

ALTERNATE OPERATING MODEL FOR THE RECORD INDUSTRY BASED ON THE
DEVELOPMENT AND APPLICATION OF A NONTRADITIONAL FINANCIAL MODEL

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Don't leave me high, don't leave me dry... ¹

- Radiohead

INTRODUCTION

Is the well drying up for record companies? Are the days of monster profits coming to an end? What alternatives do record labels have and where do they go from here?

Traditional recordings² made available by the music industry record labels, to the marketplace, have steadily been on the decline year over year since 1999.³ At the same time, sales of digital downloads, both in single and album formats, have been on the rise year over year.⁴ The trend is not a secret nor is it a surprise to the music industry and the record labels. This paper will propose a novel financial model, which advances the sustainable transformation of the record industry in light of the aforementioned trends.

¹ Chorus from the Radiohead song entitled “High and Dry” from their sophomore album “The Bends”.

² Traditional recordings include compact discs, compact disc singles, cassettes, cassette singles, and LP/EP’s.

³ Recording Industry Association of America 2005 Year-End Statistics, at <http://www.riaa.com>

⁴ *Id.*

Currently, there are few financial models that serve as roadmaps or templates that shed light on the path ahead. Understanding what hedge and private equity funds and insurance products are and how they operate provide a basis to developing a new financial operating model for the recording industry.

As a result of technological advances and the availability of affordable powerful personal computers, the barrier to entry into the music marketplace has been all but removed as related to recording, producing and manufacturing musical recordings. Musicians can create, record and produce their own recordings using computers and recording equipment that they own, essentially creating their own private studio. Furthermore, musicians can then make their digital recordings available to their fans and the marketplace with few of the obstacles or barriers that existed before the advent of affordable technology. The low barrier to entry into the music marketplace coupled with the numerous places that digital recordings are available leads to musicians being more readily “discoverable,” today, than at any other time in the past.

What if a financial vehicle, akin to a hedge fund, private equity fund, or insurance product, was created and then musician’s intellectual property (“IP”)⁵ was acquired and IP assembled into a form analogous to a portfolio found in conventional financial products?

This paper explores the history of both the hedge/private equity fund, insurance and music industries that lead to this crossroad. Furthermore, the formation and structure of

⁵ Black’s Law Dictionary defines intellectual property as “**1.** A category of intangible rights protecting commercially valuable products of the human intellect. • The category comprises primarily trademark, copyright, and patent rights, but also includes trade-secret rights, publicity rights, moral rights, and rights against unfair competition. [Cases: Copyrights and Intellectual Property 1. C.J.S. *Copyrights and Intellectual Property* §§ 2, 4-5.] **2.** A commercially valuable product of the human intellect, in a concrete or abstract form, such as a copyrightable work, a

traditional funds will be discussed as will the distinction between these products and the financial model proposed in this paper. Additionally, the valuation methodology of the IP will be explored by looking at a couple of valuation processes (e.g. predictive or regressive modeling⁶). Ultimately, this financial model will be an alternative operating method for the record industry as it struggles to deal with the inevitabilities of what the future brings.

BACKGROUND

History of the Recording Industry

By all accounts, the history of recorded music began in the late nineteenth century.⁷ “On December 24, [1877], [Thomas] Edison applied for the US Patent 200 521 which covered talking machines and sound writers to be known as Phonographs.”⁸ The invention of the phonograph was the spark that truly set in motion the development and progression of the [recorded] music industry. “[T]he New York Phonograph Company opened the first purpose-built recording studios [in 1890].”⁹ “By now [1895] recorded music as a medium of entertainment had become firmly established with the public. The demand for recordings provided the incentive for research and investment in the infant record business.”¹⁰

protectable trademark, a patentable invention, or a trade secret. -- Abbr. IP.”, Black’s Law Dictionary (8th ed. 2004)

⁶ Define predictive/regressive modeling

⁷ “Music Record Industry: The History” at <http://www.soc.duke.edu/~s142tm01/history.html>, April 25, 2007

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

The Emergence of Record Labels

“The first 12 inch diameter records were released on the Monarch label.”¹¹ Furthermore, record labels that still survive today began to surface. His Master’s Voice (HMV),¹² Columbia Graphophone Co.¹³ (later Columbia Records) and The Radio Corporation of America (later RCA)¹⁴ all emerged in the early 1900’s. Recorded music was beginning to become popular and an industry that would grow exponentially was born.

