

ECONOMIC VALUE OF MUSIC FOR FM RADIO IN INDIA

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EXECUTIVE SUMMARY

The Indian music industry has been subject to various economic distortions in licensing its product (music) for commercial use by FM radio companies.

Since 2010 under terms set by the Copyright Board, the music industry is forced to compulsorily sell its content to FM radio companies at a **royalty rate of 2% of net advertising revenues** earned by the radio companies. These terms, valid for a decade, were deemed necessary in order to develop the FM radio industry from its infancy and was perceived to be a public good.

FM radio flourished and grew rapidly under these conditions. The bedrock of the growth of the radio industry was music content. Music was the single largest source of content for radio companies and nearly all of its growth was derived on this foundation.

However, the terms of the Copyright Board have proved to be distortive of an efficient market and runs the risk of hampering future growth and sustainability. It is now established that music and FM radio are tightly integrated and can grow rapidly on the back of each other. The Copyright Board order of 2010 has divided the music industry into various sub-groups with differing terms, skewed the balance heavily against the music labels that are strictly bound by the order, led to a parallel market of individual negotiations between music companies and radio companies and triggered mistrust among market participants.

It is now time to clean up these distortions and move to a more efficient model that will foster mutual growth and trust. This report recommends a simple revenue model for music companies to license their content to FM radio companies for terrestrial broadcast.

7.5% royalty of gross revenues of radio companies to be paid for music

This recommendation is derived from an extensive study of the industry, detailed analysis of data over the past decade and a market imputed rationale, which is explained in detail in this report.

INTRODUCTION

The Indian music industry is organised in a complex manner for licensing and commercial terms for its products. Unlike a typical free market structure where the producer and the consumer are engaged in mutually negotiated transactions for purchase and sale of product or service, music in India is divided along lines of broadcast mediums and organised sub-structures.

Music played on terrestrial broadcast mediums such as FM radio have an entirely different market structure vis-à-vis digital broadcast mediums such as Spotify or Apple music.

Separately, some music companies are organised into smaller sub-groups and associations while others are not.

Phonographic Performance Ltd ("PPL") is a collective body and the controller of licenses to be granted for radio broadcasting for a large number of national and regional music labels in India. But not all music companies are organised under the PPL umbrella. A few but significant number of music labels are not part of PPL but command a sizeable market share. Super Cassettes Pvt. Ltd. (T Series), Yash Raj Films/Music, Zee Music are among the few large music labels that are outside the PPL ambit.

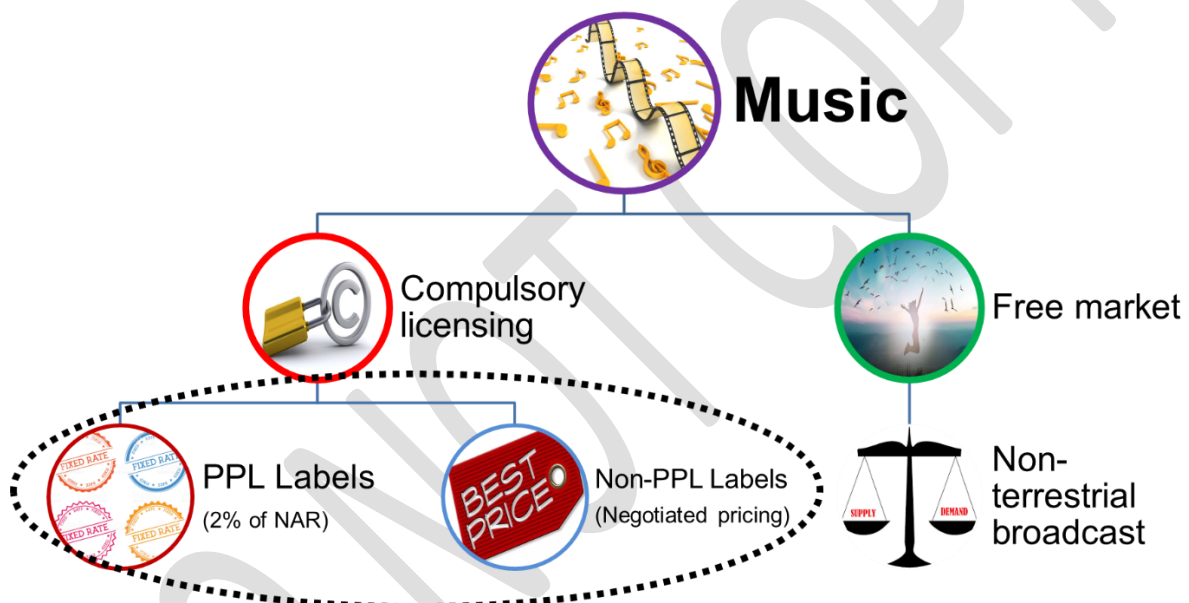
Terrestrial broadcast needs government licensing for specific geographies for which the broadcast companies are required to pay a fee either through an auction or another process that the Government of India may deem appropriate in the future. It is inherently different from digital music platforms which are free to air and do not incur the heavy upfront costs of terrestrial broadcast. Hence, the economic value model for music on terrestrial broadcast mediums is different from digital mediums.

