Supplementary written evidence submitted by the Association of Independent Music

Dear Chair

I wanted to write to thank you for the chance to appear in front of the DCMS Select Committee last week.

For our part, it felt like a constructive session and we were grateful for the opportunity to describe and illustrate the perspective and practices of the independent music community of entrepreneurs in the UK.

Inevitably, in the back and forth of the session there were some areas that we felt might not have been explained sufficiently clearly, or that could benefit from some further clarification and I wanted to take this opportunity just to follow up on three of these.

'Writing Off':

During our evidence session last week, there appeared to be some uncertainty as to whether the 'Major' labels 'write off' unrecouped balances after a set period of time with respect to recording agreements with artists.

I wanted to follow up as I think this is an important point for clarification.

There are two areas between which 'writing off' could become ambiguous:

Record labels will have company accounts in which liabilities or investments are 'written off' for tax purposes after a certain period of time as is common practice in commercial entities.

This is separate and very different from the 'writing off' of balances that we were referring to during our evidence session and by which we mean specifically the forgiveness of unrecouped balances on artist ledgers with the label, irrespective of the treatment of those balances in the company's accounts or for tax purposes.

To our knowledge, Majors may well 'write off', for tax purposes, losses incurred when artists do not recoup advances, but this does not necessarily mean those balances are 'forgiven' in the artist's ledger with the label should their music generate revenue in the future – in which case any revenue would still accrue against any outstanding advances and not be paid through to the artist.

This is in contrast to the practice described by Beggars, in which they specifically forgive artists' unrecouped balances in their ledger with the label after 15 years at which point any cashflow would be shared with the artist, irrespective of whether or not they had previously recouped.

In these two circumstances, 'writing off' can result in two very different outcomes for an artist and their label.

'Digital Costs'

Rupert Skellett from Beggars mentioned in his evidence that digital music delivery and promotion doesn't come with the same costs of physical music distribution, such as warehousing, transport etc. Whilst this is true, it is not the whole story and his evidence did not detail the costs that are incurred in the digital market – it is not accurate to think of it as ‘cost-free’. Systems, data analysts and the complexity of successfully navigating the digital market comes at considerable cost and labels have seen the need to increase head-count, and invest considerably in these areas.

Labels have to a large degree seen a displacement of cost, rather than removal of cost, in the transition from the physical to the digital marketplace. Furthermore, the requirement to increase marketing and promotional spend in order to try to help releases ‘cut through’ the increasingly crowded market applies further cost pressure.

It is worth pointing out that these costs make up part of the label’s cost base and are not part of any balances that would be recouped against artist’s share of revenues.

A&R / Recoupment

In terms of what costs are applied to the artist’s share of revenue in the context of recoupment, I remember there being the suggestion that some follow up would be helpful and I understood the Committee said they would follow up with Rupert Skellett on this.

In the meantime, I thought it might be helpful to set out AIM’s understanding of general practice in the independent music community.

When a label signs a deal with an artist, they generally establish an internal ledger which tracks their account with the artist.

In a deal that is based on a ‘share of net’, agreed costs are taken off the top, with any balance being split between label and the artist once the project has reached its breakeven point. Advances tend to be much lower than those found in more traditional recording agreements and this reflects the different risk / return profile of these deals.

In the case of a more traditional ‘royalty’ structure, costs that are recoupable against the artist’s share of revenue are entered into the ledger and revenues that accrue to the artist’s account are recorded so that recoupment and disbursements can be tracked. Outstanding balances on the artist’s account do not accrue interest, or other charges, effectively making the artist’s ‘cost of capital’ zero.

As stated above, the status of the balances in this internal ledger is separate and different from how capital investment in artists is treated by the business for tax and balance sheet purposes.

Costs that are generally recoupable from the artist’s share and would be applied to the ledger include:

- Personal cash advances
- Advances to cover recording costs
- Advances to fund touring activities (‘Tour Support’)

Open to negotiation include:

- Music video production costs (often shared 50/50)

Non-Recoupable Investment by the label include:

- Overhead
- Marketing
- Promotion
- Physical product manufacturing / shipping
- Digital distribution costs
- Data analytics

At the point that an artist ‘recoups’, they have earned out the advance royalties received on account. At that point, in the case of traditional ‘advance-led’ deals, the label will have received a proportional share of the gross revenue (as set out in the contract) – but would have used this to fund the non-recoupable elements of the deal and their general overheard / business costs.

Finally, I have attached an early-stage economic paper looking at the potential application of ‘degressive’ scales to streaming distributions, which we believe could solve the problem Mr Brennan and others on the Committee referred to in the evidence session, of getting credible niche and developing artists a sustainable revenue from streaming at lower scale than the current ‘winner takes all’ model, and does so much more effectively than the ‘User Centric’ model that has been proposed elsewhere.

I hope that is helpful and am at your disposal for any follow up.

Yours sincerely

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Association of Independent Music