The University of Manchester
Manchester
Business School

MANCHESTER
1824

THE
CHARTERED INSTITUTE OF
PURCHASING & SUPPLY

The Transformation of the Music Industry Supply Chain: A Major Label Perspective•

Prepared by: Dr Gary Graham
gary.graham@mbs.ac.uk
0161 200 3468

Supply Chain Management Research Group
Manchester Business School

Executive Briefing 2006-06

The music industry is a highly innovative and creative sector that is at the centre of much supply chain policy activity. This briefing analyses the impact of the internet on supply chain management in the music industry. While the music establishment has seen their control and production consolidate over the last 50 years, the internet is challenging the power and industry dominance, of the 'big five' major record companies. Strategic changes in the music industry supply chain are discussed along four main operational dimensions: (1) governance mechanisms; (2) co-ordination structures; (3) the choice of actors, and (4) the structure of supply chain activities.

Background

While the music establishment has seen their control and production consolidate over the last 50 years, as a high value, capital growth process, the structural formation of the music industry, is presented as one of being fractured, to the extent that producer and consumer identities have become blurred. This is threatening the supply chain dominance of the 'big five' major record companies[1].

Our briefing examines the impact of the internet on the music supply chain. The supply chain concept is experiencing a fundamental paradigm shift in respect to the music industry, that is being evidenced by the following research findings: (1) the methods of production and supply are becoming highly distributed through peer-to-peer (P2P) networks; (2) a music industry, which is becoming based on a highly convergent approach towards cultural consumption and production, and (3) music companies are emotionally 'charged' organisations (and supply chain structures) based on unstructured forms of working to meet the immediate need to innovate.

The emotionally focused nature of many of the creative organisations, such as music sector, are based on a 'life style' attitude where work and leisure boundaries are being blurred and, as a consequence they are very hard to reach, for supply chain academics (Caves, 2001). This research project has strived to overcome such barriers by establishing long term relations with organisations and individuals, who are operating at different stages in the supply chain.

Research Questions

Two research questions were composed in order to structure the research study. The first question is fairly general and strategic in nature, while the second takes on more of a specific and operational-based perspective.

1. To explore the impact of the internet on the music supply chain, in respect to four critical strategic dimensions (e.g. governance, structure of activities, choice of actors, and co-ordination structure).

2. To investigate the nature and form of actor relationships in a digital music supply chain

[1] These are EMI, Sony, Universal-Vivendi, Time Warner and Bertelsmann BMG.

Methods

All the ‘big five’ record companies have their headquarters in New York where the interviewing took place. All the interview participants (of the five major record companies) occupied executive level positions or had senior management experience in the music industry. A total of 15 personal interviews were conducted.

Discussion of Results

Structure of activities:

The digital downloading, of music, by consumers is significantly changing the way the record companies carry out their business activities. Digital music is increasingly being distributed through the internet, both legally and illegally. In response, to the rising demand for digital music distribution, and in particularly to combat illegal ‘peer-to-peer’ (P2P) websites, the major record companies have tried to establish their own on-line sales services (Pressplay, MusicNet, Liquidaudio), but none so far have been successful.

The majority (n=12) of the interviewees have partnerships with specialist on-line distribution companies (most notably Apple). Such partnerships are now seen as the way to deal with the operational work of on-line sales and distribution. Therefore, as shown in Table 1, digital downloading is transforming the structure of activities with a virtual network structure replacing the more sequential chain style of supply chain operation.

The choice of actors:

The majority (n = 11) of record companies are focusing less on integrating activities into their organisation. Table 2 (overpage) emphasises the process of supply chain deconstruction – from a static linear to a dynamic and flexible structure – which will lead to a proliferation in the number of actors – involved in the supply of music. The consumer and artist will take on a much more central and powerful role in the production and distribution of music. In some sub-genres (electronic dance music) the producer is increasingly becoming the consumer.

Table 1 - Impact of the internet on the structure of activities

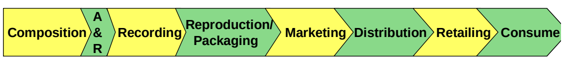
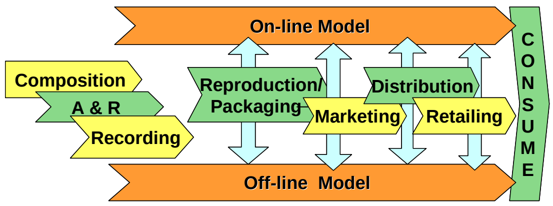
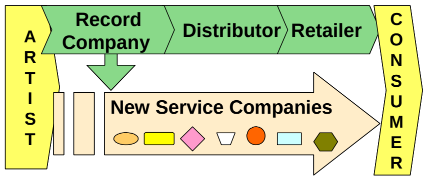
Structure of Activities	**Serial interdependent**	**Networked (Complex constellations)**
	Sequential logic of activities in a linear value creation process	Simultaneous, parallel activities belonging to different value creation processes
	High vertical integration of activities/ resources	Focus on core competencies
	Physical goods/ marketplaces (physical value activities)	Partnerships/ collaborations allow sharing resources and capabilities
		Increasingly digital goods/ market-places (virtual value activities)
		
	The traditional structure of value activities	The new structure of value activities

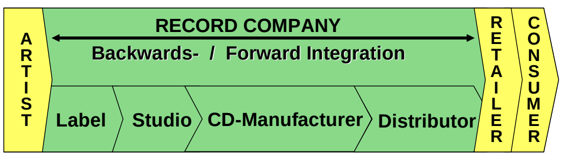
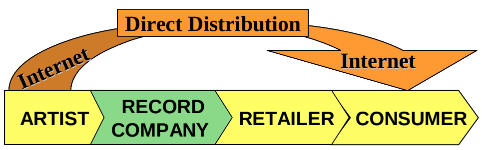
Table 2 – Evolution from static to a dynamic choice of actors

