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Chapter 2

The 21st Century Business Model

Ben Walmsley

Introduction

'The art of organization is not to create organizations but to multiply our effectiveness.' (Reiner, quoted in: Byrnes, 2009: 155).

In the opening chapter, we saw how relationships between producers and audiences are undergoing a fundamental shift, with audiences becoming increasingly more involved in the creative process. In this chapter, we will move on to consider the repercussions of this phenomenon by exploring how traditional business models are evolving in the arts and entertainment industry. To achieve this, we will focus in depth on two very different sectors: popular music and the performing arts.

We will start by defining the term 'business model' itself, as it is a term which incorporates many elements and which is therefore often confused with related terms and concepts such as 'strategy' and 'structure'. We will then apply these business concepts to the popular music and performing arts sectors and consider the range of existing and emerging models across these diverse industries. By deconstructing concepts of value and audience engagement, we will explore how modern arts and entertainment organisations are adapting their business models for the 21st Century. Finally, a case study on Watershed Media Centre will illustrate both the process and the benefits of transforming a business model to meet modern audiences' needs.

What is a business model?

A business model can be regarded as a series of relationships participating in the creation of value (Rayport and Sviokla, 1995) and therefore as the engine and framework of a business which informs all of its activities (Falk and Sheppard, 2006). Effective business models should therefore maximise value (usually by minimising costs and generating income as efficiently as possible) and provide a holistic and effective structure to the day to day processes of business. Most importantly, they should reflect the drivers and values of their customers. This is what distinguishes a modern, marketing-orientated business model from the traditional production or sales driven models.

Business models in the arts and entertainment industry

The correct interpretation of the concept of 'value' is imperative within the context of the arts and entertainment industry. In a purely commercial context, value creation is indelibly linked with profit: commercial organisations exist to create wealth for their owners, partners and/or shareholders and achieve this by maximising their profit margins. But in the non-profit, public sector and more product-led industries, value is much more subjective and therefore harder to define. In education, for example, it might be linked simplistically to a quantitative assessment of exam results, whereas a more holistic and qualitative approach might consider factors such as students' wellbeing and even transformation. But in any sector of any industry, value creation should refer back to an organisation's fundamental mission. So in the arts and entertainment industry, if an organisation's mission is to 'delight and surprise audiences' rather than to maximise profit, then value will be created (and hopefully judged) by the impact a product, event or service has on the people who engage with it.

From a marketing perspective, an effective business model should address and add tangible customer value to each of the four Ps of the marketing mix: the product, price, place and promotion. Let's now take each of these in turn and apply them to the music industry to illustrate how emerging business models have transformed the customer experience while maintaining or even generating addition revenue for the industry as a whole.

Popular music

First of all, new and emerging business models have fundamentally transformed the core product in multiple ways. What was a physical, collectable product packaged and delivered in a glossy sleeve with song lyrics and branded artwork (a CD) has become a digital, transferrable product which populates the playlist of a laptop, iPod or other mobile device. This product transformation has enabled a rigid pricing structure (the £10+ CD album and the £3.99 CD single) to morph into a flexible and cheaper pay-per-track strategy with tighter profit margins and a reduced augmented product. Apart from cheaper products, consumers have also benefitted from greater choice and control, as they are no longer forced to purchase any supplementary tracks against their will.

Place and promotion have been similarly transformed. Before legal downloads and illegal file-sharing graced the scene, consumers were bombarded with mass market sales and advertising campaigns on television and radio, on billboards and buses, in newspapers and magazines and in-store. They were obliged to commute to their nearest town, track down their CD in an over-spilling rack in a crowded record store, and finally queue at the till to pay. As click-and-mortar models emerged, consumers were slowly able to order online and wait for the CD to drop through the letter box a few days later.

Nowadays, consumers have been re-branded as fans. They communicate with each other online via blogs and dedicated fan sites, participate in online competitions to win free downloads and receive intelligent recommendations for new bands and songs they might like, based on previous purchases and their general musical tastes. A good example of this is iTunes' Genius, which suggests future purchases and builds automatic playlists based on customers' current libraries.