In 2001, PPL published a tariff rate for Rs.2400 per needle hour, which is defined as the amount of music played per hour of radio content. It was subsequently challenged by the radio companies primarily on grounds that FM radio was still in its infancy in India and a high tariff rate will inhibit the development of this sector. The matter was finally settled by the Copyright Board in 2010 in favour of the radio companies – music owners which were members of PPL had to compulsorily license music to FM radio

and also share revenue risk by charging 2% royalty of net advertising revenues earned by radio companies. These terms were valid for ten years, until 2020.

The music companies that are not part of PPL are also subjected to statutory licensing of their music content to FM radio like the PPL labels but they do not fall under the 2% royalty rate commercial terms set by the Copyright Board. These music companies have entered into individually negotiated terms for licensing their content, as shown in Figure 1.

Figure 1: Economic market structure of Indian music industry



The dotted line in Figure 1 represents the scope of this study and report. This study is undertaken to recommend a fair value economic model for compulsory music licensing for the FM radio terrestrial broadcast medium only.

FM radio flourished under these tightly regulated conditions. Listenership grew exponentially from 10% of the population in 2010 to 65% of the population¹. Number of private FM radio stations grew 60% from 242 in 2010 to 381 in 2019². Advertising revenues for FM radio grew three times in just a decade³.

¹Thomas, Abraham - . 'Radio continues to evolve in India, grew 7.5 pct in 2018'. Financial Express , 31 July 2019. [https://www.financialexpress.com/opinion/radio-continues-to-evolve-in-india-grew-7-5-pct-in-2018/1661133/#:~:text=Broadcast%20radio%20\(AM\)%20today%20reaches,ratio%20stations%20in%20the%20country.](https://www.financialexpress.com/opinion/radio-continues-to-evolve-in-india-grew-7-5-pct-in-2018/1661133/#:~:text=Broadcast%20radio%20(AM)%20today%20reaches,ratio%20stations%20in%20the%20country.)

²KPMG, FICCI

³IMI Vision 2022 report

All this development happened on the foundation of music. 75% of FM radio content in 2010 was music content⁴. As a radio station matured, its share of music content came down to 65% on average⁵, but music remained the single largest source of content. So, music was the backbone for the development of the FM radio industry in India, achieved through a compulsory licensing arrangement between FM radio stations and PPL members and risk sharing revenue arrangement between non-PPL music rights holders and FM radio stations.

But it was not all beds of roses. Compulsory licensing skewed the arrangement heavily against PPL. The most fundamental and basic rule of any free market is the right to choose to engage in a transaction. Under the Copyright Board's terms, not only were PPL members forced to sell their product at a fixed rate but they could also not refuse to sell. While the public-good nature of the FM radio industry is recognised and appreciated, it is obvious that the current arrangement between music owners and radio companies is extremely skewed in favour of the latter and unhealthy for the longer-term development of the sector.

Clear evidence that this arrangement was skewed against PPL can be seen in the fact that some major labels have chosen to remain outside the ambit of PPL. In 2010, 70% of music content played on FM radio was PPL music and 30% was non-PPL music. By 2019, this ratio had reversed to 35% PPL music and 65% non-PPL music on FM radio⁶.

