

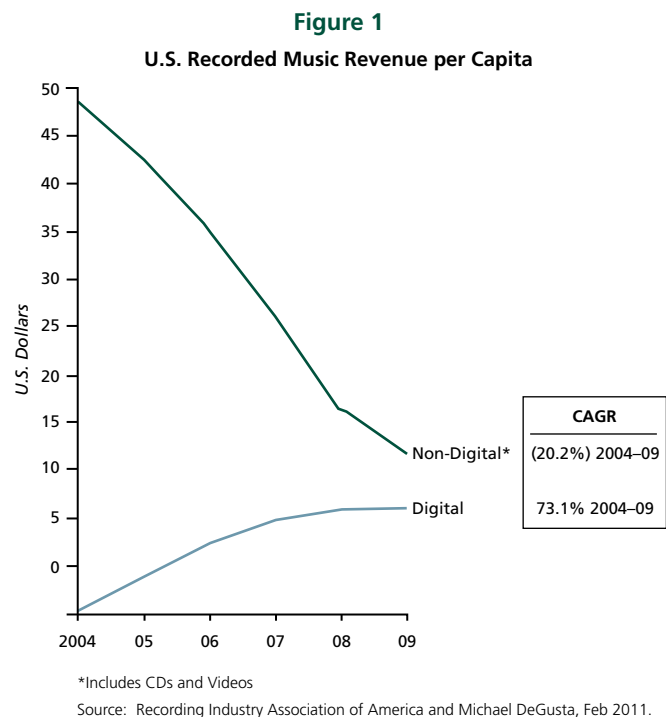
Generating Growth in the Media Industry: A New Tune for Music Labels and Concert Venues

In the fifth segment in this series, L.E.K. Consulting analyzes how music labels and concert venues can apply successful strategies from casual and social gaming companies to help create new growth opportunities.

While total revenues from recorded music have dropped significantly in recent years, digital consumption has been growing rapidly, increasing approximately 70% per year from 2004 to 2009 (see Figure 1).

This fundamental change is driven by a generational shift away from purchasing entire albums on physical media and toward purchasing individual digital songs à la carte. This evolution in consumption has been a result of the proliferation of digital distribution channels such as iTunes, which are enticing consumers with benefits that include:

- 1. Lower time commitment:** iTunes provides one-click ordering and immediate downloading of songs, saving time by eliminating trips to a retailer.
- 2. Effectively lower prices:** Consumers can sample and choose individual songs on a given album, thereby spending less than if they bought the entire album to hear a specific song.



3. Avoidance of clutter: Since all songs purchased on iTunes are digital downloads, consumers avoid the clutter of owning physical copies.

4. Portability: Many consumers enjoy having their playlist with them wherever they go – commuting to work, at the gym, running errands, etc.

Generating Growth in the Media Industry: A New Tune for Music Labels and Concert Venues was written by **Dan Schechter**, Vice President and Head of L.E.K.'s Global Media, Entertainment & Technology Practice; and **Alex Evans**, Vice President of L.E.K. Consulting. Please contact us at mediaentertainment@lek.com for additional information.

A key takeaway is that consumers still have an appetite for recorded music, but their music consumption preferences no longer support traditional music industry business models.

While the trend toward downloading individual songs directly impacts record labels, artists are more reliant on live concerts for their financial success. Rather than counting on record sales for the majority of their income, artists are leveraging the marketing and sales of their recorded music – financed by the record labels – to drive concert attendance. As revenues from recorded music shrink, labels are adapting by increasingly signing artists to what is known as the “360-degree deal,” which entitles the label to share in all artist revenues – including income from concerts and other non-recorded endeavors – in exchange for promoting the artist.