Interestingly, the record store is also making a comeback as an experiential alternative to the online models. Fans young and old can don a pair of DJ-style headphones and sample their favourite tracks, before chatting to an 'expert' vendor and finally bagging a CD together with the latest accessory merchandise. So what we are left with is a complex, multi-platform model, where legal competes with illegal, physical with digital, mass with customised and efficient with experiential. But the competition is between companies and business models: the net result for music fans is a convenient range of affordable options, catering for their varying budgets, demographics and moods.

The problem with these new models is that they have arguably tipped the balance too far in favour of the fans, leaving even the biggest record labels fighting for survival and the former gatekeepers of the industry scrapping over rapidly diminishing profits. This might not be so much of a problem if it only affected the intermediaries or middlemen. But illegal downloading and ever tighter margins have affected the industry as a whole, making it difficult for new and emerging bands to enter the marker and challenging even the most established. According to the International Federation of the Phonographic Industry (IIFPI), global music sales peaked in 1995 at US$48 billion and by 2005 had fallen by a third (Connolly and Krueger, 2006). Artists, producers and business experts have even gone as far as to sound the death-knell for the entire industry.

In the 21st Century, artists have slowly started to respond to this threat. According to Alanis Morissette's manager, Scott Welch, only the top 10% of artists make a living from selling records; the rest go out on tour (Connolly and Krueger, 2006). This increasing necessity to tour has become known as the Bowie Theory, after Davie Bowie's prediction that recorded music would just become a commodity like any other. So for the majority of artists, the core product has shifted from the record itself towards the live performance of it; and for fans, saturated with virtual and digital products, this live experience has become increasingly rare and coveted. It is therefore perhaps no coincidence that leading global artists such as The Black Eyed Peas, Lady Gaga and Rihanna are becoming increasingly theatrical in their performance styles and that in another, albeit less cited, example of convergence, music and theatre are blurring their traditional boundaries and morphing closer together.

But there are challenges with the business model even in the live performance sector. Live performance is a slow productivity growth industry with relatively rigid fixed costs. This means that efficiency gains are hard to come by, as it takes the same number of people about the same amount of time to stage a concert today as it did thirty years ago. To increase profit margins, therefore, bands have to either tour more often, tour for longer, play bigger venues or increase ticket prices. According to Connolly and Krueger (2006), what most bands are doing is raising ticket prices; and because attendance at concerts has been steadily decreasing in the past four decades, they have taken a 10% hit on their tour revenues since 2000 alone. Another challenge is that the popular music industry is heavily skewed in favour of celebrity bands, with the result that a small minority of the most popular bands earn a large proportion of the available revenue.

Bands' responses to these challenges and to the threats posed by illegal file sharing have been diverse and creative, and some innovative new business models are slowly starting to emerge. A good example of this is the pay-what-you-like model initiated by the English band Radiohead. In 2007, when their contract with EMI expired, Radiohead chose to release their seventh studio album independently via their own website, inviting consumers to pay what they felt appropriate. This model has since been much imitated, with a significant number of artists releasing their work for free in collaboration with media partners. The results have been mixed. Revenue has generally suffered, but this has on occasion been compensated for by positive PR, which has led to increased popularity on the tour and festival scene.

Another emerging model is the aggregator model. Aggregators are digital distribution agencies, who negotiate national and global licensing deals and sell their clients' music via online and mobile channels. In the UK, the leading aggregators include Emu Bands, 7 Digital Media, Consolidated Independent, Indie Mobile and Artists Without A Label. As this last name indicates, aggregators are starting to replace established music companies and labels, representing new and emerging artists who would otherwise find it difficult to break into the market. Within this model, there are different micro models at play: while some aggregators take an annual subscription and grant artists 100% royalties from their sales, others take an agreed cut of royalties.

