

2005-01-01

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Recommended Citation

Cooney, T.: General Records (Ireland). Dublin, Technological University Dublin, 2005.

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General Records (Ireland)¹

Standing outside a pub, Billy Barrett and Martin Murphy faithfully obeyed the no smoking ban that was now a feature of the Irish social scene. As they smoked their cigarettes, they discussed the singer/songwriter who played inside the premises that they stood against so nonchalantly. The gig was enjoying a great reception, with the crowd enthusiastically applauding the eclectic mix of blues, rock, and traditional music. ‘Well, Billy, how would fancy starting a record company?’ asked Martin, as if it was not really a challenge. ‘The singer playing inside wants to record a CD but she has no label. I reckon that if we could put the money together, we could sign her up as our first artist and expand slowly as we learn about the industry. We could start it as a hobby and then see where it takes us. You never know, a few years from now we could be at the MTV Awards with our Acts performing on stage.’ As Billy awoke gingerly the following morning after a late night of partying, he slowly recalled the night before and that he might have agreed to start a record company.

Developing the Business Idea

A week later Billy and Martin met to discuss the reality of starting a record company. This time they met at Martin’s home so that there would be no distractions. While it was an unusual prospect for both of them, there was a belief that if it was planned properly they really could make it work. They obviously could not compete directly against the major record labels so they needed to find an angle that would give them an advantage. With the enormous growth in music downloads from the internet, it certainly was increasingly possible to find a business model that could successfully compete against the major record labels. They broadly agreed that the basic business concept being proposed was to form a record company that would limit the number of artists it signed but would work closely in partnership with them to enhance the prospect of the artist’s success, thereby leading to a profitable existence for the record company. In its formative years, the company would seek to identify talented performers who believed in the philosophy of the organisation and were not mainstream in terms of their music, and to offer them a record deal for three CDs. The

¹ This case was prepared by Dr Thomas M. Cooney as the basis for class discussion rather than to illustrate either the effective or ineffective handling of a business situation. An earlier version of this case was first published in “Irish Cases in Entrepreneurship” which was edited by T.M. Cooney (2005) and published by Blackhall Publishing.

company would focus on the production and marketing of CDs and internet downloads, and by specialising in particular segments of the music industry, providing individual attention to a small group of gifted clients, and niche marketing their material, Billy and Martin hoped to create a sustainable competitive advantage.

The Music Industry in Ireland

To help give them some idea of the industry in which they would be operating, Billy had undertaken some quick research to assess the size of the challenge that faced them. He was surprised to learn that there were over 100 record companies/distributors in Ireland, although the vast majority of them were small labels. There were also approximately 100 recording studios available for hire and approximately 20 CD manufacturers. In addition to these groups, there were also substantial groups of people working as sound engineers, producers, promoters, agents, A&R personnel, venue owners, publicists, publishers, graphic artists, printers, equipment manufacturers and an assortment of other personnel. However, the most frightening element from the information gathered centred around the issues of contracts and royalties. The music industry is renowned for legal cases arising from disputes over these issues and understanding the critical points of an artist's contract, a producer's contract and the computation of the various types of royalties was a legal nightmare for anyone new to the industry. The size and nature of the industry made Billy and Martin realise how little they knew about the music industry and how much they needed the help of someone on the inside.

Management Team

As Billy and Martin discussed their idea, they recognised that the first key area they needed to address was the management team. Martin (married with two young children) was a computer programmer who had an interest in music over many years. He was an accomplished singer and performed in chorals across the country. He had no experience of working in the music industry and had never been involved in recording music for an album. He worked as a freelance consultant and therefore had some understanding of the demands of setting up one's own business, even if it was not in the music industry. He was also a skilled negotiator and salesman. Because of his background, and also because it was his initiative that started the process, it was agreed that Martin would be CEO and would also take charge of operations. Billy (single) worked for a training company delivering business management

workshops but had little interest in music beyond buying some CDs. His knowledge of the music industry was practically zero but he had a passion for helping people to develop their business and wanted to see for himself what it was like to start a business. His particular expertise was in the area of marketing, so it made sense that he took responsibility for this area of the business. But they recognised that the team was weak in terms of industry experience and that they would need to bring other people on board quickly. Billy and Martin both believed in the idea of building a strong team since the company would need a variety of strengths to get it established. They decided that on the next occasion they met they would compile a list of people whom they might approach to join them on their venture. If they were inviting people to join them, then they would also need to decide on how much equity they were willing to give up to attract both the right people and enough finance.

Marketing

Due to the career experiences of the management team, Billy and Martin recognised that the issue of marketing was crucial to the successful selling of any CD within the music industry and because they had limited funds they would need to generate a great deal of attention without spending much money. They decided that for the purposes of their first business plan, it was best to focus only on their first artist, rather than take a broad approach to their marketing strategy. The singer/songwriter whom they had enjoyed the evening that the idea of the record company was first suggested had verbally agreed to become the company's first artist. This artist had been a huge hit some years previously in Ireland but, having lived abroad for over a decade, she was now trying to re-establish herself in Ireland. She had been particularly successful among university students while based in Ireland and she would still receive requests from this group of fans asking where copies of her earlier albums could be purchased. Therefore it was decided to build a marketing plan for this first artist and, thereafter, each artist and CD would have individually tailored strategies devised for their needs rather than suggesting pre-determined models at this point.

