

## Digital Delivery of Popular Music: The Case of Finland



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### *Introduction*

One of the greatest opportunities, but also challenges, facing the music industry concerns the development of new technology applications that enable music to be delivered digitally. Music is spreading widely via the Internet and, as the technology used by consumers evolves (through diffusion of broadband connections, etc.), it may become the most important channel for music consumption in the future. However, most of the music files currently available online are illegal while popular file sharing creates no revenue for copyright holders of music. The International Federation of the Phonographic Industry (IFPI) estimates that in 2001 approximately 99 per cent of all music files available online were unauthorised. Besides being an indication of the extent of illegal music files available, this also reflects the reluctance and sluggish response of the music industry to provide licensed alternatives for consuming music via the Internet.

The creation and production of music needs to remain remunerative in the future, if the attractiveness of making music is to be maintained and the emergence of new music and professional musicians ensured. If, indeed, the way music is consumed is fundamentally changing, new business models and strategies will have to be established to attract consumers to the digital content market. That is, music industry profitability can be preserved in the future only if consumers are also willing to pay for the mu-

sic they consume. The development of licensed alternatives for consumers to download music offers not only a key mode for fighting net piracy, but also an opportunity to create new sources of income. If copyrights can be protected efficiently in the future, online sales of music can potentially grow into an enormous business.

At the turn of the century, enthusiasm to establish commercial online music stores began to build in Finland and many companies from both the ICT sector and music industry expressed interest in this new business area. Finland's advanced ICT cluster and high-grade technology production boosted expectations that a competitive Finnish digital music market could be developed. Despite these high expectations, developments have since been slow and difficult. So far, online music stores have been unsuccessful and a digital music market has not yet been created. Even according to the most optimistic estimates, revenue from digital delivery of music still accounts for less than one per cent of the total value of sound recording sales in Finland.

This study aims to examine the barriers surrounding the development of the digital music market. The purpose is to explore the emerging business area in Finland, its weaknesses and strengths in order to produce background information essential for promoting and supporting the development of a domestic digital music market. The study represents one of the first attempts to examine this new business area for Finland. Therefore, the emphasis is on raising the issues worth particular attention rather than on providing any precise recommendations.

### *Focus, Method and Theoretical Background*

In this paper, the development of digital delivery of music is explored by studying the decision-making process of record companies when

it comes to making music available on the Internet. Record companies possess licensing rights to extensive music catalogue and thus play an essential role in the progress of online music stores. Record companies have also been broadly accused of restraining the process, and so it is essential to examine the factors influencing their decisions.

The theoretical background of this paper comprises innovation adoption theories. In this study, an innovation is defined as a new way to deliver music via the Internet in digital format whereas adoption means acceptance of e-business strategies. These innovation adoption theories offer a framework for analysing the establishment of online stores from a company perspective and also for identifying crucial factors influencing this process. Hence, the usage of these theories aids in finding the issues promoting and delaying the process.

To describe the development of online music stores in Finland and examine the relevant market conditions, we provide an in-depth analysis of efforts to deliver music digitally in Finland. To that end, we have interviewed record companies involved in these trials. Furthermore, in order to explore the underlying decision-making process, the interviews focus on record companies in different stages of the adoption process and with different characteristics (size, ownership structure, etc.). The interview material was complemented with an extensive amount of secondary sources, such as press releases, articles, and interviews given in newspapers and on the radio.

This research takes the form of an explorative case study. This approach provides good tools for producing an overview of the development and key factors involved. However, a more thorough, quantitative examination of financial aspects involved in online music stores, such as cost and revenue allocation, is recommended for future studies.

### *Key Findings*

#### *Exploring the Emerging Business Area*

Establishing high profile online music stores rapidly does not appear feasible. Instead, the development of these stores has proved to be slow, with trial and learning experiences crucial ingredients in this process. Major obstacles

have included inadequate information on consumer behaviour and preferences and, thus, also the absence of viable business models and strategies in an online environment. Moreover, there has been uncertainty associated with the roles of the various participants in this new industry. Cooperation across industry borders – between ICT and music companies – has proven difficult, not least due to different company cultures and operational models. In addition, market conditions have not advanced as favourably as was first expected.

