

# Digital Convergence

## Opportunities and Threats in the Music Industry

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# A tale of two moguls

- The music mogul
- The tech mogul

# Convergence success stories abound

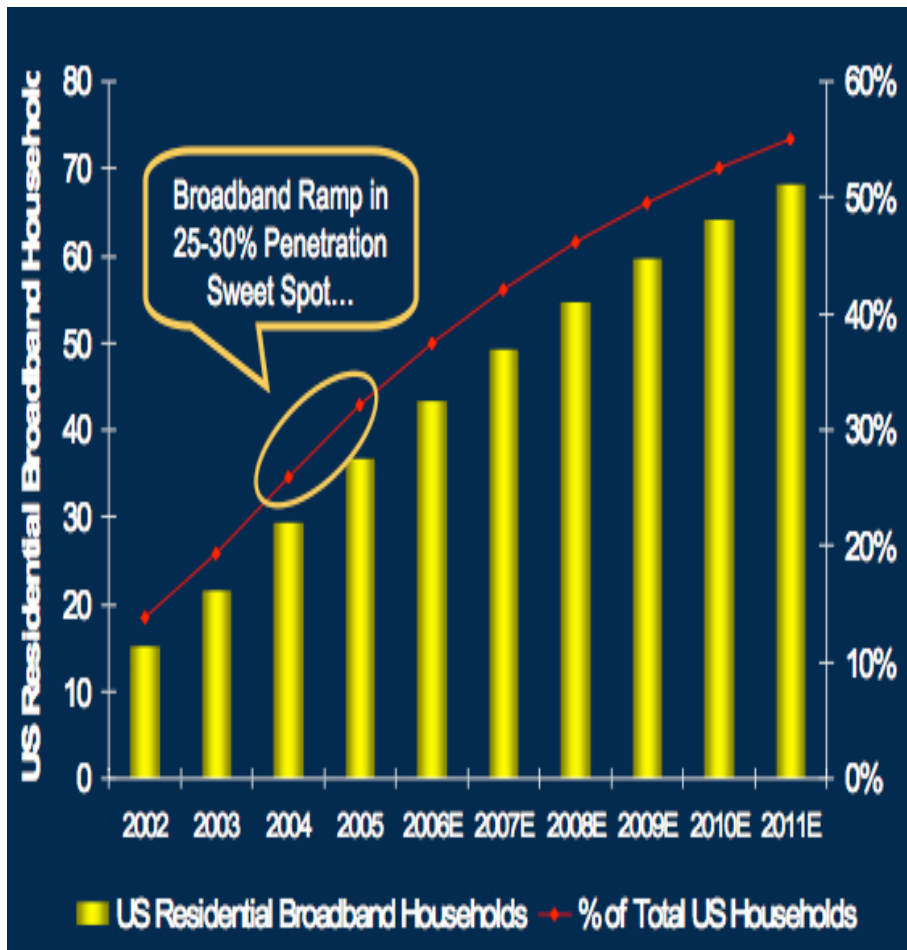
- Skype
  - fastest growing product in history 220m users
- Nokia
  - largest seller of digital cameras & MP3 players
- Apple iPhone
  - 1.4m units in a few months on just 1 operator in US
- YouTube
  - 206m monthly unique visitors
- Facebook and MySpace
  - Top 10 web sites globally

# A “perfect storm” is driving convergence

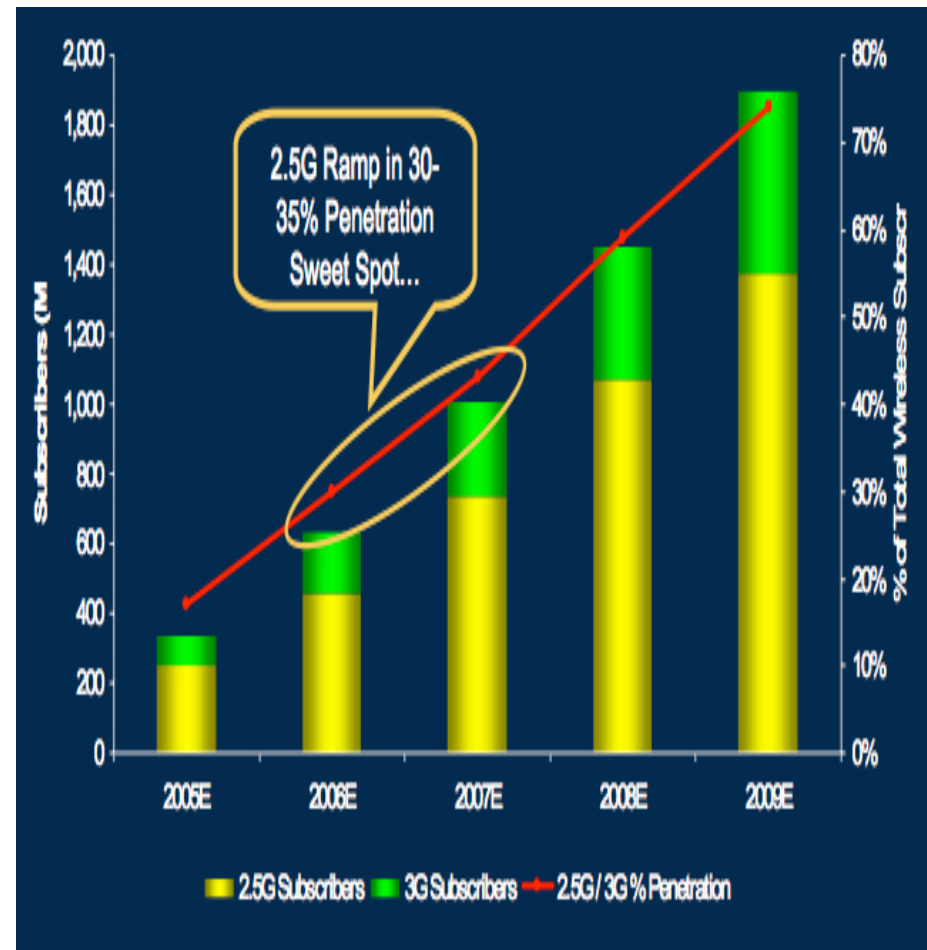
- **Perfect Storm:**
  - 1) Technology tipping point (broadband + device penetration)
  - 2) User behavior and demand
  - 3) New, innovative services that leverage them
- **Storm hits online/PC world first**
  - Web 1.0 --> Web 2.0
  - Move to user participation (user-generated content, social networking), openness and massive network effects
- **But mobile is moving in that direction. And there are twice as many mobile as PC users**
  - Mobile 1.0 ---> Mobile 2.0
  - From simple personalization and SMS to rich media entertainment, user-generated content, social networking