Again, aggregators are having mixed levels of success depending on the platforms they specialise in. For example, they are struggling to make money in the lucrative ringtone market, where the big labels are dealing directly with wireless carriers. But in the blogosphere, music blog aggregators such as The Hype Machine have successfully harnessed RSS technology to track and display the latest blogs on their home pages, making it easier for fans to keep up to date with the latest industry knowledge and news.

Product placement, endorsement and brand affiliation are other successful alternative models. Product placement in the music industry has been around for decades and it can work in one of two ways. In the first model, artists include and therefore endorse products in their songs, usually in return for payment. The most famous recent example of this model at play is probably hip-hop artist Busta Rhymes' song Pass the Courvoisier, which radically increased the cognac company's short-term sales and led to a further deal. Industry experts anticipate that in the very near future, brands will be funding the entire production costs of an album. The second model works the other way round by agents and managers placing their artists' work in films, television dramas and soap operas. A simple version of this is of course the old fashioned film track, which often breathes future life into flagging song and album sales, or complements a current marketing campaign.

Brand affiliation is an extended version of product placement and is a more reciprocal model. The model works by matching an artist or album with a product according to their respective brand values and image. This is generally a harder proposition than a straightforward product placement, but when it does work it can reinforce both brands and widen their appeal. A recent success story here is Bacardi's deal with Groove Armada, whereby Bacardi agreed to fund the band's new releases in return for using their tracks and live performances to promote its brand. The main problems with these types of model are their dependence on other models to sustain them (no band has yet survived from this kind of deal alone) and potentially the loss of artistic control inherent to a band being temporarily 'bought' by a commercial enterprise with its own mission and agenda.

One of the most radical and innovative approaches to the challenges facing the industry is Bandstocks. As the name suggests, Bandstocks works by offering fans the opportunity to invest in the bands of the future. Founded by Andrew Lewis and supported by the teams behind Kaiser Chiefs and Primal Scream, it works like this: Fans buy stocks in new bands or artists in increments of £10, and once the investment fund has reached a certain level, the money is released to the artists(s) so they can record an album. The model basically works as a venture capital fund invested in by fans. In return for their investment, fans receive a copy of the album and a percentage share of its profits, together with benefits such as priority booking for concerts and access to special editions. The benefit for artists is that they enjoy a higher royalty than with the major record labels and have more control over copyright and licensing. They also develop a strong core fan base, who literally have a vested interest in their success and who are likely therefore to become vocal and effective ambassadors for them.

The performing arts

The performing arts sector has its own, very different challenges. One of the strengths (and arguably weaknesses) of this sector is that its products cannot be digitised without losing their essential characteristic – the live experience that they offer. For this reason, the sector has not been forced to transform its business model in the way the music industry has. Instead, performing arts organisations have been able to adapt more gradually to the demands of modern audiences. But this process has inevitably left some organisations behind; and while the flexible and mobile music industry has been able to emigrate online, the performing arts sector, with its fixed, historical buildings, has had to work with what it's got. So if we repeat the exercise of mapping changes to the performing arts sector's business model against the four Ps, this picture of gradual change starts to emerge. This is illustrated in Figure 2.1.

Figure 2.1: Impact of evolving performing arts business models on the marketing mix

Element of the Marketing Mix	**Impact of evolving business models**
Product	Minimal change to the core product but increasing focus on audience involvement and interactivity Emergence of new and development of existing augmented products (e.g. online rehearsal footage; CDs and DVDs of live performances)
Price	No major impact on price
Place	The digital box office: online ticketing and seat selection Increasing popularity of live streamed events (e.g. National Theatre's plays and New York's Metropolitan Opera productions) Development of site-specific, site-sensitive and open air performances Emergence of visionary venues which open up the creative process (see Chapter 7) Rise in performing arts festivals
Promotion	Online trailers and e-marketing techniques Blogs, tweets and audience reviews

It can be seen here that the major impact of evolving business models in the performing arts sector has fallen on the place element of the marketing mix – i.e. where productions are paid for and enjoyed. Unlike in the music industry, the core product itself has remained intact and there has been no significant impact on price. Again, this is a both a strength and a weakness for the sector – a strength because its core product has remained competitive, withstood the technology revolution and been able to maintain its income base; but a weakness because little value has been added to organisations or audiences.