Another factor integral to the rise in popularity of recorded music and the success of the record labels that manufactured the recordings was the parallel relationship between technological advances and the popularity of recorded music itself.¹⁵ Magnetic recording tapes, Magnetophon tape recorders, long play records (LP’s) and ‘the 45’ are all technological advances that contributed to the increase in popularity and accessibility of recorded music.

“In the 1970s and 1980s, there was a phase of consolidation in the record industry that led to almost all major labels being owned by a very few multinational companies. CD’s still flow through a handful of sources, with the majority of the sales going through the “big four”

¹¹ “Music Record Industry: The History: 1900-1920’s” at <http://www.soc.duke.edu/~s142tm01/history2.html>, April 25, 2007

¹² <http://www.hmv.co.uk/hmvweb/navigate.do?ctx=1083;-1;-1;-1&pPageID=1684>

¹³ *See id.* note 13.

¹⁴ General Electric: Our Company: GE At-a-Glance, at http://www.ge.com/en/company/companyinfo/at_a_glance/bio_young.htm, last visited May 10, 2007.

¹⁵ explain this in that the more popular records became the further advances in technology occurred

record labels. The online digital distribution of music promises to break up the number of avenues for artists to find markets, however: something time alone will tell.”¹⁶

Hedge Funds

The definition of “hedge fund” is not found in federal or state securities laws nor is the term defined by the industry.¹⁷ “Since hedge funds do not register with Securities and Exchange Commission [SEC], their actual data cannot be independently followed; therefore hedge fund data is self-reported. There are over 9,000 hedge funds in the U.S. today. Hedge Fund assets are estimated to manage \$1.3 trillion in assets. Estimates of new assets flowing into hedge funds exceed \$25 billion on average for the last few years. The term “hedge fund” is loosely defined and does not always imply a hedging technique is being used. Hedge funds today employ all different types of strategies, and the appropriate description could simply be conveyed as ‘any unregistered, privately-offered, managed pool of capital for wealthy, financially sophisticated investors.’”¹⁸

Just after World War II, Fortune magazine hired a sociologist to work on an assignment for an article.¹⁹ The sociologist was Alfred Winslow Jones and he was tasked to research and

¹⁶ Record label, at http://en.wikipedia.org/wiki/Record_label, last visited May 10, 2007.

¹⁷ Hedge Funds - Hedge Fund – What is a Hedge Fund, at <http://www.hedgeco.net/hedge-funds.htm>, last visited May 1, 2007

¹⁸ *Id.*

¹⁹ Hedge Funds - Hedge Fund Information– HedgeCo.net, “The Origins of Hedge Funds”, at <http://www.hedgeco.net/hedge-fund-information.htm>, last visited May 1, 2007

develop forecasting models for the stock market.²⁰ As Jones became more and more involved with the project, he began to develop the concept of an investment fund.²¹ “Prior to the release of his Fortune article, Jones setup an investment fund with himself as general partner. The fund was designed as a market-neutral strategy, whereby the long positions in undervalued equities would be offset by short positions in others. This ‘hedged’ position would allow capital to be leveraged, while also enabling large wagers to be made with limited resources.”²² Jones also invented the idea of the “performance fee” that was tied to profits and gains.²³

However, Jones’ greatest notoriety stems from his innovation that specific limited partnerships, if structured correctly, are exempt from regulatory control under the Investment Company Act of 1940. This exemption allows managers to utilize techniques, such as leverage and short-selling which typically binds other mutual funds and investment companies. Consequently, many copy -cats mimicked the fee structure, but not the “hedge” mentality and philosophy that Jones inspired. It was not until another Fortune magazine article, in 1966, which branded the market-neutral strategy that Jones’ designed as a “hedge fund”.²⁴

Private Equity Funds

Another type of financial product that the recording industry can look to as a model is the private equity fund.

