The Inequality of Music Income Distribution

by
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Abstract

Online streaming of music has completely reshaped the music industry and how people access music. While streaming provides remarkable benefits, it has been a disruptive technology in terms of consumer behavior, the way labels monetize music, and the financial model for songwriters and artists. This research paper discusses why revenue shifts are needed to compensate artists more fairly, reviews current proposals to address artist royalties, and argues that shifting to a user-centric model would provide artists with better economic fairness.

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CHAPTER ONE

I. Introduction

The rise of music streaming in the twenty-first century has provoked a heated debate on how artists get compensated for their music. For centuries, the music industry has been generating revenue from the sale of physical items. Whether it be the invention of the phonograph by Thomas Edison, cassette tapes, records, or CDs, the music industry depended on the sales of physical items and knew how to distribute revenue fairly to artists and those involved in their success. However, the emergence of internet streaming has completely reshaped the music industry and has broken the long-established financial model of the music business.

Historically, artists have been compensated with a royalty for every record sold. Although the rate has changed over the years, the payments made a significant contribution to an artist's total income. Because the purchasing of physical copies of recorded music is at an all-time low, artists are no longer being paid what they used to for their music (Carter 5). Before the widespread adaptation to streaming, if people wanted to download music, they had to purchase it from providers such as iTunes, as opposed to now where anyone can pay a monthly subscription fee or use freemium services with ads and access music they do not actually own (Barrata).

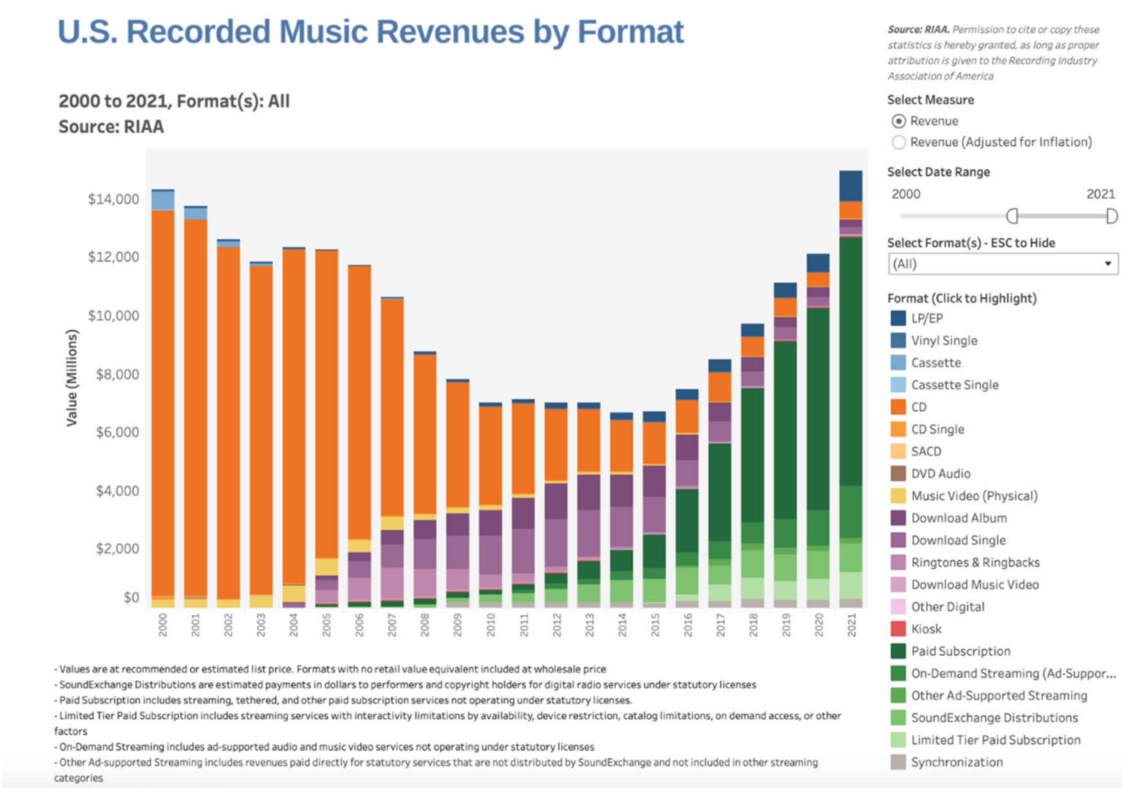
Over the last decade, the music industry has been pushed into embracing innovation and this has come with both rewards and challenges. While these changes have impacted all major stakeholders within the music industry, creating a fairer economy for artists is one of the most significant issues that need to be addressed for the music industry to continue to thrive. While this research paper focuses on a proposed solution to the inequity of music income distribution for artists, this first chapter explains how music streaming has been a disruptive technology in terms of consumer behavior and the financial model for songwriters and artists, as well as the way labels monetize music to demonstrate what caused the disparity.

