*