Evidently, music labels and companies that chose to remain outside the ambit of PPL and consequently, outside of the terms of the Copyright Board in 2010, negotiated their own terms with the radio companies. Under these individually negotiated terms, the non-PPL share of music content adopted by radio companies exceeded the PPL share of music content. Clearly, the negotiated terms of non-PPL music companies with the radio companies were mutually attractive to both parties. This demonstrates that the Copyright Board conditions were not necessarily aligned with market conditions since more favourable terms for music labels negotiated by non-PPL music companies did not act as a deterrent for radio companies to procure music content.

⁴IMI, Author's analysis

⁵IMI, Author's analysis

⁶ Author's analysis of data of FM radio companies

There are other distortions in the current revenue arrangement. The royalty rate is fixed as a percentage of net advertising revenues. This leads to, what economists term as a moral hazard problem by incentivising radio companies to engage in revenue misclassification in order to minimise royalty payments to music owners. This in turn triggers a 'need to peek' into the books of radio companies by music owners which is very inefficient and leads to a trust deficit. There are many examples of court disputes between music owners and radio companies over what specific line items constitute net advertising revenues such as the order passed in the Delhi High Court in 2018 between Music Broadcast Pvt. Ltd versus Axis Bank & ORS about books of accounts and logs not provided to the music company to validate what constitutes net advertising revenues.

Furthermore, revenue models can change and be disrupted by innovation and new industry developments. FM radio industry is already experiencing dramatic changes from advertising led revenue model to non-advertising led revenue model through events, branded content etc. **Non-advertising revenues now form nearly 20% of all revenues for radio companies, up from just 7% two years ago**⁷. It is unfair to tie music owners to a royalty attached to a specific revenue line item such as net advertising revenues when the radio industry is going through rapid change in terms of where it derives its revenues from.

After a decade of skewed licensing arrangement for the larger cause of development of the FM radio industry, it is now appropriate to re-assess the arrangement to make the market more efficient and catapult to the next phase of growth. The new licensing model needs to incorporate some basic economic principles to ensure an efficient market. They are:

1. Music might be intangible, but it is a legitimate 'property' of its owner and fundamental property rights need to be respected.
2. It is understood that for arguments about a larger public purpose, the principle of free mutual contracts may not be entirely applicable to the radio and music industries and there is a need for a regulatory authority to set pricing terms. But

⁷ "Billion screens of opportunity". Ernst & Young. <http://www.ioaa.co.in/images/EY-a-billion-screens-of-opportunity.pdf>

the pricing agreement between music and radio industries cannot stray too far away from mutual acceptability and a balance of power that a free contract market will otherwise ensure.

3. There is a need for a simple pricing model that will remove the current complexity, minimise need for external intervention, reduce scope for mistrust and eliminate the need to 'peek into books' of each other.
4. Each party needs to manage its own business risks and not force it on to the other party.

This report is the output of a detailed and comprehensive study undertaken over several months combined with extensive analysis of large amounts of data of the music and radio industry. Keeping in mind the basic principles for a new licensing arrangement laid out above, we recommend the following revenue licensing model between PPL and radio companies:

A shift from the current net advertising revenues model to gross revenues.

Net advertising revenues are no longer as relevant and the sole revenue source for radio companies as they were in 2010. A royalty rate based on overall revenues will be cleaner, more efficient and eliminate breeding of distrust and need to 'peek into books'. Our empirical analysis of FM radio companies reveals that currently the share of royalty paid by PPL and non-PPL music companies combined is about 5% of overall revenues. PPL share of music is only 35% of the overall FM radio music share. Recall, PPL music companies get a fixed royalty rate of 2% of net advertising revenues which translates to significantly less than 1% of gross revenues.

If total royalty revenues paid by radio companies to both PPL and non-PPL music companies is 5% of gross revenues and PPL music has a 35% share with less than 1% of gross revenues royalty rate, then it can be inferred that royalty paid for non-PPL music content by radio companies is around 6-7%. This clearly seems to be the negotiated market rate between non-PPL music companies and radio companies currently.

Hence, a 7.5% of gross revenues as royalty for all music content will be a fair, equitable and non-distortive revenue structure.

This new revenue model is expected to be far more efficient to administer and not saddle radio and music companies with long legal disputes and mistrust. It incorporates the interests of both the counterparties and is intended to be flexible to adapt to rapid changes in either of the industries.