II. The Internet Transformed the Music Industry

In the early 2000s, the music industry suffered financially due to illegal downloads of music that were obtainable through the internet. The industry was especially crippled by Napster, a free file-sharing website that allowed users to download music. Napster provided a free and easy alternative that consumers had never seen before, making it an obvious choice for those who were accustomed to purchasing physical items. However, most of the music that was downloaded on Napster was illegal and contributed to the music industry's slow decline as it siphoned sales from legitimate music retailers. Although Napster was eventually sued by the music industry for its illegal practices, it set forth many changes in both the financial model and consumer behaviors that would forever change the music industry.

In 2003, the iTunes music store was created by Apple with the aim to make music downloading as easy as file sharing, but with a price. For the first time, iTunes allowed consumers to buy single songs instead of an entire album. Over time, iTunes became the most popular online retailer of music, causing a dramatic shift in the format of physical sales. In addition, a popular streaming service known as Spotify was created in 2008 and has since become the world's most dominant audio streaming subscription service with more than 400 million monthly active users on Spotify. Following Spotify's success, Apple soon adapted and replaced the iTunes app for the purchase of digital downloads with one branded as Apple Music to focus more on subscription models (Spiker). The figures below show US Recorded Music Revenues by Format.

Figure 1: U.S. Recorded Music Revenues by Format from 2000 to 2021



Source: RIAA (2021) US Sales Database

Figure 2: US Music Revenues 2009.

Source: RIAA

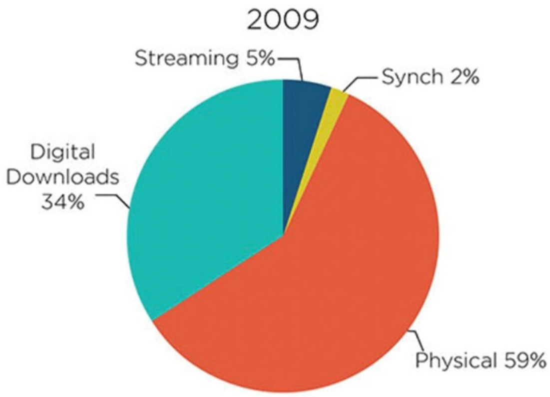


Figure 3: US Music Revenues 2016

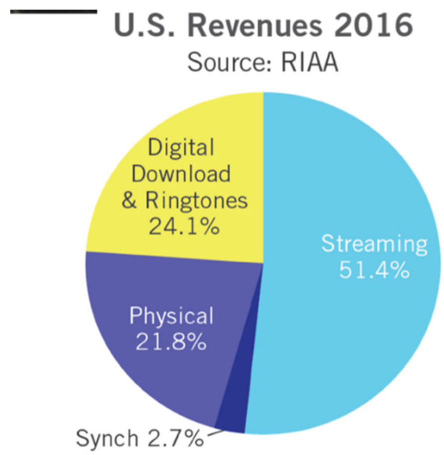
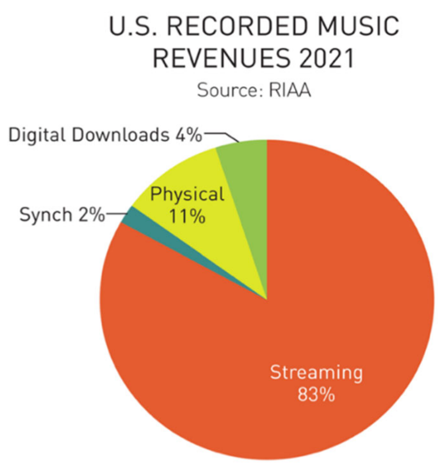


