

Adrian Rahman
Assistant Director
Mergers and Asset Sales, Sydney
Australian Competition and Consumer Commission
BY EMAIL
June 24 2004

Dear Mr Rahman

RE: Proposed merger of Sony Music Entertainment (Australia) Limited and BMG Australia Limited

Thank you for providing the opportunity for the Music Council of Australia to comment on this matter. Please accept our apology for the late response.

Given the short period to the deadline for this submission, and the limitations on its resources, the Music Council was unable to conduct the intensive research warranted by this issue.

Further, given the lack of objective research findings, members' opinions derive not from any shared body of knowledge, but from opinions arrived at in their own separate and contrasting circumstances.

Finally, the Council is being asked not to comment on present fact, but to conjecture about future probabilities.

Considering all these circumstances, the Music Council has decided that this submission will not take a position for or against the merger, but rather will present first the opinions of some music professionals in support of its being permitted, and then a list of opinions from some who believe it is disadvantageous to competition and to the local industry.

ARGUMENTS FOR NOT OBSTRUCTING THE MERGER

General comment: The shrinking size and fewer number of multinational companies is inevitable and simply opens up more opportunities for new and established independent companies to grow.

There is plenty of competition in the market place and this will not diminish appreciably with a Sony/BMG merger.

Import competition. Import competition depends in the main upon the retail sector. Any retailer can import any product from any properly licensed area. This can be from a third world country at a very cheap price – and doubtful quality sometimes, or from whatever territory the product emanates. The level of importation will only escalate if local wholesalers are slow to release product or fail to release, as prices are very reasonable and stable and delivery is prompt.

Height of barriers to entry. There are no barriers to entry in Australia.

Level of concentration in the market. The level of concentration is and always has been the province of the majors. They will always strive to represent the higher selling (or potentially higher selling acts). They will pay higher royalties, pay higher advances, take more risks and spend significantly more on the marketing front. CEO's of majors are paid on turnover, not profit, so the higher the sales – almost regardless of profit – the better.

Note however that concentration should be measured by sales, not repertoire. For example, Hot/Didgeridoo has around 6,000 album line items or approximately 25% of available product in Australia, but represents probably less than 1% in sales.

Degree of countervailing power in the market. An econometric question which the Music Council cannot respond to in the present circumstances.

Likelihood that merger would result in higher prices or profit margins. Market circumstances make it unlikely that the new company would substantially increase prices.

Extent to which substitutes are or are likely to be available in the market. This is a normal aspect of the record market. The company that does not own the latest/hottest product will attempt to come up with a clone to try to share in the perceived action.

Dynamic characteristics in the market. This is a complicated question and would need to be viewed in the light of online music delivery but more particularly commercial radio. Radio airplay has a direct influence on sales. The takeovers and narrowing ownerships in the radio sector, creating large, narrowly controlled networks with very limited diversity in programming, will be a massive challenge for recording here as already in the USA. This could be an issue for investigation by the ACCC.

Removal from the market of a vigorous and effective competitor. No comment

Nature and extent of vertical integration. No comment.

ARGUMENTS FOR DISALLOWING THE MERGER

General comments. The questions posed by the Commission might be read as focused upon the possible effects of the merger on consumers and competition. These of course are important issues. However, the survival of an Australian musical culture is also a most important issue, and one with which this group of Music Councillors' response is very concerned. We have attempted with some difficulty to put those arguments into the framework of the Commission's questions.

The five major recording corporations are believed to have in the order of 90% of the Australian market. It is possible that, based on their present shares, the merged companies will hold nearly half of that. The merger is unlikely to create greater service or more competition.

Import competition. It is conceivable that the merged company will reduce its commitment to Australian artists and increase imports. Recordings already successful on overseas markets, and especially the US market, have amortised their costs before export and sale in Australia is highly profitable. By comparison, recordings initiated in Australia are a risk investment and only a small percentage will succeed. Increasing power of US-managed major companies in Europe has seen contraction or elimination of locally based production. Activity in Australia could follow the same model.

Height of barriers to entry. It is not difficult to establish a small recording company. In that sense, there is no barrier to entry.

But it is almost impossible to turn it into a large recording company; if by good fortune it becomes a successful medium sized company it becomes a target for takeover by the major corporations. The Australian industry is comprised of a good number of small independent companies and the major transnational corporations, with very little in between. The merger is unlikely to affect this basic fact of life and will exacerbate further the imbalance. As noted elsewhere in this submission, the large companies hold almost the entire market and the entry of new, small record companies offers them very little competition.