Target Customers

Based on the success of previous albums of the artist the target group was identified primarily as graduate students in Ireland over the past twenty years. This group was central to the artist's previous success and would act as a base from which to build sales of her new CD.

The profile of the target group would be graduates aged between 25 and 40 with an appreciation for quality niche performers. Linked to this profile was a secondary group, that of existing third-level students. This decision was based on the principle of re-using a formula that had already proved very successful for the artist in previous years. By engaging present-day students a new following could be developed, thus enlarging the overall fan base. Three geographic markets were identified for the first CD: Ireland, USA and Europe. Initially this would be achieved by focusing on selling the CD through distribution outlets in Ireland and through downloads via the internet.

1. Ireland – given the strength of the fan base in Ireland for this artist, the alliances with industry personnel, the ability to undertake a concert tour to launch the CD and the depth of knowledge presently held on that market made Ireland a strong launching base. However, it is also a very disparate market with few substantial niches and strong competition from the record companies, and from artists and groups trying to establish themselves via the internet. Thus, a focused promotional campaign would be essential to success and this would require hiring a specialist in promotional activity.

2. Internet – the second target market was based on the enormous growth in music downloads over the past five years. General Records would design its own website that would allow people to download directly from the company, giving it higher gross margins. The CD would be available on sites such as iTunes, which attracts thousands of hits per day from the Irish abroad. Given the ability of exiled graduates to easily access such an avenue of distribution, this represented an exciting opportunity to expand the traditional methods of selling the product.

It was anticipated that sales in the European and American markets would initially come from off-stage sales (i.e. artist sells the CDs themselves at their gigs). For this purpose the artist would be given the product at preferential terms and any profits made thereafter would be for her own benefit.

Product

In developing the product the company would be committed to a total quality product. While the music itself is central to a successful album, product enhancements also influence sales positively. The design of the cover would intensify the prospect of a sale and thus needed to be designed with great care and thought. Included within the sleeve notes would be the words of the songs, information on the website of the record label and of the artist, e-mail addresses

to build a fan database so as to provide updated information, in addition to the data normally provided on the sleeve notes.

Following a number of phone calls placed in advance of the meeting, Martin and Billy had identified that the process involved appeared relatively straightforward. Having agreed a contract with the artist regarding the CD, royalties and marketing activities, they would then need to identify a top-quality producer who would produce the CD for them. They would also need to book a recording studio for a period of weeks, although many producers had their own studios. Once the CD was finished it would then need to be finished through mastering. The sleeve would need to be designed to suit the CD and the target market before an independent company manufactured the completed sleeve. Billy and Martin would then need to have someone distribute the album to music stores throughout the country. But however simple it appeared on paper, conversations with people in the industry only highlighted the many challenges that awaited them. Alternatively, the process of downloading was much simpler since there was no production and distribution activities involved, and this form of purchase would also require far less start-up capital for the business.

Distribution

Billy and Martin had quickly decided that the CDs would be made available through downloads, distributors, direct sales from the company and direct sales from the artist. Each of these distribution avenues required a different approach and would need to be carefully researched.

1. Downloads – the tracks from the CD would be made available through online music stores such as iTunes. An average charge per track is 99c with approximately 33 per cent of this being paid as royalty to the artist. Obviously, downloading from the company's website would generate a higher margin. Martin and Billy have no idea currently of how many downloads they might expect for their first artist and so were having great difficulty in estimating how much could be generated from this activity.
2. Distributor – a distributor for Ireland had been proposed to Billy by someone that he knew in the business. The distribution fee was 25 per cent of the price to the distributor and payment on sales was made by them 45 days after the month of sales, less their 25 per cent. The company had the ability to make the product available nationwide, to provide support to the sales effort, to work within the overall strategy

of the record label and within a cost structure that was agreeable to General Records. They also had the capacity to distribute in Europe should that route be taken. A constant check would also be maintained on retail outlets to ensure every opportunity was available for people to purchase the CD. According to the distributor, the estimated level of sales from this source in the first three years of operation was 3,000 units.

3. Direct Sales from the Company – internet sales would be catered for by the company directly. As orders were received via the website the company would send a CD from its storage and mail it to the buyer. The buyer would carry the shipping costs. The estimated level of sales from this source in the first three years of operation was 1,000 units.

4. Direct Sales from the Artist – the company would sell the product in batch units to the artist at agreed terms. The artist would then be responsible for the sale of that inventory through live performances; it was anticipated by the artist that 6,000 units could be sold via this channel of distribution in the first three years.

As the markets expanded, other forms of distribution would be considered and added so to ensure that the product was as widely available as possible within their small budget. It would be essential that each avenue be pursued vigorously so as to maximise sales for the company.