The first attempts to deliver music digitally in Finland were mainly initiated by minor players in the ICT and music industries. However, these pilot initiatives have been unprofitable for too long and have required too much risk-carrying capacity with respect to the resources of the small companies engaged in the field. At the turn of the century, when the first trials were made in Finland, many record companies also planned to establish online stores of their own. With improved knowledge about the emerging business, there is now a greater appreciation of the fact that, to succeed, an online store needs to have broad product selection and content, for which reason much cooperation between the different players is required.

Domestic record companies, even the subsidiaries of the five “majors,” BMG, EMI, Universal, Warner and Sony, are rather small. Hence, the limited resources of record companies have not allowed them to experiment with digital delivery without broad cooperation. Willingness to cooperate, however, appears to have been lacking in the industry. In addition, growing costs of producing and marketing music, coupled with weakening financial positions, have dampened the enthusiasm of record companies to invest in exploring new business areas.

The telecommunications companies operating in Finland, in contrast, are large and few in number. Apart from having the required resources, they also have the needed flexibility to adopt and make innovations and explore new business opportunities. Therefore, telecommunications operators have commonly taken over online music services starting with content aggregation, encoding and compression to clearing house functions, and retailing. However, these companies have shown no interest in diversifying into music production. Due to the

extensive amount of music available on the Internet, there appears to be an urgent need for utilising the special know-how of record companies in R&D and marketing.

The development of online music stores in Finland seems to have been dependent on the motivation and enthusiasm of telecommunications companies to invest in experiments in this field. Telecom operators heading these initiatives have not, however, allowed record companies and other music industry players to have much influence on the business models and revenue allocation structures used. Furthermore, although appearing to be a tempting opportunity, digital delivery of music represents only one potential area for operators to expand their business activities. Hence, if the process proves to be too difficult and time consuming, it may well be that these companies will withdraw from the projects. This could be a crucial blow to the advancement of the digital music market in Finland. Moreover, telecommunications companies may not have the required interest in cherishing the value of the music product as such.

#### *The Decision Making of Record Companies*

Company characteristics appear to influence how motivated and flexible a record company is to take part in the digital delivery of music. Small, independent labels have been more enthusiastic about selling their music production via the Internet and have seen the technological development as a great opportunity rather than a threat. For companies with high costs and limited access to the traditional distribution channels of sound recordings, the Internet has represented a potential, new way to reach consumers more widely. However, the financial opportunities for small companies to establish online music stores on their own are meagre. They have also faced more difficulties in finding partners interested in cooperation due to the less significant marketing value of their narrow music catalogues when enticing consumers.

Small, independent labels have also been more flexible in adopting the new models and strategies required for pursuing a digital music market. Finnish subsidiary companies have, in most cases, needed the approval of the parent company before they have been able to start digital delivery of their music production. Hence, their

decision-making process has been slow and troublesome. Moreover, the farther away the decision maker is, the less it understands the special characteristics of Finland and the less it is interested in the small market that the country offers. The broad music catalogues of big companies is another feature that tends to reduce their flexibility. More time is devoted to updating artists' contracts, and to encoding and compressing great numbers of music files. In addition, the financial risk involved in engaging in online delivery of music is a lot greater for companies with substantial catalogues than for companies with a small music production.

Another important factor determining how interested and motivated a record company is to get involved in e-commerce relates to its managerial goals. Many record companies appear to consider the unprofitable pilot period as a necessity for constructing viable strategies for the future and also for providing a legal alternative for those willing to consume music digitally via the Internet. On the other hand, the reluctance of some companies to become involved in the digital delivery of music can be seen as an attempt to take advantage of their dominant market position.

