

The Impact of New Business Models on Artists

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A minor Greek philosopher is credited with first observing that "Change is the only constant". That principle has never been more evident than in the recording industry during the last few years.

We are all familiar with the recent economic challenges faced by major record companies and many independents. Whether those challenges resulted from illegal file sharing, dramatically increased competition for the limited discretionary income of targeted consumers, or global market conditions, record companies are experiencing their most difficult struggle for profitability in the history of the industry.

Much has been written in these pages and other publications about these challenges and the "new business models" being employed by record labels to counter the trend toward diminishing profits. Those new business models have been characterized by two simple strategies. First, to increase and diversify the labels' products and revenue sources. Second, to increase the profitability of existing products and revenue sources. While these business models and strategies have been widely discussed, there has been surprisingly little discussion of their impact on recording artists—the record companies' creative partners in this endeavor. A detailed examination of the impact of the new strategies on recording artists is beyond the scope of this article, but we will consider a few of the most important changes that

implement these strategies in recording contracts currently being offered by the major and many independent labels.

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Increasing & Diversifying Revenue Sources

1. Requiring artists to create new products for the mobile communications market. These new products include "voice tones" (artist spoken word clips used for everything from phone ringers to subscription wake up messages), ring backs and electronic wallpaper for computers. These products are frequently characterized as "promotional" (i.e., no royalties paid) but usually are not related to a particular single or album and are intended to generate revenue for the company.

2. Sale of advertising and merchandise on artist websites. Labels now require that they own and control the

artist's "official" website and may generate revenue from those websites by selling advertising. Many contracts also permit the sale of merchandise created by the label using album artwork or other label owned materials. The artist's participation in this revenue, if any, is a matter of negotiation, but neither of these activities would have been permitted by most recording contracts negotiated 3 to 4 years ago.

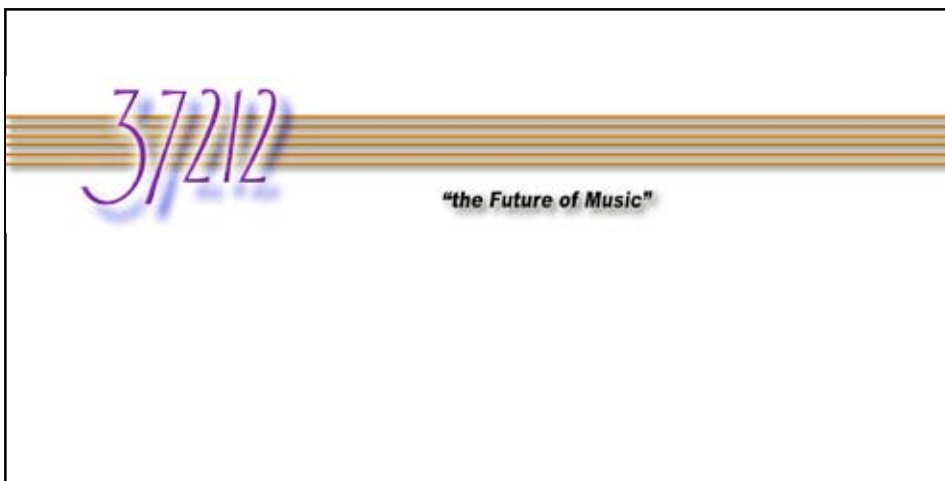
3. Licensing of album artwork. Album cover artwork incorporating the artist's name and likeness is licensed for use in connection with products other than records.

4. Requiring that artists pay a portion of their touring and/or merchandise revenue to the record company. The amount of the required label participation varies widely, but this new requirement significantly reduces a source of income that has previously belonged solely to the artist. Touring and merchandising revenue has been particularly important to artists in the early years of their careers because they cannot expect to receive royalties from record sales because of recoupment by the label of recording, video production, independent marketing, promotion and other costs from their royalties.

5. Increasing the market for authorized electronic sales and similar electronic revenue sources such as subscription music services. While expansion of this market would appear to benefit the artist financially, the new artist's proportionate participation in revenue from such sales is often significantly lower than that derived from a comparable sale in CD configuration. So as electronic sales increase and CD sales diminish, the artist's proportionate share of the record label's revenue from the artist's recordings will be reduced.

Increasing Profitability From Existing Revenue Sources

1. Reducing artist's income participa-



tion from sales of single and multiple tracks via electronic sales. As indicated above, by diminishing an artist's proportionate participation in electronic sales, the company increases the profitability of such sales for the company. Many contracts still apply deductions for packaging, free goods and returns reserves in calculating an artist's royalties from electronic sales even though there are no packaging costs incurred, no free goods offered or return rights granted by the company or its licensee in connection with those sales.

2. Increasing the percentage of record company expenditures that are recoupable from artist. Whereas labels have traditionally recouped 50% of independent marketing and promotion costs from artist royalties, many labels are now requiring that the artist bear a greater percentage of those costs and often attempt to shift other costs traditionally borne by the label to the artist's side of the ledger.

3. Reducing artist's income partici-

pation in revenue from licensing the artist's recordings or other rights. The participation by the artist in a label's licensing revenue is a matter of negotiation. However, traditionally, when recordings were licensed by the company for products other than sound recordings, the net revenue received was divided equally

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between the label and the artist. No more. In many contracts offered by record companies to new artists, the artist's share of that income is significantly less than half of the net. As an example, in contracts using

suggested retail price as a royalty base, the artist may receive as little as 12% of the net revenue rather than the 50% that would have been payable under most contracts a few years ago.

While there are many other examples of changes in new artist recording agreements resulting from the labels' efforts to maintain or preserve profitability those discussed above are some of the most common in the contracts being offered by many of the major labels and many independents. The debate will continue between record companies and artists regarding the proper or fair division of the revenue from sales and other exploitations by a label of a recording artist's talents, but the disparity in bargaining power between record companies and new artists makes it imperative that artists and their representatives be aware of the changing contractual landscape and of the commitments being required of new artists as labels try to survive in this rapidly changing market environment. ■

