

Music

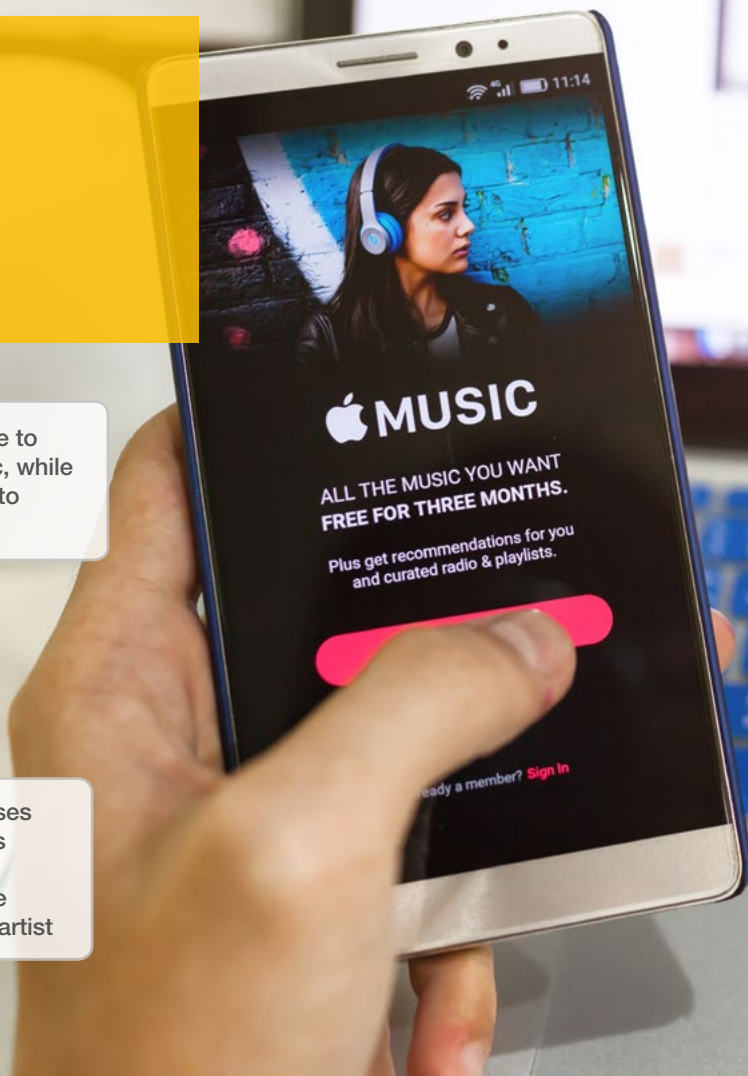


Streaming services continue to drive digital recorded music, while the download format is set to become obsolete

The decline of the physical market is slower than expected in Switzerland



Data analysis of music now uses social media aspects, and has become indispensable for the development of music and the relationship between fan and artist



Segment definition

The music market encompasses live as well as recorded music. Live music includes concerts and festivals, and the related revenue is from ticket sales and sponsorship support, but it excludes merchandise sold.