Private equity funds are the pools of capital invested by private equity firms. Although other structures exist, private equity funds are generally organized as limited partnerships which are controlled by the private equity firm that acts as the general partner... private equity funds are generally organized as limited

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

partnerships which are controlled by the private equity firm that acts as the general partner. The limited partnership is often called the 'Fund', and the general partners are sometimes designated as the 'Management Company' (although at times, that is a separate company affiliated with the general partner). The fund obtains capital commitments from certain qualified investors such as pension funds, financial institutions and wealthy individuals to invest a specified amount. These investors become passive limited partners in the fund partnership.²⁵

Private equity investments in 2005 reach the \$135 billion level.²⁶ "Private equity fund raising also surpassed prior years in 2005 and totalled \$232bn, up three-quarters on 2004."²⁷

The regional breakdown of private equity activity shows that in 2005, North America accounted for 40% of global private equity investments (down from 68% in 2000) and 52% of funds raised (down from 69%). Between 2000 and 2005, Europe increased its share of investments (from 17% to 43%) and funds raised (from 17% to 38%). This was largely a result of strong buyout market activity in Europe. Asia-Pacific region's share of investments increased from 6% to 11% during this period while its share of funds raised remained unchanged at around 8%. [1]²⁸

Insurance

In the United States, the insurance industry has existed for centuries.²⁹ "[W]hen you buy insurance, you're making a bet with an insurance company, which the insurance company wins on average because it must cover administrative costs and earn a competitive return for its

²⁵ "Private Equity: Definition and Much More from Answers.com", at <http://www.answers.com/topic/private-equity>, last visited May 1, 2007

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ "The History of Insurance – Risk Through the Ages", at <http://www.thehistoryof.net/the-history-of-insurance.html>, last visited May 1, 2007

shareholders.”³⁰ Insurance is defined as “a contract (insurance policy) in which the insurer (insurance company) agrees for a fee (insurance premiums) to pay the insured party all or a portion of any loss suffered by accident or death.”³¹ In the case at hand, the loss would not be accident or death but would rather be loss attributed to the lack of return produced by certain IP compared to the general pool of IP that makes up the fund portfolio.

DISCUSSION

One way to think about online distribution is as changing the shape of the expected-value lottery from the perspective of the aspiring musician. A kind of caricature of the old model might look something like this: You've got a large probability of either never catching on, or perhaps breaking even and covering your production costs, a small probability of enjoying some moderate success, and a tiny probability of hitting the jackpot and becoming a massive cash cow. So the economic component of someone's decision of whether to devote time and resources to making and distributing music consists of a lottery over those outcomes.³²

The fund will purchase a diverse portfolio of artist IP with the goal that some proportion of the portfolio becomes popular.³³ In turn, if a share of the songs or artists, in fact becomes popular, the overall risk is diminished as compared to an artist that acts alone.³⁴ As artist IP is consolidated into a diverse portfolio, the cumulative risk of the pool, as a whole, is reduced.

³⁰ “The Insurance Industry In America”, at

<http://www.brookings.edu/comm/conferencereport/cr17.htm>, last visited May 1, 2007

³¹ law.com Law Dictionary, at <http://dictionary.law.com/default2.asp?selected=990&bold=|||>, last visited May 10, 2007.

³² Notes from the Lounge: Wait, You Mean... I'm Not Getting Paid For This?, at http://juliansanchez.com/notes/archives/2007/04/wait_you_mean_im_not_getting_p.php, last visited May 11, 2007.

³³ *Id.*

This strategy is analogous to the strategy utilized in assembling traditional investment portfolios. In a traditional portfolio, some investments are riskier than others. However taken cumulatively, high risk investments assembled along side less riskier investments smoothes out the over all risk as compared to an investment made independently. “The jackpot payoff is smaller, but the probability of at least being able to cover your costs for a release is higher.”³⁵

The financial product proposed in this paper exhibits some of the characteristics of a private equity fund. As such, the product is structured as a private venture, in the form of a limited partnership. Control and management of the fund vests with the limited partnership’s general partner. The general partner is typically an entity that organizes and establishes the fund.³⁶ At the onset, the general partner’s primary task is to raise capital by soliciting investors. Although private equity funds are loosely regulated, typically those that invest in these funds are accredited investors.³⁷ The investors in the fund, in turn, are the limited partners of the partnership.³⁸ Limited partners do not take part in management or control of the fund.