Figure 4: US Music Revenues 2021



As demonstrated by the figures above, the shift happened in a little more than a decade. Music streaming is now the dominant method of music consumption and represents the biggest source of consumer listening.

III. The Consumer Shift

From a consumer standpoint, there is no denying the unlimited benefits music streaming has brought to music listeners. One of the greatest advantages that online music streaming services have to offer is convenience for the listener. Consumers have the enviable position of being able to pull up an extensive library of music whenever and wherever they want. There has never been a time in history when consumers have had the direct access they have now, and it is easier than ever to have that access by the touch of a button on a handheld device. In addition, streaming has allowed music listeners to personalize their music in a way like never before such as in the form of building playlists. According to Spotify, their software includes an algorithm that tracks what every user is listening to which creates a unique and personal experience for each subscriber. Perhaps the greatest impact on consumers has been the shift from a model based on “ownership” to one based on “access.”

Before the widespread use of internet streaming, music consumers secured access by purchasing records, CDs, or digital downloads. Now all consumers need is a device with an internet connection to access music for free or as low as $5 per month on some platforms. Because the bulk of music is no longer being purchased, the long-established financial model of the music business has been broken, and the distribution of royalties for artists has been widely argued as unfair. While most businesses in society steadily raise their prices over the years, music streaming subscriptions have been sold for the same price for more than a decade. This has led some to believe a solution for providing better economic fairness to artists could be solved by raising subscription prices significantly for consumers.

If music streaming services raised their prices significantly, the streaming economy would likely grow and be able to provide more money to artists as long as the increases did not result in attrition. Given the economic pressures consumers continue to face, it could be argued that there simply is not enough price elasticity in the marketplace. Although raising subscription prices for consumers could help raise the monetary amount that artists make from streaming, perhaps the biggest problem with this proposal is that it never solves the underlying issue of why artists are not receiving as many royalties for their music as they use to.

IV. Artists

Like other music industry professionals, artists rely on royalty payments as a primary source of income. Royalties are simply compensatory payments received by artists in exchange for the licensed use of their music, and the two main types are known as performance and mechanical royalties (Soundcharts). Performance royalties are generated when someone performs an artist's song publicly, and mechanical royalties are distributed when a musical composition is physically or digitally reproduced. Notably, artists do not receive compensation for songs broadcast on AM/FM radio, which is an issue that the recently proposed American Music Fairness Act hopes to rectify. For this paper, the focus will be on mechanical royalties. Historically, mechanical royalties referred to physical sales such as CDs and cassette tapes. An artist's income was heavily driven by these sales and the royalties were easily distributed based on how many albums an artist sold. However, artists' royalties are now based on streams, and digital reproduction happens every time a play button is pressed.

When contrasting CD and digital download sales to streaming, streaming provides a fraction of the royalty revenue of a single downloaded purchase or CD purchase. For example, if an artist sells 2,000 CDs for $15 per copy, then the gross profit would be $30,000. Compared to streaming, that same artist would have to generate roughly 9 million streams to make an equivalent income (Fitzjohn). Because of this loss of revenue, artists have had to rely heavily on income from other sources such as merchandise sales, product endorsements, sponsorships, and touring to make up for the lack of revenue of income from music sales. To be fair, music consumption's shift from physical to digital forms has altered how record labels and songwriters earn money as well, and those changes have further impacted the way artists monetize their music.