Let's now consider how and why business models are evolving in the sector. The structure of the performing arts sector is extremely complex. It has developed organically over centuries and is characterised by piecemeal strategy, financial instability and artistic inter-dependence. Traditional models in the sector include subsidised producing and receiving theatres and concert halls; commercial producing venues; commercial receiving venues and chains; and producing touring companies. But there is increasing evidence of evolution, with innovative models such as Artsadmin's producer model and the national touring models championed by National Theatre of Scotland and National Theatre Wales attracting increasing attention. There are also signs of a newfound strategic integration and commercialism, as evidenced by Royal Opera House's diversification into the DVD market through its recent acquisition of Opus Arte.

The wider socio-political context is also impacting on the way the sector operates. It has been argued that there are currently too many under-funded arts organisations operating close to breaking point both financially and operationally; and as there is insufficient evidence to measure and evaluate the impact of the arts, it is difficult to determine whether public money is being spent wisely (Knell, 2005). With the recent cuts in government funding to the arts in the UK, this situation is unlikely to get any easier. Knell (2005) argues that the current portfolio of arts organisations in the UK is too fixed and that the funding system favours existing companies over new entrants. In other words, there are significant barriers to entry. Because arts organisations compete against one another for funding, there is no strategic overview of the sector, which might promote more collaborations, mergers and acquisitions. In the commercial sector, these beasts of necessity often provide the only means of survival.

Knell's solution to this problem is that organisations should learn 'the art of dying'. Those that survive need to reorganise or merge and focus on their strategic mission rather than on struggling to survive. The sector needs to engage in an open and honest debate about the future of arts funding and design effective business models for the 21st Century. Arts organisations must stop being defensive and become more flexible, better networked and more commercial in their models and practice (Knell, 2005). More efficient models could include sharing back-office functions and production facilities, for example, with savings being used to free up artists to do what they do best.

But these transformations will not happen overnight: 'This strategic shift requires radical intent. It requires leaders of arts organisations to commit to radically different conceptions of how they might operate, and to accept that one of their primary leadership responsibilities is to make their organisations more adaptive. As in other sectors, this means embracing a vision of organisations as more mobile and fluid and less tied to an unshared fixed cost base. This demands partnering with others in more imaginative ways, whether with the private sector or through emerging public interest company type vehicles, and embracing new operational models which are more dependent on networking and collaboration.' (Knell, 2005: 8).