The general partner charges a performance and management fee for performing its duties. Furthermore, a “high watermark”³⁹ is tied to the performance and management fees.

A hedge fund manager may receive several forms of compensation. The manager often receives a performance allocation equal to a percentage (usually 20%) of realized and unrealized appreciation of the hedge fund's assets payable on a yearly

³⁴ *Id.*

³⁵ *Id.*

³⁶ Private equity, at http://en.wikipedia.org/wiki/Private_equity, last visited May 10, 2007

³⁷ Black’s Law Dictionary defines accredited investor as “An investor treated under the Securities Act of 1933 as being knowledgeable and sophisticated about financial matters, esp. because of the investor's large net worth.”, Black's Law Dictionary (8th ed. 2004).

³⁸ *See id.* note 37.

³⁹ “This means that the manager does not receive incentive fees unless the value of the fund exceeds the highest net asset value it has previously achieved.”, Hedge fund, at http://en.wikipedia.org/wiki/Hedge_fund, last visited May 10, 2007.

basis. In addition, the manager typically receives a management fee equal to a percentage (usually 1% annually) of assets under management, which may be payable quarterly or monthly. When two management entities are used, ordinarily the general partner receives the performance allocation and the management company receives the management fee. In such instances, the management company is responsible for paying the hedge fund manager's overhead expenses (e.g. rent, furniture, equipment) and employs the manager's personnel. The general partner, however, should not employ any personnel and be solely responsible for managing the hedge fund's assets.⁴⁰

Once the fund is established and the general partner raises equity capital, it must then assemble and manage the fund's portfolio. Typically, a private equity fund's portfolio is made up of securities⁴¹ that are not traded or listed on any public exchange.⁴² In contrast, the portfolio of the financial product that is proposed here consists of musicians' intellectual property that the general partner has acquired on behalf of the fund. Most importantly, the factor that distinguishes this product from a traditional private equity fund is the composition of the portfolio.

A portfolio comprised of artist IP, is a novel concept. How should the portfolio be assembled? There are numerous factors and categories that impact the make up of the portfolio. Musical genre, musical preferences by geographic region, current pop culture trends and tastes, to name a few, will all have an impact on the portfolio's composition. MySpace alone lists sixty-six different searchable music genres while iTunes lists twenty different genres. Geography also plays a part in determining the make up of the portfolio. For example, in the early 1990's,

⁴⁰ http://www.hedgefundworld.com/forming_a_hedge_fund.htm

⁴¹ Black's Law Dictionary defines a security as "A security indicates an interest based on an investment in a common enterprise rather than direct participation in the enterprise.", Black's Law Dictionary (8th ed. 2004).

⁴² *See id.* note 37.

grunge⁴³ rock was born and exploded out of the Pacific Northwest⁴⁴ onto the music scene with the likes of Nirvana, Pearl Jam, and Soundgarden with many bands from all over the world soon mimicking them. Furthermore, current trends and tastes play a roll in making up the composition of the fund's portfolio. The big hair/glam rock bands of the 1980's a la Poison, Motley Crue, and Cinderella were extremely popular then but not now (except for nostalgic reasons of course).

“[O]ne way of thinking of the function of music labels is to see them not just as firms that coordinate production, distribution, and marketing, but as a species of hedge fund or insurance pool: They'll sign a diverse portfolio of nascent artists in the hopes that some small percentage will become superstars, thereby absorbing risk that might be too high for artists acting individually.”⁴⁵

Record Company Functions

Most record companies are large corporations that own a number of record labels.⁴⁶

“These corporations usually consist of a parent company that owns more than one record label. In today's economy, most large record companies are actually huge conglomerates that own a

⁴³ “A style of rock music that incorporates elements of punk rock and heavy metal, popularized in the early 1990s and often marked by lyrics exhibiting nihilism, dissatisfaction, or apathy.”, grunge - definition of grunge by the Free Online Dictionary, <http://www.thefreedictionary.com/grunge>, last visited May 10, 2007.