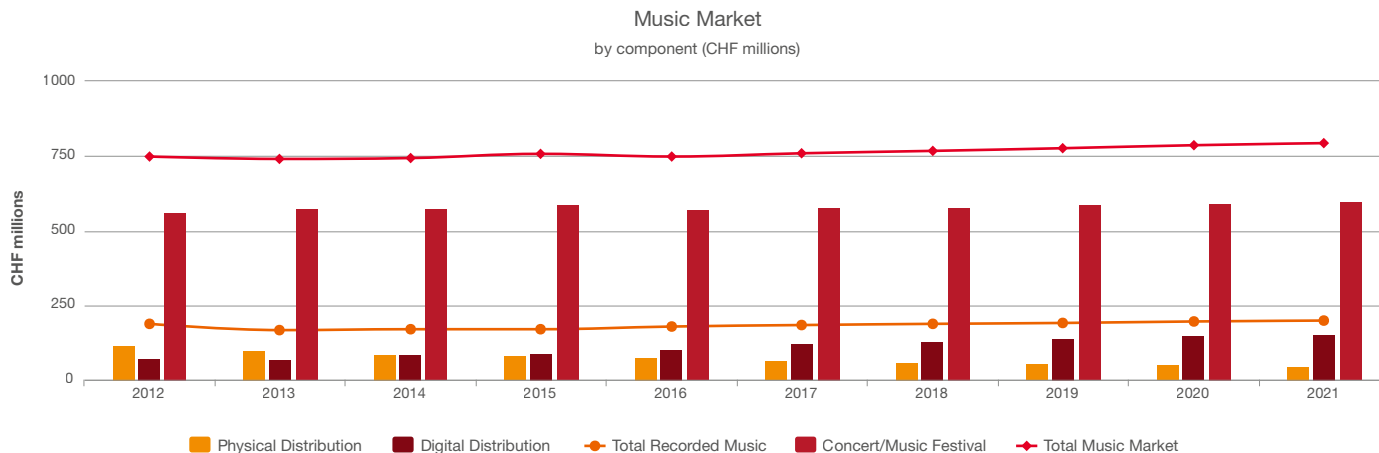
Recorded music can be subdivided into two main categories: digital and physical. Digital music is shared and distributed electronically to different devices such as mobile phones and computers. The transmission is accomplished via streaming or downloading. Physical music comprises all retail sales of CDs, music videos and singles in the form of hard copies. Any revenues generated by advertising or subscriptions to internet radio services are not included in the recorded music segment unless these are part of a **streaming** service.

Retail values are used as the quantifier for all music purchases, thus they are higher than the trade or complete sale values indicated.

Business innovation

'Value gap' – the biggest challenge to sustainable growth

The shift to the digitisation of music through the growing use and industry of streaming has created a market distortion known as the 'value gap'. This refers to artists, creators and record labels that are not being properly compensated for their contributions to published music. The value gap is the greatest threat to the future sustainability of the music industry. The recorded music industry is now trying its best to regain sustainable growth following an 8-year decline, during which revenues dropped by more than 40%, from CHF 318 million to CHF 169 million in 2015. Success requires a resolution of the growing mismatch between the value that user-upload type services, such as YouTube, extract from music and the revenue returned to those who create and invest in music.



Analysis by PwC

Tidal, a new streaming platform, has become the pioneer in the effort to resolve this unfair remuneration practice by compensating those involved in the creation process. This service is owned and run by renowned artists such as Beyoncé, Chris Martin, Jay Z, Madonna and many more whose quest is to help music regain its value. The notion that music should be free has been spreading for years, to the extent that music is practically no longer treated like an art. As a consequence of Tidal's only holding a small market share, this consortium cannot influence or change the whole industry, but they have provided an example for other services to follow.

Like most streaming services, the world's most popular streaming music service, Spotify, has had issues with ensuring that the right creators are paid for every stream due to the complexity of the situation. This led to a significant fine in 2016 for unpaid royalties in the USA. Many songs do not have the proper metadata

to ensure that the correct songwriters, artists or rights holders are tagged; hence the loss or nonrecognition of royalties.

Blockchain technology is one of the hottest topics in the music industry. It is a decentralised database that links a streamed song to its artist. In April 2017, Spotify acquired a blockchain start-up, Mediachain, to solve music's attribution problem and achieve transparency.

The Swiss music market

Market overview

The overall Swiss music market is experiencing an invariant phase: for the past four years, the average annual growth rate has been a meagre 0.3% (CAGR) and ended in a 1.2% decrease in 2016. The Swiss music industry is dominated by the live music sector. With a 76% share, this segment suffered a 3.1%



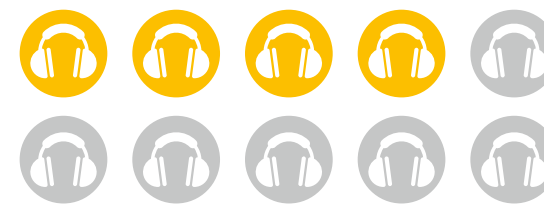
decline last year, thereby causing an overall decay. The streaming segment of the digital domain has seen the largest change in the music industry, with revenues growing from a CHF 1.4 million in 2012 to CHF 65.7 million in 2016.