The Finnish record industry seems to be characterised by structural factors that diminish its capability to adopt innovations (ownership structure, inability to cooperate, etc.). Simultaneously, the ability to adopt and implement innovations is becoming increasingly important as the industry is confronted with digital technology solutions. By delaying their involvement in initiatives to sell music digitally, record companies are weakening their own chances of success in the future music market and endangering the advancement of the Finnish popular music industry. Global companies, which enjoy scale advantages, will most likely pursue the domination of digital music delivery in Finland, too. Moreover, dawdling in this matter is also likely to impact consumer attitudes and willingness to purchase chargeable music services.

#### *Adopting the e-Business Strategy*

The piloting process has persisted for a couple of years and even today no decision committing to the e-commerce of music has been made in Finland. Instead, the music catalogues available online are still very limited and there

has been hardly any marketing done to promote either of the two online stores currently open. Marketing requires a lot of resources and the participants have been reluctant to make this investment before being ensured profits.

Entrepreneurship in e-commerce is even weaker now than it was a few years ago. It appears that current market conditions and the confused business environment are generating uncertainties and expectations that online business will not yield profits. Thus, committing to e-business is not tempting. Despite the experiments, there appear to remain several unresolved issues. Viable business models are still under development and cooperation between the various participants is insufficient. Experimenting with different business models and strategies has been impeded due to the narrow music catalogues available for these trials. In addition, cost-effective services for the delivery of music digitally have not been achieved.

The costs of creating and running online music stores have remained high. The lack of viable methods of payment for small remittances, and the incoherent field of DRM (Digital Rights Management) technologies, for example, has made it expensive to establish online music services. Finland is the leading country in the per capita use of e-banking services and Internet banking is also cost-effective for online payments. However, online bank accounts are not sufficiently distributed among the target group of young people. Simultaneously, mobile payment, which reaches the masses in Finland, is currently too expensive for small transactions. A multitude of various DRM technologies and their licensing costs have also distinctly raised costs and diminished the feasibility of online services. Selling music tracks via the Internet without the DRM technology includes a great risk of increasing net piracy and, therefore, many record companies have insisted on its use in the trials. The excessive supervision of one's own interests and the inflexibility of some participants are additional features keeping costs high.

Due to the high costs, online music stores need to be in strong demand to be profitable. However, Finland has a very small domestic market and the potential target group of online stores is currently extremely small. Moreover, it is not feasible to purchase music tracks via the Internet without a broadband connection due to

the cost and slow speed of the modem and ISDN connections. But the adoption of broadband connections has been very slow in Finland. In autumn 2002, the Ministry of Transport and Communications estimated that there were some 170,000 broadband connections in Finland, including those in companies. Domestic consumers have, overall, also been extremely slow in learning and accepting the new way of consuming via the Internet. Lack of standards and continuous product development of devices suitable for music are also reducing the willingness of consumers to purchase music digitally.

Digital delivery services require many different skills, and getting music available on the Internet necessitates cooperation between many participants. So far, the division of roles has been ineffective in Finland and there has been a lack of retailers, for example, in the online environment. In addition, the revenue allocation structure has evolved poorly. This underdeveloped infrastructure has increased confusion and reduced the willingness to participate in e-business.

Engaging in the digital delivery of music via the Internet carries great risks and high uncertainty. There are no guarantees that consumers will be willing to pay for music on the Internet when they can obtain large numbers of music tracks for free. So far all that has been done is pilot schemes. No online services with extensive music catalogues and real marketing efforts have been launched in Finland and, thus, it is difficult to assess how consumers would react to the new environment.

### *Industry and Policy Challenges*

#### *Industry Challenges*

Digital technology solutions are fundamentally changing the way music is delivered and consumed. To maintain its competitiveness, the music industry needs to be flexible and forward-looking. In view of recent trends of diminishing sound recording sales and the decreasing willingness of consumers to pay for music, the industry would be inconsiderate not to review its traditional business strategies. In order to stay in the game, it needs to adopt and develop new viable business models suitable for the online environment. How to attract consumers to the

digital content market and protect music content should be high-priority concerns. Efforts should be made to establish high quality, flexible and secured online services that satisfy consumer demand. The pricing strategies are also essential when trying to succeed in the digital delivery of music. The Internet also provides great opportunities that should be utilised efficiently, such as the better exploitation of back catalogues. However, investments in exploring this new emerging business area should be made cautiously, keeping in mind the risks involved and the high uncertainty of the future.