# Broadband has reached tipping point

## US Residential Broadband (Fixed Line)



## Global 2.5 / 3G Penetration (Mobile)



Source: Morgan Stanley

# Technology enables convergence, but are consumers driving it

- People have fundamental need to communicate, connect and participate
- New generation of “digital natives” driving this
  - Creators, not just consumers
  - Digitally fashion-conscious - modify, share and customize
  - Tech-savvy, multi-taskers
- Consumers and digital music
  - 7 years ago, the music industry controlled its means of distribution. Today, consumers are in control.
  - What they want:
    - Good value for money and services that work (interoperability)
    - Minimal friction - needs to “feel free”
    - Flexible ways to pay for and consume content - a la carte, subscription, ad-supported, and free!

# Opportunities for the music industry

- Digital platforms enhance access and relationship with consumers
  - Provides direct access to and information about customers
  - Supercharges consumer word-of-mouth marketing
  - Consumer becoming retailers and even creators
  - Like digital services, entertainment creates an “emotional” bond
    - e.g. Young people can’t live without their music or their mobile phones
- Digital platforms both:
  - Extend existing product/business models (album and songs)
  - Enable creation of completely new products and services (online- or mobile-only products/models)

## Opportunities (continued)

- Digital provides efficiencies and savings
  - Creative (A&R)
    - Scouring nightclubs ---> discovering talent online
  - Marketing
    - Expensive traditional marketing without reusable data  
---> more efficient, direct ongoing fan relationships
  - Manufacturing and Distribution
    - Cost-intensive “packaged goods” business  
---> less costly digital distribution business
- Music’s unique media opportunity
  - Multi-tasking - can listen to it while doing other things.
  - Digital convergence hyper-enables this and expands amount of potential listening hours.

# Major progress in digital music in past 4 years

- Real revenue
  - From 0% to over 10% of a major label's revenues
- Experimentation and innovation
  - From 2 products to dozens of products and business models spanning both online and mobile.
  - From a handful of retailers to hundreds, and growing
- Recognition among majors that the days of “control” are gone
  - All majors actively licensing all legitimate services
  - EMI and Universal dropping DRM; others to follow?
  - Openness to new models like ad-supported content vs. traditional “customer must pay” thinking
- People listening to more music now than ever. The demand is there - the challenge is monetizing it.

# However, the threats are numerous and transformation has been highly disruptive

- "The music industry is growing. The record industry is not growing." - *Edgar Bronfman - CEO, Warner Music Group*
- Overall music industry  $\neq$  RECORDED music industry
  - Concerts, merchandise, advertising/film placements all benefit from scarcity. Recorded music used to, but doesn't anymore
  - Will cheap/free music continue to subsidize these other areas?
  - Do young consumers have a "mental budget" for music and to what degree does recorded music factor into it?
- 7 straight years of declining revenues in recorded music
  - CD sales in freefall.
  - "Bundles" (CDs) giving way to "one-sies" and "two-sies" (downloads)
  - Digital revenue gains not offsetting physical decline

## Threats (continued)

- Rampant piracy
  - Illegally music downloads dwarf legitimate ones
  - Industry suing filesharers, but litigation alone is not the solution
- Legitimate market dominated by a handful of players (online: Apple; mobile: ringtone vendors)
- Music has become the cheap fuel of the much larger device and communications industries
- Beginning of exodus of top artists from majors
  - Radiohead, Prince, Madonna, Nine Inch Nails

# Challenges in an uncertain future

- Consistently experiment and innovate to capture consumer imagination and trust
- Partner and enable all legitimate services to help consumers embrace paid or ad-supported models
- Ensure services are transparent, fair and consumer friendly
- Continuously address piracy and substitution
  - *particularly as open IP penetrates mobile*
- However, there is no easy answer and still a long road ahead