In the last decade, the FM radio industry and the music industry chose a "swim or sink" relationship framework in order to help the radio industry grow; growth which would also be beneficial to the music industry. This framework helped the radio industry grow substantially but it tilted the scales heavily to the side of the radio industry. Such market structures are inherently unsustainable and will break. Hence, in the larger interests of both the FM radio industry and the music industry, the time is ripe to right these wrongs and balance the scales.

We have therefore suggested a simple model of pricing with a 'swim or sink' framework providing the right incentive structure for the longer-term development of both the industries.

METHODOLOGY

This report relies largely on an empirical method to analyse the state of the FM radio industry, its development and arrive at an appropriate method of commercial arrangement between the music industry and the FM radio industry for its sustained growth. For any empirical analysis, it is necessary to use relevant data and cite the data sources as well as the methodology used. This section aims to outline these.

Using a detailed dataset of city wise number of hours of PPL music played, overall revenues and royalty paid to PPL over the past decade from 2010 to 2019, an analytical framework was designed, and a model built to analyse.

Financial statements of large radio companies such as ENIL, MBL, DB Corp, HT Media, KAL Radio and South Asian Radio over the last decade were analysed in detail.

Data for other countries was also collected through various sources, including academic research papers and phonographic associations. Some primary research was also conducted to estimate hours of PPL music played in various cities on a random sample method. Discussions were held with advertisers, advertising agencies and brands to understand current and future trends in radio advertising and revenue models.

MUSIC AS INTELLECTUAL PROPERTY

Intellectual Property Rights (IPRs) have very little intrinsic value in and off themselves. What creates value for an IPR is the ability of the owner to monetise it by keeping out competitors in their market or setting the terms of the market in a way that is favourable to them. It is a legal right that grants the creator/inventor/owner exclusivity over their product.

An IPR is meant to reward the creator for the hard work that went into innovating. It is understood to be one's property since the person has put in work to create said product; it is the right to own "creations of their minds".⁸ IPRs are also meant to incentivise innovation. The progress of humans depends on their ability to innovate and if there are no institutional protections that allow one to benefit economically and socially from their intellectual creation, the incentive to innovate is taken away from them. IPRs provide this incentive. They promote innovation and creation.

Since music, too, is a creation born out of an artiste's time, energy, and efforts, and heavy investments by producers, music is also considered an intellectual property. The rights related to musical works as an intellectual property are defined within national copyright laws which are, in large part, shaped by international treaties, many of which are administered by WIPO.⁹

The music industry depends on copyright. It is copyright protection and enforcement that makes investment in music possible. It is copyright that allows the industry that helps artistes, gain a return on its investment and plough back new funds and resources into the next generation of talent.

Challenges with Implementing Copyright Law in Music

1. It is hard to maintain uniformity across the different cases since the lines of what the "right" rate for a performance varies case to case.

⁸ 'WTO | Intellectual Property (TRIPS) - What Are Intellectual Property Rights?' Accessed 19 June 2020. https://www.wto.org/english/tratop_e/trips_e/intel1_e.htm.

⁹ 'Summary of the Berne Convention for the Protection of Literary and Artistic Works (1886)'. Accessed 15 June 2020. https://www.wipo.int/treaties/en/ip/berne/summary_berne.html.

2. In India, there is no institutionalised way of reviewing the rates set by any tribunal leading to the implementation of old systems not accounting for transitions in technology and innovations in the field.
3. Changing technology has made new business models for delivering entertainment possible. However, non-exclusive, compulsory licenses prevent the music industry from taking full advantage of these changes, in contrast with the less-restricted movie and television industry.
4. The patterns of music consumption have rapidly changed in the last few decades, consequently changing the music business. For example, sales of physical products like Compact Discs have declined and digital streaming and other forms have taken over as a key source of revenue for the industry. These changes in the marketplace for music are relevant to rates for performance licenses for two reasons:
 - a. *The Decreasing Relevance of the Promotional Effect Argument:* Given that consumers increasingly stream music rather than buying it undermines the longstanding contention that license fees for performances should be discounted to account for their promotional effect on record sales.
 - b. *The Establishment of a Comparable Rate, established in a Free Market Negotiation:* The emergence of streaming has created, for the first time, a significant transaction in the music market that is not governed by a statute, court decision, or regulatory proceeding. Services such as Spotify and Apple Music have freely negotiated their rates with record labels. Streaming services like Apple and Spotify pay most of their revenue as royalties. It has been reported that Apple pays 70% of its revenue to music rights owners – 58% to the owners of copyrights in sound recordings and 12% to the owners of copyrights in musical compositions¹⁰. Spotify reportedly pays a similar proportion, 55% to the owners of sound recordings¹¹. It is notable that when streaming services negotiated a rate in the free market for music, such free market