V. Record Labels

Record labels have also been affected by streaming since they are no longer relying on income from album sales. However, unlike artists, record companies have found ways to make up for this loss such as from aggregate subscriptions and the development of what is known as a "360 deal" that allows a label to take a percentage of the earnings from every area of an artist's activities (Pittman). Although streaming has caused a disruption in the way labels monetize music, streaming has revolutionized consumer behavior and offers social media insights, which has provided labels the ability to target specific fans based on their listening consumption and many more analytical details about their preferences (Lesser). In conjunction with greater knowledge about consumer behavior, it is important to note that the role of a record label has also changed. Before the widespread use of the internet, record labels were a necessity if an artist wanted to release music, and while receiving a record deal is still considered a great accomplishment and provides many benefits, artists no longer need a label to release their music due to music distribution companies who release music for artists without record deals. Still, labels serve an important function as they can use their marketing muscle to propel artists into superstars.

VI. Songwriters

While streaming has given songwriters great exposure, the shift to digital has negatively impacted the financials of the songwriting community. Like artists, songwriters receive a percentage of royalties when their music is streamed. In the music industry, there are two different assets when a song is streamed. A sound recording, also known as the master, is simply the recording of a performance, and these royalties go to the owner of the recording. The second asset is the underlying composition of a musical work such as the music and lyrics of a song, and songwriters receive these types of royalties when the music they write is used.

The problem with songwriter royalties is that they are more than three times smaller than recording owner royalties, and while most artists and musicians have other income streams such as touring and sponsorships, songwriters rely solely on royalty credit (Mulligan). Songwriters also have their hands tied when it comes to negotiating fairer rates due to the Copyright Royalty Board setting the mechanical royalty rates every five years. However, after many years of fighting for their voices to be heard, The National Music Publishers Association has recently announced that they reached an agreement that will provide songwriters with higher royalty rates when their music is played on digital platforms such as Spotify or Apple Music (NMPA). In addition, artists who are also songwriters will benefit from the increased rates as well. Although there is still much that needs to change, this is a historic settlement for songwriter compensation.

As demonstrated above, there is no denying that streaming has taken over as the dominant force in the music business, and the shift to digital formats has had numerous consequences for all major stakeholders. While the disparity for songwriters has been partially resolved with the recent ruling, artist compensation is perhaps one of the most significant issues that have yet to be properly addressed. This next chapter takes a closer look at how music streaming services distribute revenue to artists and proposed changes to make earned income more equitable.

CHAPTER TWO

I. Average Pay Out Per Stream

One of the most contentious topics in the music industry today revolves around how much artists earn from streaming. While there are many factors involved when determining that amount, the table below serves as a guide, showing the average payout per stream.