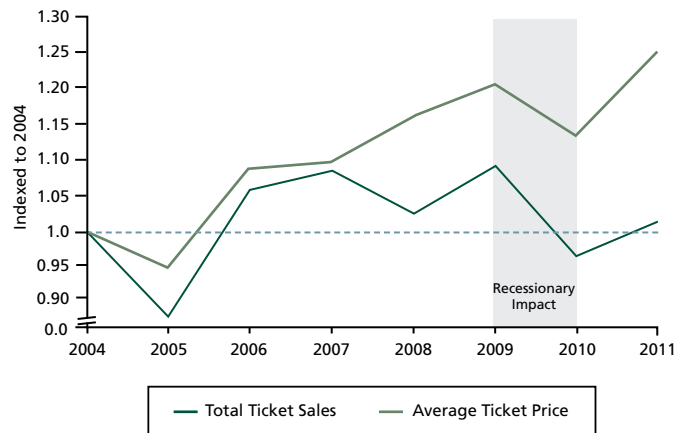
Live concert revenues are subject to two main factors:

- 1. Concert revenues tend to track closely with recessionary cycles.** Concert ticket purchases are highly discretionary and are easily cut from consumer budgets in a down economy.
- 2. Tours by popular performers (e.g., U2) that can sell out entire arenas bring in the majority of concert revenues for an entire year.** In some years, these tours can effectively absorb the negative impact that a recession has on ticket sales, as was the case in 2009 (see Figure 2).

The fan base for these older superstar performers often spans multiple generations. That said, an older crowd tends to follow older performers, which may be a key to driving ticket sales. Younger fans, however, seem to be less engaged in seeing live music. According to Edison Research’s report “Radio’s Future II: The 2010 American Youth Study,” music concert attendance by fans between the ages of 12-24 has decreased by nearly 60% during the past 10 years (from 2.1% to 0.9%) while overall attendance has remained consistent. One can infer from this finding that older generations are slightly increasing the number of music concerts that they attend annually to offset the younger generation’s reduction in seeing live music.

Figure 2

Top 100 Total Tickets Sold and Average Price (Mid-Year 2004-11)



Source: PollStar Mid Year Business Analysis 2011

Many of the industry’s “arena performers” began attracting fans 30-50 years ago when there was a far more concentrated market with fewer media outlets competing for consumers’ attention. In recent years, the vast array of outlets available for learning about new artists (e.g., MySpace, YouTube) has resulted in a far more fragmented market. New artists can get discovered more easily, which helps them to get booked in small clubs, but they are far less likely to develop the fan base necessary to sell out an arena in the near term (and many performers never attract such a large-scale following).

Moreover, the sheer number of outlets available for artists results in more of them competing for consumers’ attention, making loyalty to any one artist much lower than the levels of loyalty experienced by most arena performers. Superstar performers like Lady Gaga and Coldplay are becoming less common, and the sold-out arena will become far less prevalent as a result.

Learning from Social and Casual Gaming

The social and casual gaming industry exhibits several similarities to the music business, and has had much success using a variety of the following online monetization and promotional strategies:

1. Dependence on “buzz”: Social games, like labels and artists, have relied heavily on new media outlets such as Twitter for spreading popularity. Social networks can help a new game “go viral” just as a YouTube video can do the same for a new performer.

2. Accessible performance metrics: Tracking monthly average users and other online statistics is a straightforward way of gauging performance and helps game developers make decisions about modifying their strategies to bring in new users, increase revenue and achieve other goals. Similarly, music sales and concert attendance are equally objective measures of success that allow labels and artists to evaluate their marketing practices.

3. Ancillary revenue streams: Social gaming utilizes multiple business models resulting in greater stability. This is also true for recorded music (e.g., licensing music for commercial purposes) and concerts (e.g., merchandising, selling ad space at venues).

Though applying the lessons learned from social and casual games may not solve all the challenges facing the music industry, engagement with social networks can have a positive impact on the size and enthusiasm of an artist’s fan base. Opportunities to utilize the lessons of the social gaming world follow.

Leverage Social Networks to Boost Music Consumption and Revenues

Facebook’s partnership with music sharing service Spotify illustrates the important role that social networks can play in the music industry. These types of services can enable users to share their favorite songs with their friends, which can help to promote artists virally. In addition to artists sharing their music through these types of services, labels and artists could collaborate to create portals within existing social networks such as Facebook where users could browse and listen to music – both live and studio recordings – create and share playlists, and post or recommend songs and playlists to their friends in a manner similar to radio station sharing on Pandora.

Users could vote for favorite songs or playlists posted in their social network, and top-rated posts could be featured on a

“leader board.” This would encourage user interaction and also foster the type of competition that drives social gaming’s popularity. These portals should be simple to set up (i.e., no credit card information should be required initially) and should be accessible directly through social networking sites and as a downloadable mobile app.