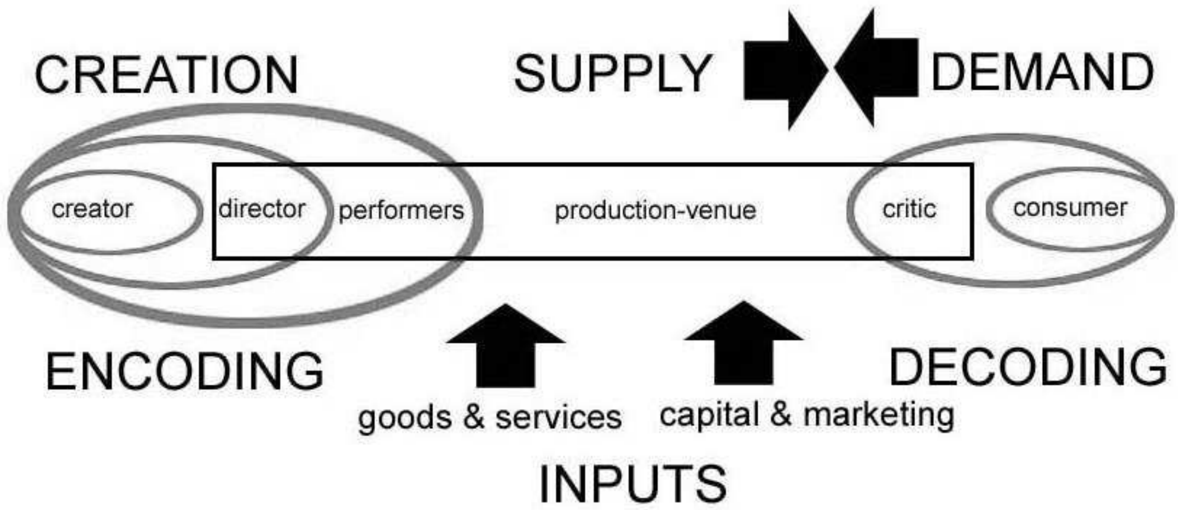
Some of the emerging models discussed above have responded to this call to arms – Artsadmin has been providing producing and administrative support for artists and arts organisations since 1979, freeing them from the burden of budgets and red tape to create the best work they can; and in the past few years, flagship national companies like National Theatre of Scotland and National Theatre Wales have rejected the static, building-based model in favour of a collaborative, mobile, fluid and even online approach. This model has succeeded in reducing their fixed cost base (there are no expensive venues to design, construct and maintain) and in bringing theatre to the people through imaginative partnerships and artistic collaborations. Models such as these have finally found a way to add value to both the organisation and the audience.

Adding value

At the beginning of the chapter, we noted that the overriding aim of a good business model is to maximise value. We also discussed how in the arts and entertainment industry, value can be a subjective concept that is often hard to define and that the only objective way to measure value is therefore to measure it against an organisation's mission statement. A business model should provide the link between an organisation's mission and the value it aims to create. For as Magretta (2002: 92) points out: 'Because a business model tells a good story, it can be used to get everyone in the organization aligned around the kind of value the company wants to create'. In this section, we are going to consider how and where value can be created in the arts and entertainment industry.

In the wider world of commerce, the way an organisation configures its resources and activities to create value and competitive advantage is often illustrated via a framework known as a value chain. Value chains are usually applied to manufacturing based organisations and therefore focus predominantly on commercial and product-based activities such as procurement, logistics and operations. But there have been attempts to apply the framework to the arts and entertainment industry, as illustrated in Figure 2.1 below.

Figure 2.1: 20th Century Performing Arts Value Chain



Source: Brecknock (2004: 2).

This simple framework illustrates the supply chain or creative process for the performing arts sector. It presents a traditional approach, where the work of art emanates from the 'creator' (e.g. playwright or composer), is 'encoded' (shaped and nuanced) by the director through the performers and produced by the venue or company, before being 'decoded' (interpreted and judged) by the critic and consumed by the audience.

The main purpose of the value chain is to pinpoint where value is being created or lost, and this works in one of two ways. Firstly, an organisation can add value by excelling in any of the processes described above. So, for example, it could rest on the laurels of an excellent composer or blow the audience away through stunning production values (an amazing set, for example). Secondly, it can add value in a holistic way by excelling at the process itself. This will involve excellent communication between different teams (creative, production and marketing, for example) and the implementation of appropriate systems and structures so that the entire process works like a well-oiled machine. This can only be achieved through training, strong leadership and passionate, experienced staff.

However, considering the discussion in the previous chapter about the changing relationship between producers and audiences, cracks start to emerge in the value chain depicted above. For example, writers, composers and choreographers no longer always create a piece of art in isolation: they may work with or be influenced by audiences or other social groups; or the work might be devised by a collaborative group of artists, including the performers themselves. Furthermore, audiences no longer 'consume' the performing arts in isolation: they may engage with the creative team and process by attending rehearsals or post-show discussions; and they may share and shape their views via social media. Taking these changes into account, the 21st century performing arts value chain might actually look something closer to the one illustrated in Figure 2.2.