Recent developments have shown that the music industry cannot rely on the superior position of the music product, when substitutes, such as DVDs and video games, are flooding the market. Hence, the music industry should be more actively involved in the development of the digital content market. By letting the telecommunications companies take full charge of various trials to deliver music via the Internet, the music industry might be jeopardising the position of music in the future market. Moreover, development processes implemented by ICT companies may be too slow and inauspicious for the advancement of music as a product. After all, it is not the ICT sector whose survival depends on the success of music.

In addition, the music industry should not postpone its involvement in the digital content market because of its high expectations for the mobile dimension. It still may take years before mobile, Internet and wireless solutions are so advanced that music tracks can be transferred cost-effectively. Recent events in this field, such as the retreat of companies developing UMTS services, do not bode well. In addition, the business models, strategies, and alliances established for e-business on the Internet are most likely viable for the mobile dimension as well, when the time arrives. Failure to act now will diminish the chances of domestic companies to increase their revenues later, when global participants who have achieved leading positions look to enter the Finnish market. Domestic companies should try to take advantage of special characteristics (i.e., the mobile dimension, payment methods used, demand for domestic music), when competing against global firms. The technological knowledge to establish high-grade online music stores should also be better exploited.

Due to the high risks and scarce resources available, music industry participants have no other option but to cooperate with each other and consider alliances and partnerships with companies from other sectors. In addition, instead of learning everything merely from their own experiments, music industry participants should hire new employees who are able to comprehend the technology and appreciate the opportunities, as well as the limitations, of it. Overall, new know-how will be required and having competent people in a company will increase the probability of success. Likewise, examining trials that have been made abroad may provide additional valuable information and aid the domestic process.

Independent labels should consider joining forces with each other. The managerial goals and operational models among them have more in common and, thus, a strategic alliance stands out as a natural option. There may also be alternative types of online services that will turn out to be successful in the future, not merely the high profile services devised by big companies. For instance, many independent labels appear to be willing to participate in trials using the mp3 format despite the risks involved. Teaming up could also be a potential way to maintain more of their independence and decision-making power in the online environment.

Record companies should license their content to several online stores to boost competition and, thus, create opportunities for business activity. This might increase the willingness to market online stores and improve consumer awareness. Promoting competition in the digital delivery of music benefits everyone looking to succeed in the business.

#### *National Policy Challenges*

The music industry is going through a profound transitional period and its survival will require plenty of support and help. E-commerce in music will not develop without favourable market conditions and a supportive legal environment. Besides establishing a clear and profitable business environment, public policy measures should also aim at encouraging experimentation within the emerging digital music industry. Therefore it is essential to provide research and development financing and

support to reduce the risks involved in engaging in the digital delivery of music.

Many companies abroad, particularly in the United States, have accepted the e-business strategy, despite the expectations of unprofitable business in the near future. In order for domestic companies to gain a competitive advantage over these global participants, it is crucial that domestic pilots are encouraged and aided and domestic consumers educated. Letting foreign companies take over the digital delivery of music in Finland would put the visibility of domestic music on the Internet in danger and thus jeopardise the future of domestic popular music. Moreover, several advantages can be gained by getting domestic participants into the forefront in the digital music market. In particular, this can be expected to improve the chances for Finnish companies to expand their business into foreign markets and also provide opportunities for exporting domestic music. The Finnish government has persistently stated that its aim is for Finland to become one of the leading countries in digital content production, delivery and consumption. However, so far very little has been done to aid the advancement of the digital economy. Regarding the statements of the government about accomplishing a successful domestic digital content market and ensuring the survival of the diversified Finnish music culture, the following actions should be considered.