The following suggestions for monetizing such a portal apply successful business models from social gaming.

a. The freemium model: Under the freemium model, the portal could offer all of the features listed above for free while still generating revenue through ads. The low starting cost (i.e., simply supplying basic personal information) and free access to a broad range of attractive features would promote a fast-growing user base. A similar freemium model is used on MySpace, where artists can post recorded music and publicize tour dates. MySpace offers artist details, streaming videos and photos for free but may charge for downloadable music. However, users on MySpace can’t create, share or rate playlists within their personal networks, which limits the degree of social interaction influencing users’ music consumption.

b. The subscription model: The freemium model described above is designed to quickly build a large user base, but it should have limitations that can only be removed by upgrading to a paid subscription. This additional revenue stream would appeal to more avid users who perceive greater value by paying one price for a collection of added features such as more extensive search results, higher quality streaming, no ads, exclusive pre-release songs, sharing with more friends, play access to all published playlists on the leader board, “rooms” where fellow subscribers can interact and watch live concerts, and direct interaction with artists (e.g., artist chat rooms). This is similar to the approach Hulu took, using its free interface to amass a large user base before introducing its premium version, Hulu Plus.

As in the subscription model used by the popular gaming platform Club Penguin, subscribers would enjoy increased options for customizing their experience to

suit their individual tastes. Allowing users to tailor their experience to their personal musical preferences would increase the average user time spent on the portal, thus further strengthening its perceived value, particularly among the avid users who are most likely to go on to access pay-as-you-go features described below.

c. The pay-as-you-go model: Another important revenue stream to complement the freemium and subscription models is the pay-as-you-go model, which would be applied to certain premium features. The features available through pay-as-you-go micro-transactions could include unlimited access to playlists and songs sampled (assumes purchase for streaming / download, as with iTunes), a pause option for non-continuous play, ability to send playlists to non-subscribed friends as gifts, "album extras" such as a producer's commentary and interviews, and artist-generated content such as unproduced lyrics and playlists of songs that inspired the artists.

As in pay-as-you-go games, such as FarmVille, these features would be available at multiple points during the user experience. Avid users would encounter even more opportunities to purchase the features due to greater use and exploration of the portal.

d. The virtual currency model: Finally, virtual currency can be used to boost revenues from consumers who have grown accustomed to spending little or no money on music. These units of payment, which would be valid for micro-transactions (i.e., the purchase of any of the pay-as-you-go features listed above) and potentially for more traditional purchases such as live concert tickets, could be earned by playing (and getting friends to play) songs and concerts, engaging with advertisers (e.g., signing up for a free Netflix trial), and/or user referrals. Users would become accustomed to "spending" the currency, which may help them transition to spending real money on music in the future. This transition could be further advanced by offering an additional virtual currency with more purchasing power, which would only be obtainable by buying credits with real money.

Social gaming giant Zynga has had success applying the virtual currency concept, incorporating into their games opportunities to use both "coins," which are earned through user actions, and "cash," which is more easily purchased using real money and can be used to obtain more desirable virtual goods. Facebook is also exploring the potential of virtual currency with its credits system, which has the potential to achieve status as a global currency (much as PayPal attempted), thanks to its established and growing user base.

The advent of à la carte digital purchasing has presented an enormous challenge to the music industry, but thoughtful utilization of social networks presents an excellent opportunity to further monetize digital music consumption. L.E.K. can provide analysis and insight on how record labels can achieve additional growth through social network opportunities.

L.E.K.'s Media, Entertainment & Technology Expertise

L.E.K. has an established track record of helping media, entertainment & technology (MET) companies achieve tangible results amid market uncertainty. Executives turn to us for clarity and confidence as we address their most pressing challenges. We ask the hard questions, correlate information that others may overlook, and develop the innovative strategies that create value.

Our clients include leaders in all sectors. For example, we have undertaken a number of substantial projects for nearly every major movie studio and broadcast network. We also supported three of the largest media industry mergers and acquisitions (M&A) deals completed during the past five years. L.E.K. also helps many of the largest sports leagues around the world.

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded nearly 30 years ago, L.E.K. employs more than 900 professionals in 20 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns.

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