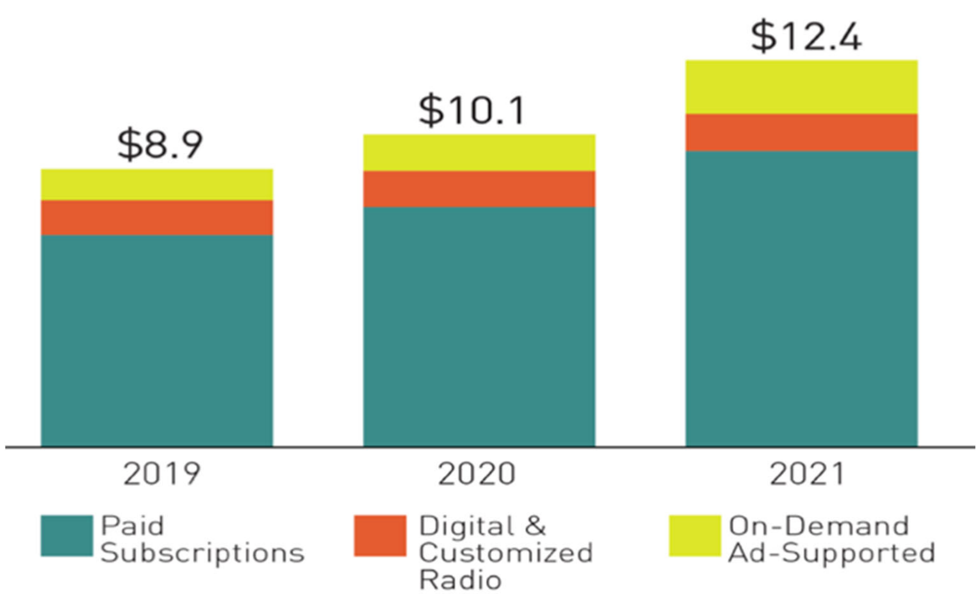
Figure 5: average payout per stream

Streaming service	Average payout per stream	Streams to earn one dollar
Apple Music	$0.008	125
Amazon Music	$0.00402	249
Spotify	$0.00318	314
YouTube	$0.002	500
Pandora	$0.00133	752

Source: Fitzjohn, Sean. (2022, April 28). Streaming Payouts Per Platform & Royalty Calculator.

Calculating how much an artist earns from their streams is very difficult and depends on many factors. For example, not every country pays the same amount for a subscription. Because some countries have higher currency value, the payout rate for an artist's streams will be different depending on the country or territory. In addition to this, most streaming platforms such as Spotify offer two types of subscription plans on their platform. For example, Spotify offers users the option to listen for free with ads or can choose a premium option that requires a paid subscription. Whether music is streamed by users with paid subscriptions or free ad-supported is crucial because ad-based subscriptions provide less income than paid subscriptions. Figure 6 below represents this in billions.

Figure 6:



Source: Year-End 2021 RIAA Revenue Statistics.

Perhaps the most important factor that determines how much an artist earns from streaming is based on the contractual terms to which an artist agrees. When an artist signs a record deal, labels usually give an artist a sum of money to fund the artist's career and cover their everyday expenses. This is known as an advance and artists are not required to directly pay back the label for these payments. However, artists will not receive any of the royalties they have earned for their music until the advance has been earned back. Once an artist breaks even with their record label, the record company will allow the artist to earn royalties. This is known as recoupment and is why many of the streaming payments never get to the artist. Some examples of costs that are recouped include expenses incurred from publicity, advertising, marketing, and producing music.

In addition to recouping costs, most artists split their royalties with intermediaries such as record labels, music publishers, songwriters, and distributors, who all take a percentage of the artist's royalties, decreasing an artist's share even more. According to a 2022 Billboard report "Who Gets Paid For A Stream," "the owner of the sound recording — usually a record label, but also, increasingly, the artist — receives about 70% of the total royalty, which is then shared with the artist at a rate dependent on their recording contract" In other words, there is an approximated revenue split of 70/30 where 70 percent goes to the rights holders and 30 percent stays with the streaming company. How much of that 70 percent an artist gets is influenced by the agreement they have with the music distributor or record label. While artist contracts are one of many factors that determine how much artists earn from streaming, part of the problem lies within the royalty distribution methods of streaming platforms. This next section examines the model streaming platforms currently use to pay streaming royalties.

II. Pro-rata Model

The major streaming platforms such as Spotify currently pay streaming royalties using a market share payment system known as the pro-rata model. In the pro rata model, the total revenue from all subscriptions is collected into one pool of money and is divided based on the individual percentage of streams an artist has received. After the streaming company takes its approximated share of 30 percent, the remaining revenue is distributed back to labels based on each artist's share of the total streams. The problem with this model is that a user's subscription might go toward an artist they never listened to instead of the specific artists he or she streamed. For example, if Taylor Swift's music accounts for 1% of all the streams on Spotify, then 1% of a user's subscription goes to Taylor Swift. Even if a user never streamed Taylor Swift, a percentage of their subscription will go to the artist because of her overall share of the number of streams. Therefore, this system favors the most listened-to tracks, allowing artists with mass appeal to make millions. According to a 2020 report in Rolling Stone, data shows that the top one percent of artists end up getting 90 percent of streaming revenue.