Figure 2.2: 21st Century Performing Arts Value Chain

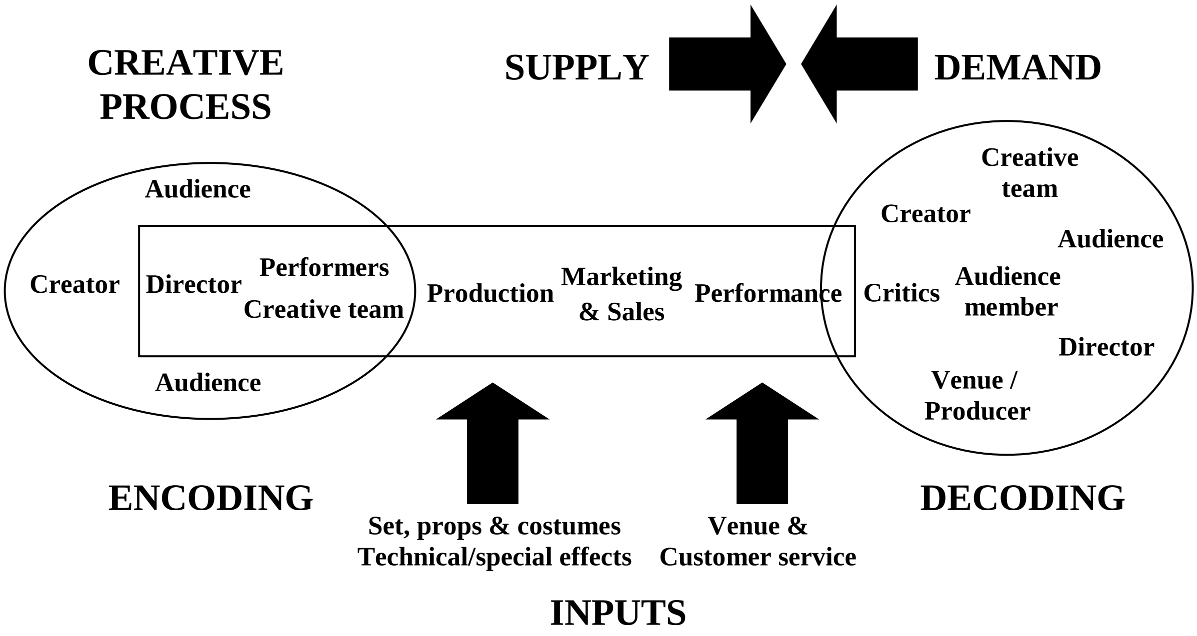


Figure 2.2 illustrates a new value chain for the performing arts. It represents a messier, more complex system of encoding and decoding by reflecting the more collaborative creative process adopted by many modern arts organisations and the more democratic, inter-connected consumption experience engaged in by modern producers, critics and audiences. Most significantly, this creative process has become more of a network of dialogues – between critics and audiences (via blogs, for example); between producers and audiences (via post-show events and Twitter, maybe); between critics, creators and creative teams; and between audience members themselves. The modern performing arts organisation can add value at each stage of the chain by supporting, facilitating and enhancing these processes; and, as discussed, they can excel by designing a business model that masters the value chain itself.

But the value chain is only part of a larger entity known as 'the value network', which has been defined as 'the set of inter-organisational links and relationships that are necessary to create a product or service' (Johnson et al., 2009: 77). In the performing arts sector, this might include the design agency which produces the print, the set builders, or even the actors and venue itself. For a touring company, the value network is particularly important, as touring shows are heavily reliant on the size, reputation, marketing, sales and customer service of the venues they tour to.

Case study: Watershed

Watershed is a cross-artform producer, which shares, develops and showcases exemplary cultural ideas and talent. Curating ideas, spaces and talent, Watershed enables artistic visions and creative collaborations to flourish. Watershed is rooted in Bristol but places no boundaries on its imagination or desire to connect with artists and audiences in the wider world.