In 2016, total recorded music showed the highest growth rate of 5.5% since PwC is tracking the market totalling revenues of CHF 178 million – a development which clarifies that streaming is now clearly able to compensate losses in physical distribution. The 50.3% pace of growth in streaming more than offset a 7% decline in physical and a 12.1% decline in download revenues. This resulted in a 17.1% increase in the digital market for 2016.

The accelerated decline in physical music distribution can be attributed to the emergence of downloading and streaming as the new norm. The user proclivity for music has shifted from expectations to mobility, with a bent towards a digital means. 69% of the Swiss population listen to Spotify on mobile devices rather than desktops. Thanks to the small number of music enthusiasts who still value purchasing an album they can actually touch, physical distribution will not disappear entirely. Since 2012, there has been a surprising increase in vinyl sales, with a 50% increase alone last year to a level that now accounts for 2% of the total music industry's revenue. Nonetheless, artists are beginning to adapt by releasing music only through streaming platforms and boycotting physical albums.

CDs result in a higher single royalty payment, while streaming offers a continuous revenue flow derived from the monthly subscription income. Streaming is considered a long-term model, but it is also in constant flux as a song's peak time may be at its release or after being included in a movie or published in the form of a new cover or remix. This enables an artist to earn revenue for a longer period than if the music were released physically. The business models involved in streaming are advertisement-based, i.e. supported by promoters, or subscription-based, which relies on a monthly fee. The advertisement model is a less certain revenue source due to the volatile market, while the subscription revenue concept is a constant and reliable income flow.

Spotify, currently the most frequently used streaming service, counts 60 million paying subscribers worldwide out of a total of 140 users in July 2017. To reach the first 10 million paying users, it took four years starting in 2010; its last 10 million paying users were acquired in less than half a year from March to July 2017. This accelerating growth rate can also be seen in the number of total users, which rose 40% between mid 2016 and mid 2017. Switzerland has still not matched that pace, as Spotify was introduced later. Last year, Amazon entered the Swiss music streaming market by launching 'Amazon Music Unlimited'. Despite Amazon already having a music platform, this new deal offers a similar number of tracks and services as its competitors in



4 out of **10** streaming users pay a monthly subscription for music streaming services

the area. For Amazon customers who have already subscribed to the company's premium delivery model, it is available at a lower price and creates a competitive advantage: for a given cost, those people get access to a music streaming service as an add-on for free.

The development of streaming largely relies on the available infrastructure, or more specifically the use and quality of mobile devices. Globally, music related applications are the second most-used on mobile devices; in Switzerland, Spotify is streamed by 57% of the population on mobile, 12% on tablet, and 31% on desktops. The available services in Switzerland have allowed for the substantial growth that has been observed. With the increased availability of high-speed data reception and wider mobile device ownership, 77% of Swiss internet users streamed more often via mobile devices than on desktops in 2016. Additionally, Switzerland currently has a very high-quality mobile broadband network, the fifth fastest internet connection in the world.



“Streaming is not only the future, but also the driving business model of the present. But physical CDs and also Vinyl are still finding their way to customers. Vinyl has become a fashion item, with sales steady until 2012 when something happened and a sudden growth spurt ultimately led to a 50% increase in 2016. Despite these higher sales, music consumption patterns have not varied: most vinyl buyers do not even use the records or have no player, since in reality they are streaming users.”

Simon Müller
Director Sales & Business Development | Sony Switzerland



The live industry, which encompasses concerts and festivals, previously was experiencing slow growth rates of around 2%, but last year it declined by 3.1%. There are a few explanations for this, the first being that Festival Live at Sunset did not take place, thereby causing a drop in tickets sold. Another aspect is the influence of the international organisers who are pushing into the Swiss market and creating too many tickets in Switzerland, which results in reduced average prices for an entry. This segment of the music market alone was responsible for about 76% of the total music revenue in 2016. The feeling of exclusivity and uniqueness is what fans have explained as being the reason for their interest.

Since both the live and streaming industries are very successful parts of the overall music market, Spotify recently combined the two by adding a feature to facilitate ticket purchasing. Thanks to its partnership with Ticketmaster and Songkick, fans are now able to access the concert schedules of their preferred artist and link to the corresponding purchasing page. Also, as of November of 2016, the platform started sending to its users personalised concert recommendation e-mails which are composed using individual listening data.