Choice of Actors	**Static** Limited choice of actors (high vertical integration of record companies) Relationships mainly long-term  The choice of actors – traditional system	**Dynamic** High flexibility in the choice of actors Relationships vary from: ➢ long-term to short-term ➢ formal to informal Relationships ad-hoc with an arising business opportunity  The choice of actors – new system

The governing mechanism:

The majority of the interviews (n = 11) believed that the record companies would exhibit less governance over their music supply chain as an increasing number of artists use the internet to create and distribute music on their own. Table 3 highlights the end of the supply chain domination of major record companies. Though the record companies were in general agreement (n = 15) that the artists will become more self-sufficient, the interviews (n = 12) also believed that the majority of artists would continue to sign up with record companies, in order to profit from their marketing know-how. Artists are likely to build direct relationships and socialise with their consumers as they develop, produce and distribute their music (the Arctic Monkey's highlight the emotional power of the web (Myspace) in music product development).

Table 3 Impacting on the governing mechanisms

Governing Mechanism	**Dominant position of major record companies because of:** ➢ Entry barriers due to high transaction and production costs ➢ Economies of scale and scope (competitive advantage due to high vertical integration) ➢ Control all distribution and marketing channels Artists depend on record companies Consumers are restricted (in terms of choice of music)  The traditional governing mechanism	**Elimination of the dominant position of record companies:** ➢ Low entry barriers due to decreased transaction and production costs ➢ Economies of scale and scope do not apply (vertical integration means no longer competitive advantage) ➢ Loss of gatekeeper position Artists gain more control (over their music and activities) Consumers gain bargaining power  The new governing mechanism

Co-ordination structure:

The emergence of internet-based network technologies is allowing music industry bodies to operate in a virtual environment and deal with multiple suppliers and consumers (communities). Interviewees (n = 14) felt that the most vital elements in these new network structures are the internet portals (Amazon) and website (MySpace), which allow the major labels to co-ordinate their activity with consumers' requirements. Table 4 summarises the key changes taking place in coordination structure.

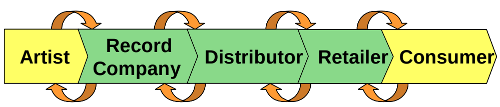
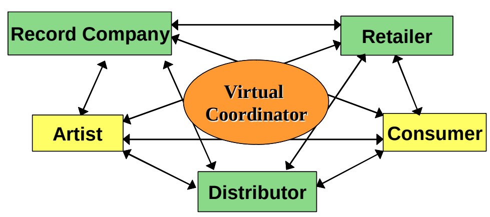
Critical Evaluation of Findings

The major record companies have to realise that they cannot stop the latest technological developments in the music industry supply chain, but instead they must react, develop and design their own digital supply chain (business) model. Any new supply chain model must be able to satisfy the on line needs of all consumer groups and, the evolution in buyer behaviour, towards music product customisation. The internet has clearly transformed all four critical music industry supply chain dimensions and the opportunity is there not only to cut down on operational costs, but to also to find innovative ways to perform activities as well as to generate higher revenues.

Recommendations

1. Record companies have been slow to react to the internet and they should enforce the shift towards a business model of an online supply chain operation, like that experienced in other sectors (e.g. computer software, newspapers, and financial services). The internet provides them with the advantages of new forms of value creation, including: cheaper digital delivery of inventory (back catalogues), greater market(ing) reach, decreasing costs of distribution, and product customisation.

Table 4 Impacting on the coordination structure

Coordination Structure	**Dyadic (hierarchic structure)**	**Myriad (complex constellations)**
	Communication through proprietary information systems (EDI) ➢ Sequential communication flow ➢ Bullwhip effect (over-and underproduction) Physical intermediaries co-ordinate information and product flow  The traditional coordination structure	Communication through the universal and open information systems (Internet) ➢ Real-time interaction with multiple suppliers/ customers ➢ Diminished Bullwhip effect Virtual intermediaries become important for co-ordination structure (central points)  The new coordination structure

2. The digital music supply chain will no longer contain a small number of highly integrated companies. Instead it will consist of a variety of players that will directly interact with each other and share in the creation of value. It is recommended that each player should focus on his or her core competencies - in the creation of supply chain value (and for the major record companies this lies with the production and the marketing, of their artists). Music consumers will also become increasingly value creators, as artists and record companies get them involved more, in their production and distribution activities (e.g. MySpace).

3. The record companies should perceive themselves as service companies. Artist relationships must become a high priority in the online supply chain (business) model, as they provide the major source of value creation. The author recommends the development and integration of an Artist Relationship Management (ARM) tool in the major record companies supply chain strategy so as to prevent the loss of artists, to improve relationships and to develop new artistic talent.

Gary Graham is a Lecturer in Operations and Supply Chain Management at Manchester Business School, UK. His research focuses on supply chain management in the creative industries such as music and newspapers, and the implication of Web 2.0 for the social network theory. He has recently published in the *International Journal of Operations and Production Management, Supply Chain Management: an International Journal and International Journal of Technology Management.*

gary.graham@mbs.ac.uk

- This Executive Briefing is based on an article by: Graham, G., Burnes, B., Lewis, G. & Langer, J. (2004). The transformation of the music industry supply chain: a major label perspective. *International Journal of Operations & Production Management*, Vol 24, No 11, pp. 1087-1103.

The Supply Chain Management Research Group (SCMRG) at Manchester Business School was launched in January 2006. SCMRG aims to be an internationally recognised centre of excellence for scholarly and relevant research in Supply Chain Management. Further information about SCMRG including its research projects, industry briefings and scholarly publications can be found at: www.scmrg.com