

## **Invest in the music industry? Been there, done that, doing it again.**

I am the first person to admit that some of my micro investments in the music industry over the last five years have been less than brilliant. However they are getting sequentially smarter. Here's my evolving portfolio:

- a big recording studio - (Longview) (a learning experience).
- a promising rock band - (Jediah) (still a learning experience).
- a bunch of music promotion software widgets (SONGboost).
- a portfolio of software patents (still working on this).
- a couple of software companies focused on music-related ventures.
- a community site for artists (Music Think Tank - owned by the contributors).
- a few of other things (to be announced this fall).

I don't have a lot of money tied up in any of these 'investments', and fortunately for me, I have been able to cleanly exit out of several of them. However unfortunately for me, I have yet to generate the returns I was hoping for.

The music industry is tough nut to crack. However, there are still substantial opportunities to be had. To wrap up this post, I am going to weigh in on the state of recent music industry investing, and then I am going to describe where I believe the overlooked investment opportunities still are.

## **The state of recent music industry investing...**

Looking across the spectrum of previous music industry investments (through October 2009), from private investments in standalone artists to venture investments in consumer-facing music 2.0 sites, even today in 2009, most of these investments are held hostage to, and will remain a prisoner of, the large label system that has dominated the music industry for decades.

Consider consumer-facing Music 2.0 investments: if you combine the costs of capital, overhead, royalties, and 'major label protection (equity) fees', less the revenues generated from any/all sources, you are probably sitting (cross fingered - ouch) on an unattractive business unless you can scale to infinity and beyond. However by the time you scale up, chances are the world has moved on to something else or it's been pie-sliced (consider what 200 cable channels did to network television) into a hundred pieces you don't control.

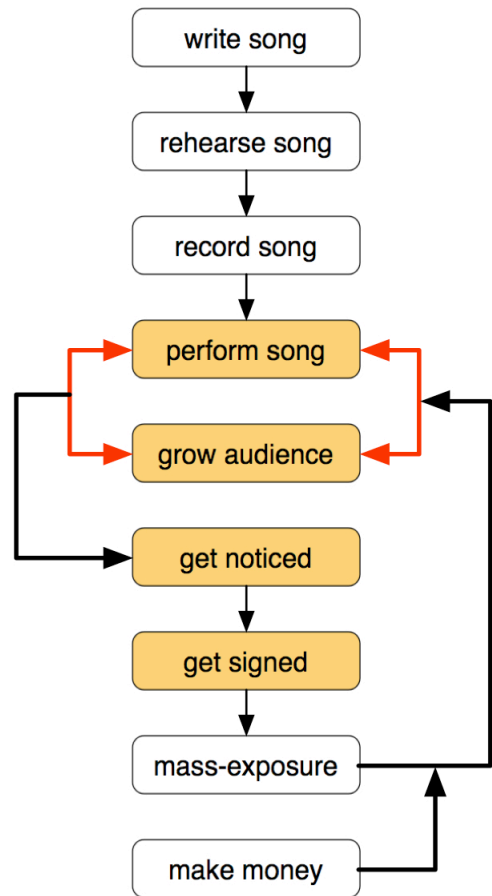
Consider the businesses building upon (services for) independent artists: The addressable market for artist services seems like it's going to hit a plateau at 500,000 artists @ \$100 annual (average) per artist for a total of \$50,000,000 in annual revenue, split between 2 or 3 large competitors and 3 to 5 smaller players. Even if you double this number, it's not a huge business unless you combine consumer-facing propositions with artist services and/or consolidate these companies. See previous and next paragraphs regarding consumer-facing propositions.

Consider businesses attempting to circumvent the major label cartel by attempting to build consumer-facing propositions that solely feature independent and/or formerly signed artists: These businesses have to overcome two significant obstacles. First, the song adoption formula practically demands that artists and songs obtain mass-market exposure; unfortunately the largest companies (labels and publishers) are aggressively sponging up the prime mass-market exposure slots (radio, television, film, adverts, etc.). Second, the digital music landscape combined with the lottery method of picking artists generates such a poor return on investment it's not worth doing it (the lottery way); just ask anyone that has invested in a rock band. Some get lucky, most don't.

## Consider how the music industry works...

The order may vary a bit from artist to artist.