Secondary ticket sales are still a problem in this segment, but due to the potential violation of the principles of commercial freedom, the illegalisation of this market is not possible in Switzerland. There are three main techniques used to restrain this practice: personalising the tickets; limiting the number of tickets sold to a given buyer; and encouraging the development of not-for-profit ticket swap sites.

Principal drivers

Streaming is the norm

The music industry at the global as well as the Swiss level is moving away from downloads and purchases towards subscription-based services. The increasing technological infrastructure has led to 79% of the European population now



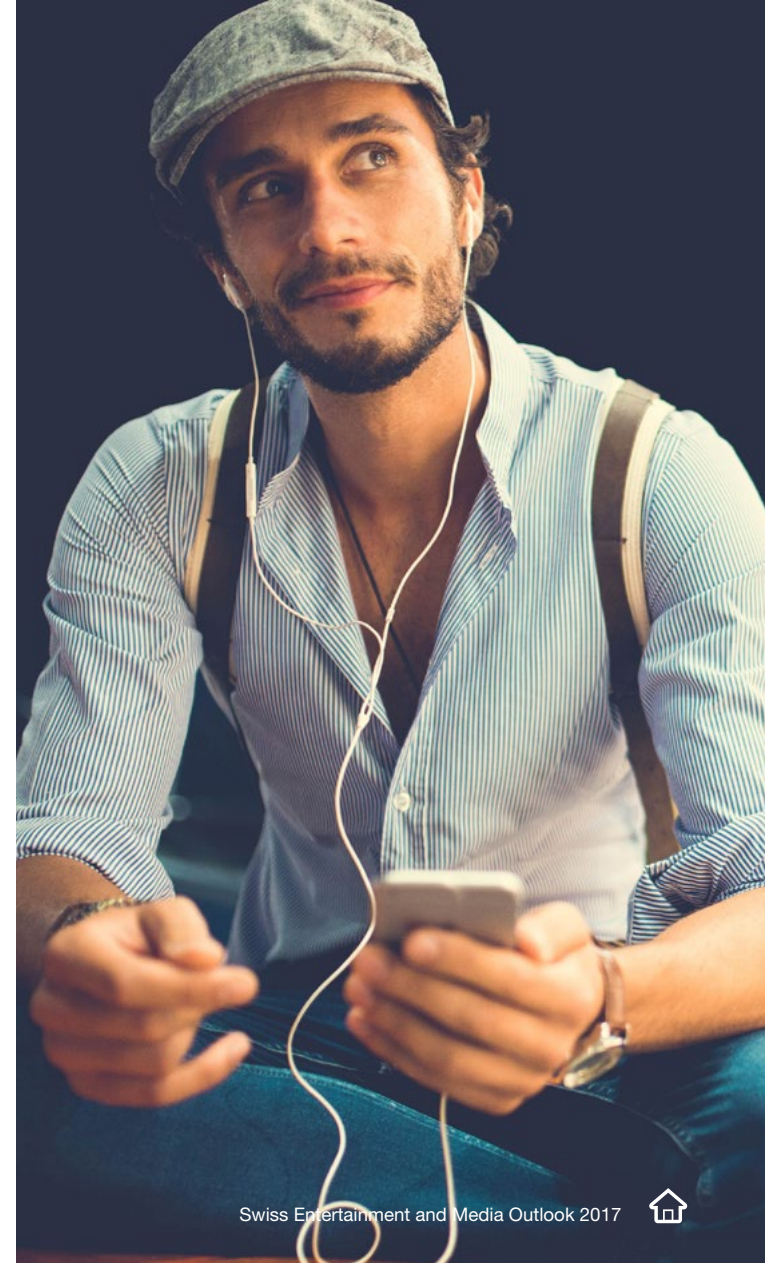
“The music industry is dominated by streaming, which will hold a two-thirds share of the recording industry, leaving the remaining one third to downloading and physical in the future. The downloading segment is disappearing – it holds only one-third of this latter portion, leaving the rest to physical distribution.”