¹⁰ Apple Insider, 'More than 70% of Apple Music revenues passed to rights owners', <https://appleinsider.com/articles/15/06/15/more-than-70-of-apple-music-revenues-passed-to-rights-owners-apple-confirms>

¹¹Business Insider. 'Here Is The Fantastically Tiny Amount Of Money Artists Get When Spotify Plays Their Songs'. Accessed 20 June 2020. <https://www.businessinsider.in/here-is-the-fantastically-tiny-amount-of-money-artists-get-when-spotify-plays-their-songs/articleshow/26922875.cms>.

negotiations turned out to be an essential input, consequently receiving a significant share of revenue. When setting rates or determining damages in IP cases, courts and agencies typically invoke a hypothetical arms-length negotiation to determine what price the parties might have achieved in a marketplace transaction.

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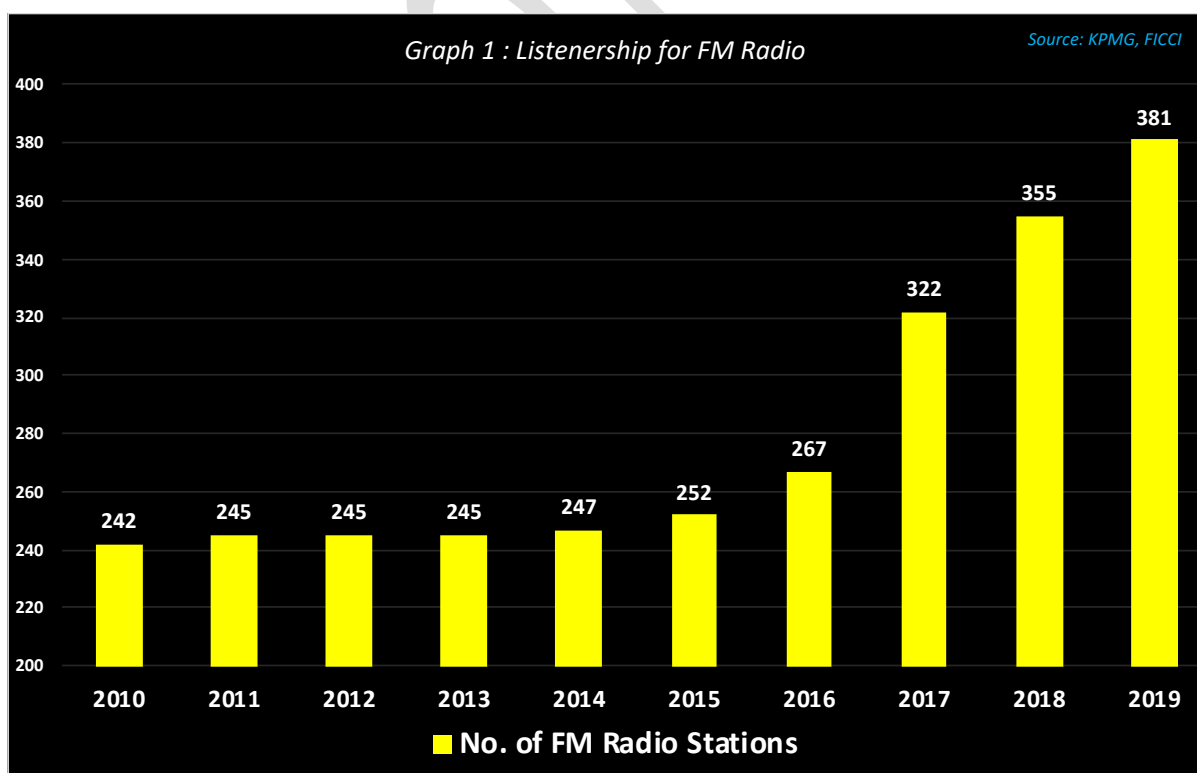
DECADAL ANALYSIS OF THE FM RADIO INDUSTRY