- Artist writes or acquires a song.
- Artist rehearses the song.
- Artist records the song.
- Artist repeatedly performs the song(s).
- The audience grows (best case scenario).
- Artist or song is then (randomly) noticed by the industry.
- Artist is signed (thus giving up some rights).
- Artist or song is then (hopefully) the benefactor of mass-market exposure (via the label's efforts / connections).
- Due to mass-market exposure the audience grows exponentially.
- At this point (probably years later), the artist (with any luck) makes some measurable amount of money.
- Artist repeatedly performs the song(s).
- The audience grows or fades. Repeat loop.



Occasionally an artist or songwriter jumps several steps via some stunt or self-obtained mass-market exposure slot, but this is getting harder and harder to do now that labels and publishers are doing the same stunts and pushing for the same slots.

## Here are the pain points...

To date, there is not a single company that successfully breaks the cycle of requiring artists to obtain major label assistance to gain significant and repetitive mass-market exposure.

Just about every company in the marketplace today reinforces the preexisting way of doing things (see graphic above).

Everyone is still using forced-fed, random (lottery) mechanisms to find artists and songs, albeit statistics, analytics and algorithms will (are) perhaps accelerating the pre-existing way of doing things.

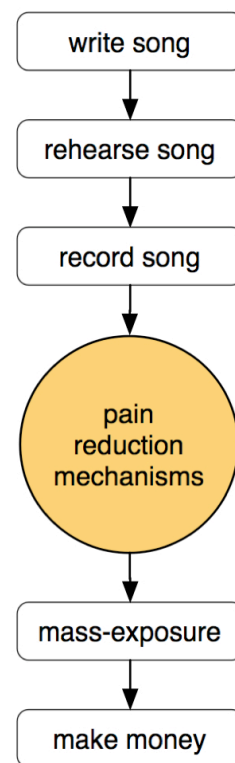
The entire pain cycle (shaded in orange in the graphic above) is still incredibly lengthy and inefficient. Moreover the pre-existing way of doing things, coupled to the free music paradigm is leaving songwriters out in the cold.

Legacy royalty / publishing laws and practices are preventing the maximum number of songs from receiving maximum exposure frequency via all the exposure slots that could/should be available.

## So, where are the investment opportunities?

Anything that can dramatically compress or replace everything shaded in orange in the graphic above into one or several mechanisms that accomplishes the following (loosely depicted in the graphic to the right):

- Enables songwriters to generate immediate and upside returns outside of the existing publishing/royalty system. However not replacing performing rights organizations, but ultimately growing and enhancing them within the free and competitive (where artists choose the free option) music world we now live in.
- Enables a far bigger ocean of unknown songs to receive maximum exposure outside of the existing publishing/royalty system, and entirely without relinquishing the hard-won, preexisting privileges of rightsholders.
- Enables qualifying songs/artists to go from production to mass-market exposure in hours instead of years.
- Thus eliminating the inefficient cycle of performing and growing until the day an artist (randomly) becomes worthy of mass-exposure.
- Enables non-qualifying artists to so trust the mechanism(s) (the pain reduction mechanisms) that they actually use it to rapidly and iteratively learn and improve by.



I can't describe (here) a complete roadmap of how one would actually go from the pre-existing system depicted in the first graphic to the alternate ecosystem depicted in the second graphic (that's what I do for a living). These are however the problems I want to solve, and this is the analysis I will use to pick the next company to invest in or partner with.

The company (could be multiple companies) solving the problems and delivering the value described above is collapsing (replacing) numerous links on the value chain and it resembles none of the companies profitably operating (in the way that it operates) within the industry today. Here are some descriptors:

- It's probably not selling music.
- It's eventually selling music-related product.
- It's not capturing any rights.
- It's a fee-based artist services company.
- It's also a consumer-facing company.
- It's not solely dependent on advertising for revenue.
- It's marketing / promotion costs are minimal to none.
- It's operating outside, parallel, but complementary to the royalty / publishing ecosystem.
- It's fully capable of producing / spinning out hit songs.
- It's not using major label content in any manner that requires negotiating with labels.
- It's also an essential learning tool for artists.
- It's operates at high velocity with minimal friction.

These are some of the hallmarks of the company(s) that will change the music industry and it/they will be the companies worth investing in. Revenue projections would only be pure speculation, as execution is really the only thing that matters at this point. In my humble opinion, it's still a great time to invest in the music industry.

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