Simon Müller
Director Sales & Business Development |
Sony Switzerland

being internet users, and 87% of Swiss. The easier accessibility has also caused streaming services to be even more favoured. In Europe, 77% of streaming users are paying instead using free ad-based services, whereas Switzerland lags in regard with a 40% share. Music streaming has been present for many years via YouTube, but not until Spotify did this concept become monetisable. The success of this service shows that customers are willing to pay for music.

Big Data to solve a big problem

Data analytics in the music industry is a growing business aid. It focuses on using the social media aspects of streaming platforms to gain a greater understanding of who listens to what, when, where and how frequently. Music analysis used to be constrained to the number of albums sold; now, specific information about individual tracks can be determined. This kind of data analysis has many applications, one of which is to predict future music trends, another is to build radio content or aid distributors' planned releases and tours.



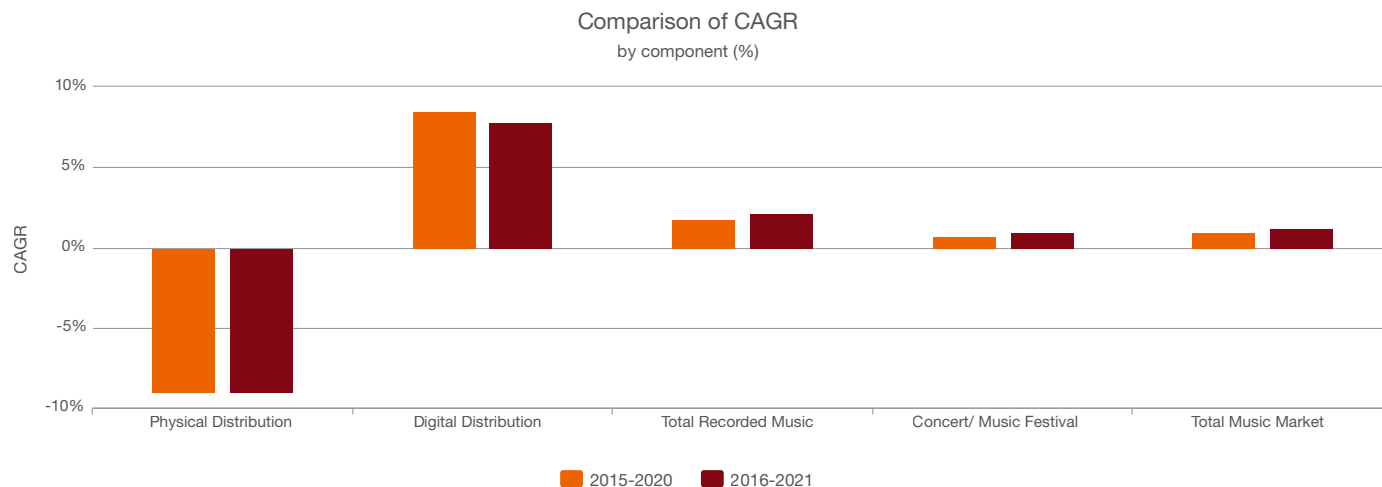
Another aspect of data analysis is user feedback, which has shaped music production by making it more ‘spotifiable’ for short-attention-span audiences. Music needs to catch the listeners’ interest in a few seconds, since skipping tracks is now possible. Writers have started to reorganise traditional song structure to fit into the business model. Streaming allows the constant feedback from fans to be recognised, and artists are able to release a track, see the reaction and, considering the public’s opinion, publish a refined version.

Promoting local markets will benefit the global industry

Streaming services have specialists who create public playlists based on current hits as well as most listened to or liked tracks. As global companies, they are not concerned with supporting local artists who will not result in as many clicks as international, established artists. Many Swiss artists are reluctant to put their music on streaming platforms as they will not see any profit by doing so. In the top 100 hits of Switzerland 2016, there was only one Swiss artist in the penultimate position. The IFPI announced that, on the 25th of August 2017, Spotify started promoting the Swiss music market by developing specialised playlists directed to the local market, e.g. ‘Top Hits Schweiz’ and ‘New Music Friday Schweiz’. Similarly, Apple Music appointed a specialist for Swiss music, who in July 2017 began to focus on the development of the Swiss market. The aim of these lists is to promote Swiss artists internationally and increase their presence on the platform.