⁴⁴ “[A] region in the northwest of North America.” Pacific Northwest, at http://en.wikipedia.org/wiki/Pacific_Northwest, last visited May 10, 2007.

⁴⁵ See *id.* note 32

variety of subsidiary record labels. Often, the subsidiary labels are each mini-companies operating under the umbrella of the larger corporation.”⁴⁷ A Record label is made up of a number of departments.⁴⁸ For example, a record label will typically have the following departments: A&R (artists and repertoire), Graphic Art Department, Artist Development, Business Affairs, Label Liaison, Legal, Marketing, Promotion, Publicity and Sales.⁴⁹ (see table 1)

Table 1 - Functions of a Traditional Record Label⁵⁰

Department	Functions of a Traditional Record Label
Artist and Repertoire (A&R)	<ul style="list-style-type: none"> • Discovering new talent • Signing new talent • Assisting artist with song selection • Arranging album/song production • Arranging and selecting studio selection
Art Department	<ul style="list-style-type: none"> • Creates album artwork • Creates advertisements • Creates displays at stores
Artist Development	<ul style="list-style-type: none"> • Develops the careers of the artists

⁴⁶ Howstuffworks “How Record Labels Work,” at <http://entertainment.howstuffworks.com/record-label.htm>, last visited May 7, 2007.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

	<ul style="list-style-type: none"> • Assists with artist promotion and publicity
Business Affairs	<ul style="list-style-type: none"> • Runs the business operations
Label Liaison	<ul style="list-style-type: none"> • Serves as a liaison between the record company and the distribution company
Legal	<ul style="list-style-type: none"> • Handles all legal issues and tasks
Marketing	<ul style="list-style-type: none"> • Manages overall marketing for each album
Publicity	<ul style="list-style-type: none"> • Publicizes new and established artists by getting articles in newspapers and magazines and getting artist's interviews on radio and tv
Promotion	<ul style="list-style-type: none"> • Promotes artist to radios to get radio airplay
Sales	<ul style="list-style-type: none"> • Coordinates the retail facet of the record business • Coordinates with Promotion, Publicity, Marketing

In the traditional model, there are nearly a dozen functional departments in a record company. Each department must be funded and these funds come from one source, record sales. As a result, the success of each artist is critical to the overall success of the label. Whereas, in a Private Equity Music IP Fund the portfolio is assembled where different IP is rated and constitutes a certain risk level. Therefore, the portfolio can be assembled to address different investment strategies. A fund can be formed as a high growth, high risk fund or on the other end of the spectrum, a fund can be assembled as a low growth, low risk fund. The middle ground is a

fund that is created where the presence of high risk IP is balanced by analyzing and including lower risk IP in the portfolio.

Revenue generated by the IP fund will not be distributed to the many departments that make up a traditional record company. The nearly dozen departments of a traditional record company are whittled down to four functional departments in the IP fund. (see table 2) This is possible because many functions of the conventional record label are eliminated or consolidated.

Artist development is eliminated. Furthermore, the art department is also completely eliminated as the individual artists would perform this function. As a result of the advent of digital distribution, artists can make their music available to the marketplace without engaging in a coordinated effort with brick and mortar retail outfits.

Music is discovered in so many ways these days. The radio is no longer the place musicians strive to have themselves heard. Services like Pandora⁵¹, Musicoverly⁵² along with other internet radio outfits and social network services like MySpace and Facebook make artist exposure widespread and discovery more frequent than via yesteryear's radio airplay model.

The word "discoverable" in the context of this article relates to how fans learn about new music and musicians. Internet radio services like Pandora and Musicoverly allow the user to discover music that is similar to their presents tastes. Pandora lets the user enter an artist name or song title and through a comprehensive analytical process the service will chose and play similar songs. As Pandora suggests each subsequent song from its vast catalogue, it asks the user to give the song a "thumbs up" or thumbs down" as to whether the user likes the music or not. Musicoverly takes a different approach. This service allows the user to discover music by first

⁵¹ Pandora can be found at <http://www.pandora.com>.

making a choice between categories. The user chooses either “mood” or “dance” and then has to make a choice based on the quadrant system (when “mood” is chosen, on the quadrant the ‘y’ axis encompasses music from “energetic” to “calm” and the ‘x’ axis covers music from “dark” to “positive”; when “dance” is chosen, on the quadrant, the ‘y’ axis represents music from “tempo +” to “tempo -” and the ‘x’ axis represents music from “dance +” to “dance -”), finally the user chooses from 18 genres of music. Internet radio is not the only way to discover new music.