Music has been the first cultural commodity to face the impacts of digital technology, but it will certainly not be the only one. The foundations that are established for the music sector will also help the development of the whole digital content market. Furthermore, many of the issues that need to be solved in order to establish online music stores will also be crucial when considering other e-commerce activities (development of cost-effective payment methods, diffusion of broadband connections, etc.). Hence, the promotion and facilitation by the government of the digital content market should be centralised and administered by one single organisation. This would intensify and strengthen the coordination, funding and channelling of cooperation, for instance. One potential option is the suggestion made recently by former Minister of Transport and Communications, Kimmo Sasi, to establish the appointment of a Minister of the Information Society. This

might also help the digital music sector get the attention and support it deserves. Moreover, the digital delivery of music should be regarded as part of the R&D strategies and national innovation system, and, thus, of public innovation policies.

Exploring new business models and developing viable strategies to sell music via the Internet require plenty of resources. However, trials are necessary to obtain the required information and knowledge and, thus, establish competitive online music services. In addition, constructing and maintaining pilots will create demand for the digital delivery of music. The resources of the mostly small domestic participants are, however, insufficient for this purpose, for which reason supportive financial mechanisms are needed to enable experimentation and product development. Risk financing and funding should be channelled to these trials more effectively. Furthermore, different pilots must be encouraged and promoted to ensure the survival of a diversified Finnish music culture.

Inadequate information and understanding of the emerging music industry has restrained its development. Besides providing financing for experiments, the government should also commission studies and research on key factors impacting the digital delivery market. Moreover, the information obtained should be widely disseminated via seminars, for example. In addition, the new industry requires new skills and know-how. This should also be considered in the planning of education programmes.

Digital delivery of music requires the cooperation of various participants across sector borders. This has not been accomplished and the value-added chain of the emerging business is still very poorly evolved. However, developing the infrastructure of the music industry and the cluster surrounding it is essential in order to create a competitive digital content industry. Hence, public policy should try to coordinate and improve the cooperation and networking of the companies involved. In addition, specialisation in the digital content market should be encouraged. Furthermore, market access issues and dominant market positions should be more closely examined and necessary measures undertaken. Excessive protection of one's own interest that restrains the development and inhibits the emergence of the digital music market must be mitigated.

It is also highly recommended that the value-added tax (VAT) on digital music be reduced from its current level of 22 per cent. Digital music delivery has plenty of intermediaries and is desperately struggling with the issue of profitability. The current VAT distinctly decreases the chances of online music stores operating successfully.

Without a clear and predictable legal environment, successful development of the digital delivery of music is impossible. Creating a favourable legislative and regulatory environment must be a high-priority concern of public policy. The Internet is a new environment for business activities and there are several regulatory issues that need to be resolved in order to create real potential for e-commerce business to evolve.

Copyrights lay the foundation of the music industry and their purpose is to protect the creative work undertaken. Exploitation of copyrights makes up an important part of the revenues in the music business and they, in turn, are essential for encouraging investments in the creation and production of music. The development of digital technology applications has cre-

ated new requirements for copyrights, and updating the Copyright Act to deal with them is a crucial prerequisite for the advancement of the digital delivery of music. Moreover, the ability to protect copyrights will be necessary for establishing entrepreneurship in e-commerce of music. It is not feasible for online music services to compete against solutions that illegally provide large numbers of music tracks for free. Protecting the copyrights will be crucial for ensuring creative work in the digital economy.

More security and clarity in the digital market is also required for building trust and confidence among consumers. Furthermore, the required technologies and equipment for purchasing digital content from e-commerce must also be more efficiently distributed among consumers. Market forces have thus far failed to accomplish an extensive spread of broadband connections, for example. The government should more effectively intervene when it comes to both competition-related and financing-related market failures of the digital market, of which the unprofitability of extending broadband connections to sparsely inhabited areas is one major aspect.