Music enthusiasts are provided with better quality

The opposite of the mainstream music consumer, who listens to music without necessarily focusing on the quality, are the audiophiles. Even though they might be a smaller target group, quality is their top priority. Parallel to technological progress, music quality has been deteriorating due to loss of data in the compression processes. This has led to the recent development of High Resolution Audio (HRA) files. By using different encoding procedures, the true depth of the track can be heard and hence



Analysis by PwC

fully appreciated when the proper equipment is used. In 2016, Sony spurred this technology by creating hardware to support HRA tracks. With platforms like HIGHRESAUDIO or Tidal now offering tracks and albums of this quality, audiophiles are encouraged to move from CDs to digital formats. The superior sound allows for higher pricing and premium subscriptions, which result in an overall revenue gain.

Market growth

In a general sense, the global music market is constantly changing and adapting to the new trends and technologies. While the individual components of the industry are in constant flux, the

Swiss market grew by 1.9% in 2015 but experienced a decline of 1.2% in 2016.

The total Swiss music market was valued at CHF 748 million in 2016, and is predicted to reach CHF 793 million by 2021 at a CAGR of 1.2%.

The total recorded music revenue was CHF 178 million in 2016, a 5.5% gain over the previous year. It is forecasted to reach CHF 198 million in 2021 at a CAGR of 2.1%. Physical distribution fell by CHF 6 million to a total of CHF 74 million, while the digital market generated CHF 104 million.





“The process involved in music ownership has flipped; in earlier years, artists released their music on the radio to gain exposure, which then led to their playing live shows; and if listeners liked their music, they would consider spending money to buy the CD. Nowadays, music is paid for via streaming platforms and, if it is listened to, liked or shared enough, it will be played on the radio, which in turn opens the possibility for concerts.”

Simon Müller

Director Sales & Business Development |
Sony Switzerland

In 2015, physical distribution accounted for 47% of the recorded music in total, but dropped to 42% in 2016 and will further shrink to about 23% by 2021. Within the digital distribution segment, downloads declined from 46% to 37% of the total for the digital music industry, and streaming grew to 63% in 2016. By 2021, the number of paying subscribers and subscribers of the leading streaming platforms is expected to reach or surpass the 100 million milestone, thus the forecast that digital distribution in Switzerland will grow at a CAGR of 7.8%.

The live market is a very influential part of the music industry in Switzerland: in 2015, its revenue was accountable for 78% of the total, and in 2016, 76%. Due to the scale of this segment, its negative change this past year had such a significant influence that the overall market fell. Nevertheless, it is predicted to record flat growth of 0.9% (CAGR) through 2021.

In sum, considering the combination of a rising live segment, falling physical market and a digital market that is experiencing both (i.e. in streaming as opposed to downloading), the Swiss music market is expected to continue its flat rate of growth.