Promotion

A co-ordinated promotional campaign would be necessary to give maximum exposure to the launch of the album. This would involve interacting closely with the artist's promotional manager. Additionally, a professional music industry publicist would need to be hired to undertake the following activities:

- Advertisements – on music magazines and a select number of other media focused on the target market,
- Sponsorship – opportunities would be sought in which the CD could be linked with sponsorship,
- TV Appearances – that the artist would appear on a minimum of three TV shows after the product launch,
- Radio – a co-ordinated campaign would promote the CD through free CDs to key DJs,

- Personal Selling – the directors would work with the publicist to promote the album intensively,
- Internet Notice Boards and Social Networks – much free publicity could be generated through the use of notice boards announcing events and music industry happenings, plus a promotional video on YouTube would launch the CD,
- PR – positive CD reviews would be vital to enhance the prospects of sales and thus a concentrated PR campaign would be made towards key individuals in the media.

The whole promotional campaign would be built around a concert tour at the time of launch, although the company would not bear the costs of the tour.

Manufacturing

Four quotes had been received by telephone from Irish CD manufacturers in addition to an investigation of CD manufacturers in England. The best quote received was from a company in Dublin who offered a price of €2,500 per 1,000 CDs. This price included films, PQ encoding, glass mastering, four-page colour booklet, two-colour label, and barcode. A number of options existed also to manufacture the product in Boston for the U.S. markets. However, for the European market it would make more economic sense to manufacture the product in Ireland. All of these options needed further examination before a final decision could be made.

CD Sleeve Design

One Dublin design studio offered a design and print service based on they being supplied the artwork. The cost suggested was €1,500 for booklets, which would give full colour on pages one and four with text on pages two and three. Other design studios were also being investigated.

Pricing

As part of the preparations for the meeting, Martin had carried out some provisional research on what the cost might be for the CD. These were only indicative figures but at least it gave them something to discuss before they examined the financial budgets in finer detail. The following was the outline cost structure developed for the first album:

Initial Costs

- CD manufacturing = €7,500 (3,000 units x €2.50 per unit)
- Recording = €10,000
- Advance to artist = €2,500
- Other costs (including promotional activity, legal fees and general overheads) = €10,000
- Total = €30,000

CD Sales Prices

- To the artist for sales off-stage = €8
- To the distributor = €10
- To the consumer = €18

Royalties

- Mechanical/Publisher = 8 per cent of distributor's price (€0.80 per album but the company would seek a 50:50 split on these royalties)
- Artist = 7 per cent of distributor's price (€0.70 per album)
- Producer = 3 per cent of distributor's price (€0.30 per album)
- Public performance/Broadcasting = this is calculated depending on usage and goes to the publishers of the songs.

The amount paid for the royalties on each album would remain the same for each avenue of distribution. These figures were not exact but a detailed computation of the figures was proving difficult at this point due to the need for negotiation on mechanical/publishing royalties, artist royalties, producer royalties and broadcasting royalties. These royalties would also be influenced by performance and by a tiered financial arrangement that the company hoped to put in place with the artist. However, the principal objective from Martin and Billy's perspective was that each contract negotiated with an artist would have the primary goal of recouping their investment as quickly as possible.

Financing the Company

A key difficulty that any start-up faces is how to finance the operation. Billy and Martin discussed at length the various options that were open to them. Between them they could raise about €10,000, with Martin putting in €6,000 for 60 per cent of the company and Billy getting 40 per cent for his €4,000. That still left them €20,000 short. As they would get no grant aid for this type of business which meant that they would have to raise €20,000 either

through loan finance or through equity finance. They perceived that a bank would be slow to offer a loan to this type of business given the difficult market in which it would be operating. It also made little sense for a professional investor to put money into the company as they suspected that the potential return on investment would be low, although they could not be sure of this until the financial budgets had been completed. Billy suggested that they should seek finance from their friends who might be interested in the venture for what he termed 'cocktail party value', that is the ability to tell friends and work colleagues that you have a piece of action in a record company which Billy hoped might attract some of their friends who had cash to spare. They also estimated that if they did not produce any CDs in the first instance and simply made the CD available for downloading, then they would only require €20,000 to get started, but making it available only through downloading was a high-risk strategy.

Getting Late

It was now 2am and Billy and Martin were beginning to tire. They had got through a significant amount of work but many decisions remained outstanding. For example, they would need to develop a more detailed marketing strategy, especially if they were looking to develop the business beyond the first CD. Instead of looking at the business as one CD, maybe they should take a more professional approach and develop a detailed business plan for the company. They really had no vision of where they wanted the company to be in three years' time. They also needed to consider what type of people they should bring onto their management team and what they could offer them in return. Contract and royalty negotiations would be critical and they had no experience in this area. Most of all they needed to develop detailed financial calculations to give themselves a break-even figure and expected rates of return. The most difficult question of all was what business proposition were they going to offer the potential investors that they needed to get the company started and what would be the exit strategy for the investors. They also needed to discuss further the possibility of not manufacturing any CDs and making the tracks available only through downloads which would significantly reduce their need for initial capital. As Billy headed for the front door, he turned to Martin and quietly asked, 'Are we mad?'