Social networking site like Myspace and Facebook allow users to interact with one another by creating their own pages and sharing their pages with “friends”. Bands, TV networks individuals, concert venues can all create, and have created pages to share with one another. The content of these pages, among other things, includes basic information, to music, and video. This has been a popular way for musicians to gain exposure and clearly serves as a promotional tool as well as a node in the supply and distribution chain. This service allows musicians to directly interact with their fans and vice versa.

It’s not just the fans that can use the social networks and the world wide web to discover musicians. The IP fund discussed in this paper would identify potential IP by scouring these sites.

Therefore, promoting artists to radio stations to get radio airplay is no longer a viable expenditure or function and can be eliminated. Finally, the distribution function is greatly reduced as physical copies of the music is no longer created. Since the physical recordings are not created and reproduced en masse, the supply chain and movement of the physical recordings to brick and mortar stores is severely reduced, approaching a no physical distribution state.

⁵² Musicoverly can be found at <http://www.musicoverly.com>.

Table 2 - Functional Department of a Private Equity Music IP Fund⁵³

Department	Functions of a Private Equity Music IP Fund
Fund Manager/General Partner	<ul style="list-style-type: none"> • Creates the Fund • Raises the initial capital by attracting investors • Runs the business operations
Portfolio Management	<ul style="list-style-type: none"> • Discovers new talent • Assembles portfolio by purchasing IP from artists or obtaining exclusive license of IP from artists • Manages online distribution by coordinating with online retailers
Marketing	<ul style="list-style-type: none"> • Manages overall marketing for the portfolio • Publicizes and promotes new and established artists (used to be Publicity function) • Coordinates with Promotion, Publicity, Marketing (used to be Sales function)
Legal	<ul style="list-style-type: none"> • Handles all legal issues and tasks

Money not spent on the traditional record label functions can be used to focus on promotion and marketing the artist IP portfolio that was purchased or licensed. As the promoted

⁵³ *Id.*

artists generate revenue the value of the fund increases. In turn as the value of the fund increases, the value of the investor's investment increases.

Valuation

“In statistics, regression analysis examines the relation of a dependent variable⁵⁴ (response variable) to specified independent variables⁵⁵ (predictors). The mathematical model of their relationship is the *regression equation*. The dependent variable is modeled as a random variable because of uncertainty as to its value, given values of the independent variables. A regression equation contains estimates of one or more unknown *regression* parameters ("constants"), which quantitatively link the dependent and independent variables. The parameters are estimated from given data. In practical applications, data could come from any combination of public or private sources.”⁵⁶

In order to determine the value of musician's IP, a mathematical model would need to be developed. “Any valuation model for IP assets must take into account both business parameters

⁵⁴ “Term used in regression analysis to represent the element or condition that is dependent on values of one or more other independent variables.” <http://financial-dictionary.thefreedictionary.com/Dependant+variable>, last visited May 8, 2007.

⁵⁵ “Term used in regression analysis to represent the element or condition that is expected to influence another (so-called dependent) variable.” <http://financial-dictionary.thefreedictionary.com/independant+variable>, last visited May 8, 2007.

