Internet Music Streaming Growing Pains

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Abstract

Since 1980, the recorded music industry has gone through three major transformations. First, the compact disk (CD) revitalized an industry that was dormant, reaching its peak in 2000 with revenues of 15 billion dollars in the USA. Second, the expansion of the broadband Internet decimated the market for music CDs. Sales of CDs sank by 75% between 2000 and 2012, and continue to drop. This period saw the emergence of legal music downloading as the main recorded music model, spurred by an agreement between Apple and the major labels. Legal downloading of music did not stop the decline of CD sales, but it stopped the overall decline of recorded music sales. Third, the business model of legal downloading is now challenged by a new business model: music streaming over the Internet.Two 2011 surveys in France indicate that more Internet music customers listen to streamed music rather than downloaded music. A recent survey in Europe indicates that European revenues at Spotify, a music streaming provider, were higher than Apple iTunes download revenues.

There are two types of music streaming over the Internet: on-demand streaming and “internet-radio” streaming. In on-demand streaming, the Internet music provider of on-demand music must get a license from the music performance “owner”, typically a record label, and pay that owner a license fee to be negotiated. In internet-radio streaming, the Internet music provider must pay royalties fees to the musicperformance owner. These royalty fees are based on the rates and rules set by the Copyright Royalty Board, of which members are appointed by the Library of Congress. Both types of Internet music providers also paycopyright royalties to the copyright owners (namely the music and lyrics composers).

Internet-radio webcasters may be radio-stations that extend their reach through the Internet and webcast via a few channels;or webcasters that customize webcast music streams on a per-listener basis via many channels. Pandora is the best example of the later. Listeners need to subscribe. One plan is free, paid by advertisement to which customers must listen between songs. There is also a paid plan without advertising. Software analyzes the listening habits of the customers to propose songs for either listening or buying online. In spite of a large number of users (estimated to 75 million) and revenues in the hundreds of millions, Pandora does not make a profit. Their largest expense comes from the royalties they must pay to the music performance right holders. This exemplifies the plight of many smaller webcasters. Traditional radio-stations do not pay royalties to performers. When Congress changed the law for webcasting, many webcasters protested that the rates set by the Copyright Royalty Board would drive them out of business. Whereas arrangements were made for small webcasters (such as paying fees as a percent of revenues rather than fees based on the number of listeners and listening channels),

large webcasters such as Pandora have been stuck with large fees. It is to be seen whether webcasters like Pandora may reach profitability and survive.

On-demand webcasters are typified by Spotify and Rhapsody in the USA, by Deezer in France. As for Pandora, Spotify and Deezer customers have the choice between a free plan, which requires them to listen to advertising (and have limitations on the number of songs that are available) and a pay plan, free of advertising and limitations. In May 2014, Spotify announced 10 million paying subscribers and 40 million non-paying listeners. In spite of annual revenues over 1.2 billion from subscription alone, Spotify is not profitable.. Similarly, in spite of an increasing number of customers (paying subscribers and free listeners), Deezer is not profitable. Rhapsody, another US music streaming provider, which offersonly paying subscriptions, was also showing an increase in revenues, but has not shown a profit yet.

Music streaming providers are also facing another problem: a revolt of performing artists. Artists have long complained that they get very little revenues from music streaming providers, even when they have a large number of listeners. The music streaming providers indicate that they pay up to 70% of their revenues in royalties and license fees. Yet, whereas $.07 to $.1 are paid to the performing artist for a download (after the labels also receive their own part), for a stream, a fraction of one cent is paid to the label, which in turn pays a small part of it to the artist). Performers also think that music streaming cannibalize the revenues from downloading. For example, Apple iTunes revenues from music are down 13% this year. So far, several well-known performers have pulled back from music streaming providers, or just refuse any deal with them: Taylor Swift and the lead singers from Radiohead and Talking Heads, to mention a few.

In conclusion, music streaming has been gainingcustomers and revenues in the past few years at the expense of music downloading and CDs. Yet none of the major music streaming providers is showing profitability (not including YouTube, which employs a special model of its own). Performers are gaining very little from music streaming and some of the best known are pulling away or staying away from it, preferring the downloading model. It is going to take several years to see whether the current growth of music streaming continues, whether some of the providers reach profitability, and whether artists can get decent revenues from it.