To provide better economic fairness to artists, a growing number of artists, songwriters, and other proponents argue that the way streaming platforms calculate royalties should be changed. One of the most suggested models is the user-centric model where a subscriber's monthly payment would only go to the specific artists they listened to, providing a fairer way to distribute royalties.

III. User-Centric Model

Under the user-centric model, user subscription payments still get collected every month; however, the money each user paid for a subscription would only be given to the artists that they listened to instead of distributing the money based on popularity. For example, if one user only listens to Selena Gomez, all their subscription money is going to Selena Gomez. While in the pro rata model subscription fees may go to artists even if they have never listened to them, this model ensures that the artists a subscriber streams are the artists that receive their money (Pekec). The figures below show a visual comparison of how these models distribute revenue to artists.

Figure 7: Pro-Rata Model

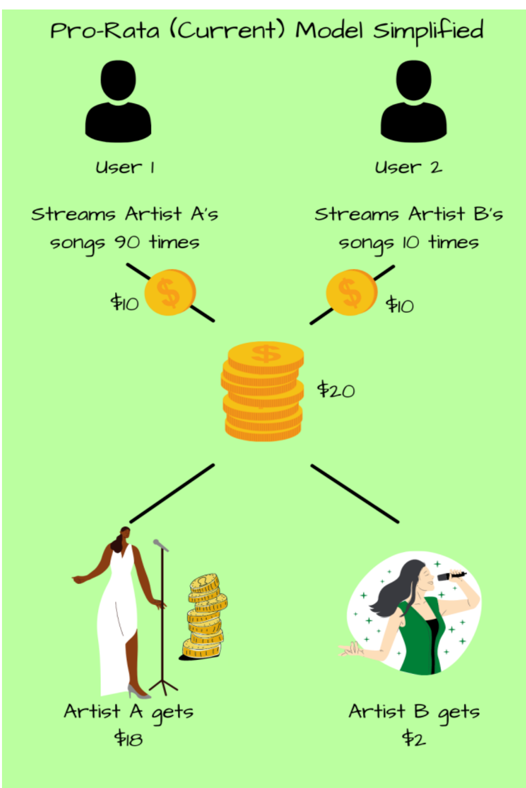
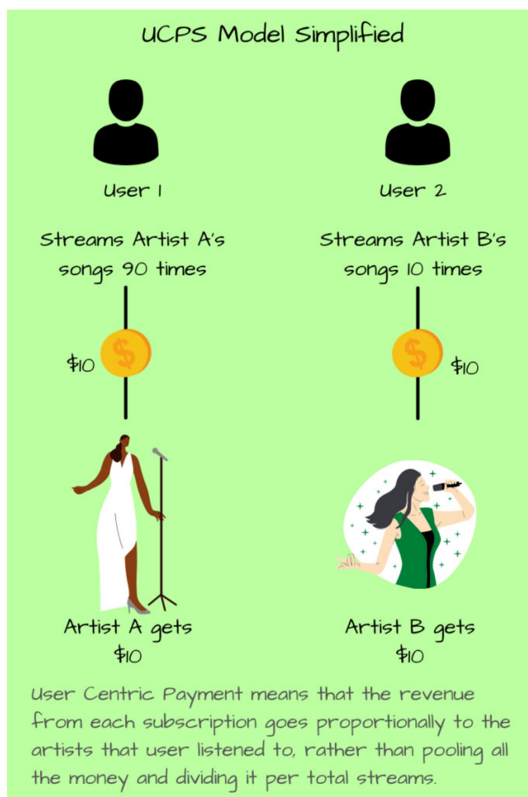


Figure 8: User-Centric Model



Source: Davie, Owen. (2021, November 4). How Spotify Royalties Actually Work

As demonstrated above, the user-centric model would provide a fairer way for artists to receive royalties since a subscriber's monthly payment would be split among the specific artists to whom that individual listened. In addition to this, the user-centric model is also the closest financial model to the era of physical sales because each user's subscription only goes to the artists they listen to, without the streaming patterns of other users having an impact (Dredge).