The height of the barrier to entry for a very large company other than by takeover of an existing company is enormous and the merger can only raise it further.

Compared with starting an independent record company it is relatively difficult to establish a viable, efficient publishing entity (margins are much smaller). A publisher survives on catalogue, its ability to collect on publishing copyrights over an extended period of time, and number of territories. It is not just a single new song that makes publishing profitable and sustainable but rather, the control of the heritage catalogue. Catalogues are usually up for sale to the highest bidder. The ability of the merged entity to be that bidder will be enhanced.

The major publishers are less 'doers' than they are administrators (collectors) and banks, paying advances to secure the rights to new artist material. The fact that Australian composers are now losing another 'bank' is of concern.

Level of concentration in the market.

Airplay. Extrapolating from data published by The Music Network last November, the combined companies would have approximately 40% of radio airplay. There is a demonstrated correlation between airplay and record sales.

Whether the new entity will have the power to further enlarge its market share cannot be known at this time.

Less available catalogue. It is probable, considering the effects of previous mergers, that the combined catalogue would be culled, resulting in a smaller catalogue being available to Australian consumers.

Domination of airwaves. The production of recordings is in some ways the least problematic aspect of the supply chain. The difficulty is in bringing the product effectively before the public. The major record companies use their financial power to place their artists on broadcasters' play-lists and so dominate the airwaves. The proposed merger can only increase the ability of this company to grasp airtime and consequently market.

A reduction in the number of Australia artists to which the new company is committed The company's resources are likely to be put behind a smaller number of artists – a different form of concentration. It is probable that the merged company would cull its combined stable of artists and sign fewer new artists. Historically when two record labels merge the number of A&R staff and artists signed decreases.

Recording/publishing nexus. Both BMG and Sony have music publishing divisions. The merged record company may exert pressure on the merged publishing company not to sign a publishing contract for an act it doesn't like, further reducing the stable of artists.

A reduction in overseas touring by Australian artists and a possible flow-on of reduced Australian music exports. Fewer artists signed could result in fewer artists promoted internationally.

Less negotiation potential for artists. There will be a less competitive market with fewer major labels negotiating for acts.

A "rationalisation" resulting in less staff would contribute further to a reduced ability and commitment to develop young artists.

Degree of countervailing power in the market

In the medium term there may be more independent or artist owned record labels, mitigating some of the problems arising from the merger. Artists will try to find a means of distribution outside of the shrinking number of majors.

But historically the most successful independent companies are taken over by the large companies and many of the less successful lose money and go out of business. The effect could be temporary.

Likelihood that merger would result in higher prices or profit margins.

Probably not, but neither is the new entity likely to use its market power to lower them.

It is possible that the merged entity, with greater market power, will also use its greater power to place downward pressure on artists' royalties.

Extent to which substitutes are or are likely to be available in the market. Many more recordings are produced each year than can earn back their costs. In this sense, substitutes are available.

However, there is a sense in which there is no substitute for a particular artist. Audiences do not wish to purchase covers of their favourite artists; they prefer the recordings of the original.

There is a likelihood that when the combined catalogues are culled, the culled items will simply be removed from the market and access by audiences. Under typical terms of contract with the artists, the artists will have no power to reclaim their copyrights and the corporation may well refuse to negotiate release. Both audiences and artists are the losers.

Dynamic characteristics in the market. The online market has caused disarray among the major record corporations. However, they are beginning to address the problem. While the internet enables an individual of very limited means to produce and distribute his own recording, the practical issue is again one of marketing: how to attract attention in a global market with at least tens of thousands of suppliers?

There is evidence that, having firstly opposed and combated the new market, the major companies by one means or another are seeking to control it. One consequence of such control is the constraint on the contents of the available catalogue and the means by which the public can gain access to it. The fewer the number of large record corporations participating, the more power they have to exercise this control. This power may be further exercised through the corporations' control of consumer electronic devices used to access music – e.g. Sony's ATRAC3.

There is a further concern in this area: that the artist contracts for releasing recorded works for online distribution may be and possibly already are dramatically less favourable even than those for release on physical recordings.

Removal from the market of a vigorous and effective competitor. No comment.

Nature and extent of vertical integration. There is increasing vertical integration in the upper reaches of the recording industry, taking in copyright management, publishing, manufacturing, distribution, broadcasting and increasingly, online communications. This can only result in a narrowing of choice for consumers and a decreasing power for the smaller players in the industry, including the artists.

Once again, thank you for the opportunity to comment.

Sincerely

Dr. Richard Letts
Executive Director