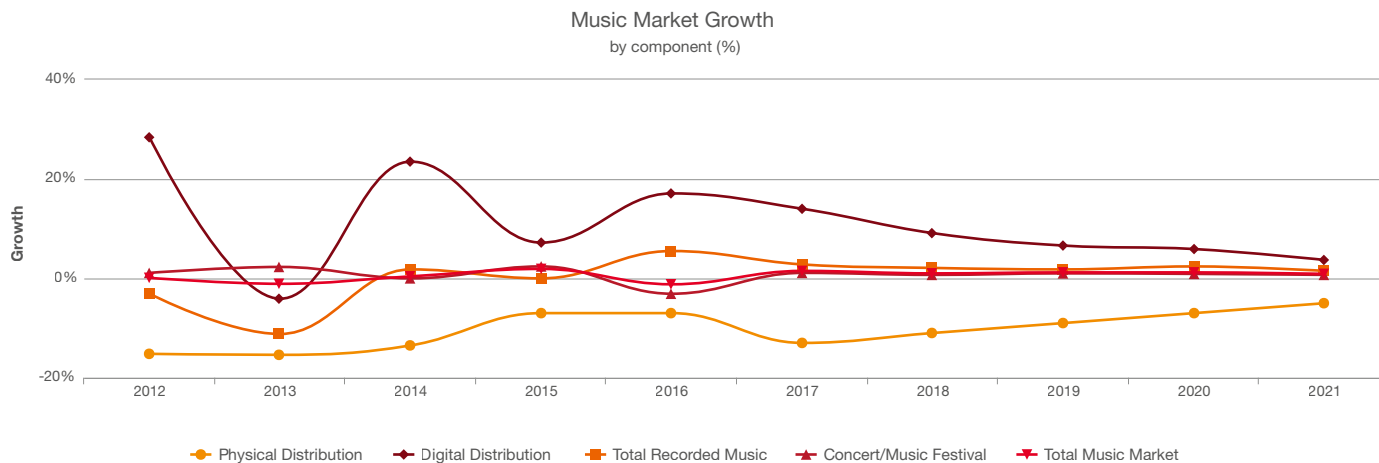


Comparison to Western Europe

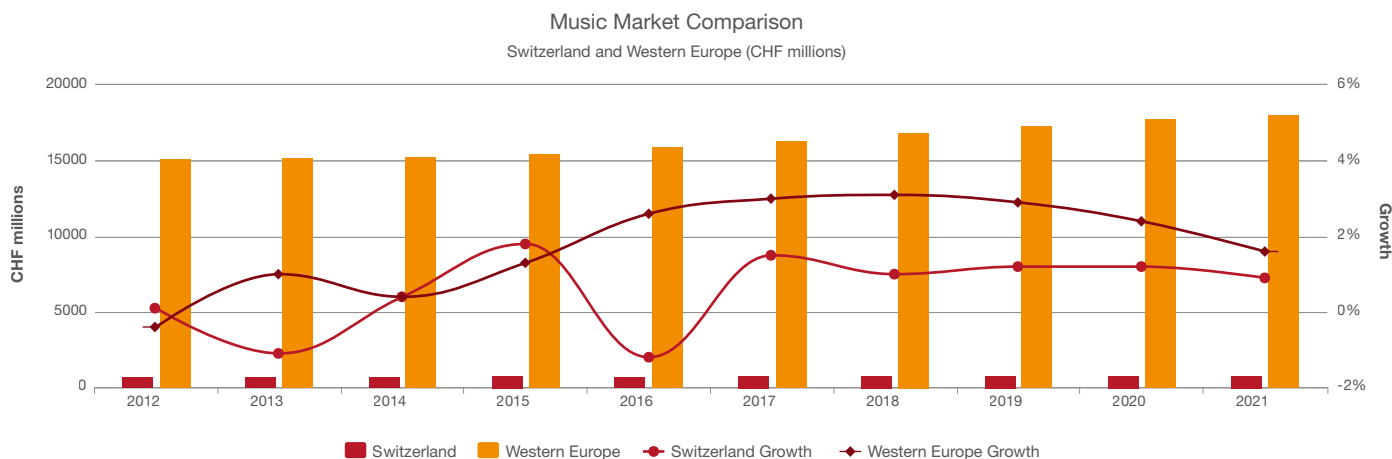
Switzerland has a growing streaming market but it has yet to reach the level seen in the majority of Europe. In 2016 it generated revenue of CHF 16 billion, such that the Swiss market constitutes 4.9% of the European total. The growth rates were similar until 2016, at which point the European market grew by 2.6% while the Swiss market shrunk by 1.2%. This can be attributed to the composition of different countries: for example, streaming in Norway comprises 95% of the music market, while in Switzerland the percentage is about 40%. Switzerland currently lags some countries in terms of the digital music market, but it should grow at a 7.8% CAGR through 2021.

The European physical market declined by 5.8% from 2015 to 2016, mimicking the 7.0% drop in Switzerland. On the other hand, the digital market grew by 15.2% and 7.2% in Europe and Switzerland, respectively.

The European live segment, like Switzerland, is saturated and the revenues are expected to remain invariant at a CAGR of 0.9% in Switzerland and 1.4% in Western Europe. This is a market that has existed far longer than for example digital distribution, so logically it has grown to the point where it can hardly expand further.



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