⁵⁶ Regression Analysis, at http://en.wikipedia.org/wiki/Regression_analysis, last visited May 8, 2007

and legal issues. The effect of legal considerations on business projections are key to deriving a quantitative value for IP assets”⁵⁷

In developing a valuation model or formula, there are many independent variables that need to be identified in order to determine the value of the IP, in this case the dependant variable. “A formula must include variables for the strength of the asset and the projected market and how the strength of the IP extends or maintains or reserves market share over the life of the IP. The formula may also take into account the state of development of the business which the IP protects. ... This increase in value stems from the increase in the value of the underlying business and arises as an increase in net present value of the business.”⁵⁸

“IP valuation consists of an interdisciplinary work drawing upon the understanding of technology, law, economics, finance, accounting, and investment.”⁵⁹ In the case at hand, some of the independent variable that would need to be considered include the following:

1. Musical genre
2. Artist skill level
3. artist technical music knowledge
4. geographic origins (where is the band from?; Is a “new scene” developing in this area?)
5. current trends in popular music
6. current cultural factors
7. innovation in sound (creating a new “sound”)

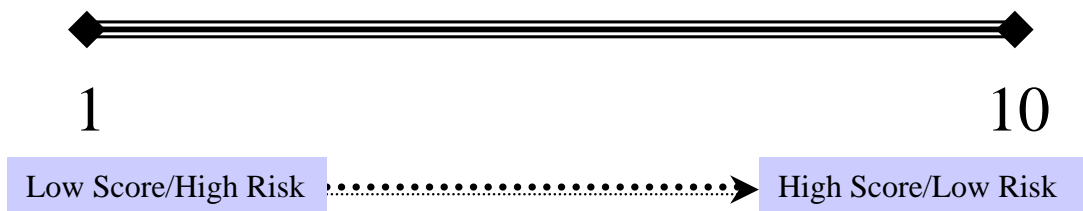
⁵⁷ Valuation Model, at <http://www.patentassets.com/valuemodel.htm>, last visited May 8, 2007

⁵⁸ *Id.*

⁵⁹ IPR - Helpdesk, at http://www.ipr-helpdesk.org/controlador/recursos/showDocument?len=en&idFicha=0000006482&formato=xm1_html&nomFichero=ES_IPValuation&idFichero=00&cod_padre=t_02.01.02.03.04&localizador=doc, last visited May 8, 2007.

8. artist creativity
9. lyrical strength
10. past sales
11. exposure (tv, radio, live, internet, film)
12. website hits (websites, social network pages etc; needs to be verified)
13. web searches for the band (google, yahoo etc...)

This list is not exhaustive by any means. It is just the preliminary list of independent variables required to develop the valuation formula in this model. Information related to each variable would need to be collected and the data comprehensively analyzed in order to develop the formula to evaluate the IP that makes up the fund portfolio. From this formula, a spectrum would be created where one pole represents IP with a low score or value while the other pole represents IP with a high score or value and thus worth acquiring. This spectrum corresponds with the following in terms of investment risk; the IP that has a low score is IP that, if acquired, represents a high risk investment. On the other hand, IP that scores a high mark poses a lower investment risk and as a consequence, constitutes a more stable investment.(see below)



The fund manager evaluates various IP and assembles a portfolio. Artists that are not popular would be willing to part with their songs and IP rights because they would not otherwise be able to make a return on these assets with out expending massive energy on promotion etc.

The cost to an independent unsigned artist would outweigh the benefit to undertake this endeavor. However, if a fund manager were to assign a value to an artist's IP, the artist may be very receptive to parting with his/her IP rights because the cost/benefit would favor the artist whereas the cost/benefit mentioned above would not favor the artist.

Conclusion

While traditional recording sales have been on the decline, the sales of digital downloaded recording have been on the rise. One of the major contributing factors to this trend is the advent of affordable recording technology and the availability of affordable powerful personal computers. At the same time, the barrier to entry into the music marketplace has been significantly diminished. Musicians are able to record, produce and distribute recordings absent the help of recording companies or record labels. This in turn has allowed the musicians to make their digital recordings available directly to their fans.

Forming and managing private equity funds that invest in, by purchasing or licensing, musician's IP is a viable alternative operating structure for the record industry. The characteristics of a private equity fund and the fact that the barrier to enter the marketplace for individual musicians is notably lower taken together with the numerous digital distribution channels and virtual "venues" reinforces the record industry's move towards this sustainable operating model.

The recording industry has been around for well over a hundred years, all the while it has evolved by adopting new technologies and responding to consumer trends and tastes as well as artistic progression and development. If the recording industry begins to think about and

implement alternative operating strategies they'll continue to evolve and perhaps the rest of the world won't leave them high and dry.