Whether streaming companies should switch to a user-centric model has been the subject of long debate within the music industry. While the pro-rata model has been the industry standard for decades, SoundCloud recently became the first streaming service to transition to the user-centric model. This next section will examine SoundCloud's new model to determine the financial impact of the transition.

IV. SoundCloud's Fan-Powered Royalties

What SoundCloud has dubbed "fan-powered royalties," the platform's new model is designed to provide better equality for artists since their royalties are based on individual subscribers' behavior (SoundCloud). Concisely, the more fans that listen to an artist on SoundCloud music, the more that artist gets paid. However, because SoundCloud made the switch a little over a year ago, it is fair to say that more research is needed to determine whether this new payout system would work in the long term and if it is the solution to these issues at hand. However, with what information SoundCloud has given us since it started in 2021, it does seem to offer artists more economic fairness. Below is a report from MIDiA Research, surveying 118,000 artists in 2021 who have been paid using SoundCloud's Fan Powered Royalties for almost a year.

> On average, independent artists earn 60% more through Fan-Powered Royalties compared to the traditional pro-rata model.
>
> There was a 97% increase in fans contributing more than $5 to a single artist.
>
> It also contributed to the growth of the number of independent artists monetizing on SoundCloud by 30% during the past year.

Source: (MIDiA 2022) Building a Fan Economy with Fan-Powered Royalties

In addition to this, a microsite launched by SoundCloud demonstrates how independent artists might be affected financially by the switch from the pro-rata model to the user-centric approach. For example, Chevy, a SoundCloud artist, currently has 12,700 followers. By switching to the "fan-powered" model, the service estimates that Chevy's estimated monthly royalties would increase by 217%. Another artist, Vincent, has 124,000 followers and would see an increase from his current payment of $120 per month to $600 using the new model (Ingham). By shifting away from the pro-rata model and using a more user-centric approach, SoundCloud provided artists with an increase in income and helped their fan base grow.

As a result of SoundCloud's success, a growing number of streaming platforms and industry professionals have explored what it would look like to make the switch. Tidal recently announced it was moving to a user-centric model, and Spotify has acknowledged the new approach to royalties but is waiting to see how other platforms respond (Shapiro). In 2022, Warner Music Group signed a licensing deal with the SoundCloud Fan-Powered Royalties system, becoming the first label to adopt the system. Given that the group controls 16% of the music market, this deal could prompt other major stakeholders to follow suit.

CHAPTER THREE

II. The Big Picture

The positive and negative effects of streaming have been the subject of long debate. While streaming companies such as Spotify and Apple Music certainly have their faults, there is no easy fix to make streaming a viable income stream for artists. Many argue that streaming companies are to blame, and several artists have publicly criticized streaming services and withheld their music from the service such as Taylor Swift in 2014. However, some claim that music streaming was never intended for artists to make a full-time living and that there are simply too many artists in the market now to be able to. In a recent IPO report, Mark Mulligan, an analyst, and managing director at MIDiA Research stated,

> "A staggering 65,000 new songs are uploaded to streaming services each day. All of this means the royalty revenue pie is not growing fast enough to spread sizeable payments across more and more songs and artists. More artists are succeeding in the streaming economy than the CD economy, but of course there are also more that are not succeeding because there are simply so many more in the market now2. I think streaming has been good for the smaller and bigger players. If we can bring in more money from streaming, that will benefit everyone and grow the value of the streaming economy."