In 1998, Watershed was a traditional arts centre with two cinema screens, a photography gallery, an education department and a café/bar. In 1999, Watershed hooked up to high speed broadband for the first time. This was initially just an experiment to see what it could achieve by embracing new technology. This experiment soon made Watershed realise that its world was about to change, and since this digital road to Damascus, technology has pushed Watershed into spaces it wouldn't normally have entered.

As technology is always changing, it is constantly pushing Watershed to innovate. For example, Watershed realised that many projects required a great deal of new material to be produced and shown outside the creative programme. This was continually creating new relationships and the staff team soon realised that they had to engage with these new relationships, get to know the people behind them and determine their relationship to Watershed. This new, closer relationship with the audience soon led the staff to ask themselves the following questions:

- Who are we?
- What is Watershed?
- What does Watershed mean and stand for?
- What does 'media centre' mean?
- What does 'art' mean?

According to Watershed's Managing Director, Dick Penny: 'Mixing it all up is important, but just as the soup becomes richer, an organisation's role in it becomes increasingly complex' (Penny, 2009, p.49). In Watershed's case, this led to the realisation that its building (converted in 1982) was no longer fit for purpose. Watershed decided that although it had built its reputation on film and photography exhibition, it was necessary to drop photography to focus on the moving image and digital work, which reflected 'the inevitability of its growing importance' (Penny, 2009, p.50). Watershed wasn't just refurbished, but significantly changed. In the process, it also learned to be more open and honest in its communications with audiences and its other stakeholders.

Its refurbishment and new identity pushed Watershed to become a more joined-up organisation, and it quickly realised that everything had to be dedicated towards creating a learning environment. In Dick's own words: 'We understood that we were not just making and selling products, but offering an experience. As part of the capital project the public space in the building was flooded with free wireless, which transformed the spaces. Suddenly the social space became an active space where people did business, where people were not consuming, but getting active.' (Penny, 2009, p.51).

Over the last decade, Watershed has transformed itself from a traditional arts centre which specialised in film and photography exhibition to an inter-connected creative space in which audiences feel a sense of ownership. Watershed's audience has transformed from a passive group of consumers to an active group of engagers and its core consumer product has morphed into a genuine experience. In a nutshell, Watershed has handed over ownership of its building to its audiences in the true sense of co-creation

Image by Toby Farrow, courtesy of Watershed

As a learning organisation, Watershed acknowledges that it has not reached the end of its journey, and its team is constantly asking itself how it can keep renewing and developing its relationships. Watershed has realised on its journey that the organisation is all about providing spaces where ‘things can happen’. This means physical spaces, intellectual spaces and virtual spaces. Watershed believes that the arts’ main role is to bring people together to create fresh conversations and encourage new thinking; and the important word here is people: technology is a great enabler, but human beings are people who like to get excited (Penny, 2009).

Conclusion

In this chapter, we have seen how the traditional business models of arts and entertainment organisations are evolving and, in some cases, transforming. This is largely due to changing relationships between audiences or consumers and producers. But it is also influenced by rapid developments in technology.

We noted at the beginning of the chapter that effective business models should maximise value, and by critiquing and updating existing models of the value chain, we have explored how arts and entertainment organisations are able to achieve this in the 21st century world of fast and cheap technology, active engagement and the hunger for genuine experiences. By focussing in depth on two different sectors of the arts and entertainment industry, namely music and the performing arts, we have also analysed how effective business models can add tangible value to the entire marketing mix. At the same time, we have seen how some sectors of the industry (like music) have been revolutionised, while others (like the performing arts) have largely remained intact.

The case study on Watershed illustrated how on some occasions, a business model can be turned on its head. Watershed’s journey highlights the courage it takes to become a genuine learning and listening organisation, which is brave enough to relinquish creative control and open up its spaces to its audiences.

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