It is important to note that streaming is still a relatively new format and while it has certainly caused many problems within the music industry, there are tremendous opportunities for growth and development in the future. While the user-centric model would provide a fairer way for artists to be paid, some disagree and have argued against making the switch. In response to adopting a user-centric payment structure, Will Page, Spotify's Director of Economics claims that switching to the user-centric model would create a significant increase in administrative costs (Roe). In addition to this, Jason Iley, Sony Music UK's Chairman, and CEO states, "a user-centric model will just shift money from some artists to other artists. Artists who lose in this scenario are not likely to see this as a more equitable way of dividing payments" (Neu). However, a music streaming service known as Deezer found in an experiment that the top ten artists would lose significant revenue from a user-centric model, concluding that big acts and labels are the ones making most of the money from the current system. While most major record labels such as Sony rely on the current model that favors their top-earning artists, a user-centric model would level the playing field and split revenue more fairly across the board. Furthermore, most fans expect their money to support the artists they listen to and music streaming in its current condition is not viable in the long term if it is hurting artists' careers. On adopting a user-centric streaming model, Founder, and CEO of Hipgnosis Songs Fund Merck Mercuriadis states,

> "What you're relying on — whether you're me or an artist — is that you've got songs that are of such extraordinary success and such cultural importance that people are going to spin them. And when they spin them, you want to get paid for the fact that they're spinning your record, not get partial payment or your payment diluted by the fact that someone thinks that they're spinning someone else's record when they're really not. If you're one of the biggest artists, you are going to be rewarded. If you're an indie artist right now, you're probably losing to artists that are being given a high promotional profile by the record companies, but there are, in fact, not actually getting the

> level of spins that the hype might make you think they're getting. Streaming is still in its infancy- the question we all have are just fair questions. Is the algorithm or user-centric system the best? What's the most fair?"

While there are many different opinions about streaming revenue, most can agree that economic fairness is essential not only for artists but for the long-term success of the music industry. The emergence of music streaming over recent years has provided a way for artists to have their music heard by a worldwide audience, and the opportunity to be discovered opens the door to an audience that most would have never had. An aspiring artist's ability to release music has never been so easy, and there are so many artists in the market all trying to earn their cut of the revenue pie. However, the problem is that streaming favors top-tier artists and has become an oversaturated market where the revenue is not growing fast enough to disperse royalties across more and more artists. Because 65,000 songs are uploaded to streaming platforms every day, an artist's cut of the pie gets further diluted making it harder for streaming to become a viable income stream for artists.

III. Conclusion

Streaming is at the center of the music industry and creating a fair economy for artists is crucial. As demonstrated in this paper, there is no denying that the emergence of music streaming has completely reshaped the music industry and broken the long-established financial model of the music business. The internet age is an ever-changing landscape, and the music industry has been radically transformed by it. As music streaming services continue to gain mass adoption, the music industry will continue to change and adapt, growing into something bigger than it ever was before. However, fairer compensation for artists is crucial to the survival and future of the recording industry.

With the shift to streaming, the industry continues to attempt to find an equitable model that works for everyone. While in the past, artists have augmented their royalty payments with other sources of revenue such as sponsorships and touring, the reduced streaming payments today have made those supplemental activities critical to the artist's survival, particularly given that a large percentage of the artist's royalties are classified as recoupable by the record label. Although the established pro-rata model is easy for the streaming platforms to execute, it unfairly rewards superstar artists while not allowing an artist's fans to directly contribute to his or her career. The user-centric model creates a much healthier environment and reduces the inequality that is seen in the pro-rata model. Not only is the user-centric model a fairer approach, but it also would enable thousands of independent artists to remain in the music industry by providing more financial stability which helps the overall industry in terms of having a diverse music landscape.

For the industry to continue to thrive, the financial model must be more equitable for artists. While music streaming provides artists the opportunity to get discovered and have their music in front of millions of listeners, the current playing field favors the more well-known artist, and the majority of artists are not fairly compensated for their music. Based on my research and conclusion, part of the problem is not streaming but the way streaming royalties are calculated and distributed. Although more testing still needs to be conducted, a shift to the user-centric model would provide more economic fairness and help fans of artists contribute directly to their success.

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