Evolution of Private Radio in India

The FM broadcasting in India began in 1977 in Madras (now, Chennai) with the government run All India Radio. This was true till the 1990s, when private broadcasters emerged in cities like Delhi, Mumbai, Kolkata, Goa and Chennai resulting in the creation of private FM slots.

Beginning in 2001, private radio licenses were sold through auctions in select cities. This, deemed as the first phase in the evolution of Indian private radio, covering less than 10% of India's population, was only the beginning of radio's journey. 96 years since its inception, FM radio remains a cherished source of entertainment, a favourite, especially amongst commuters, with more than 381 operational private radio stations, covering more than 106 cities and towns¹².

Exponential Growth in Listenership



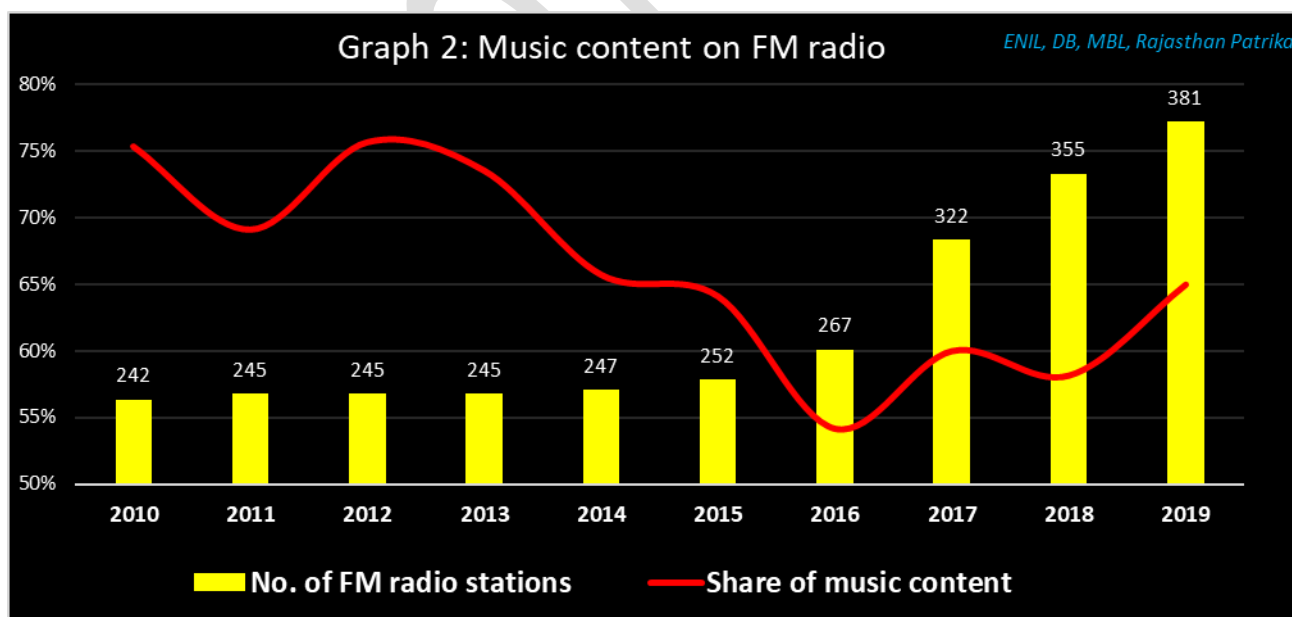
¹² Graph 1

Music remains the core of the programming for private radio channels. There are different radio channels playing various genres of music ranging from Bollywood to western music. All India Radio which is run by state-owned Prasar Bharti airs dedicated music programs to showcase the talent of classical music artistes but programming in private radio revolves largely around recorded music.

There has also been an exponential rise in the number of people listening to FM radio, as evidenced in Graph 1.

Listenership has grown from 10% of the population in 2012 to over 65% now¹³. In 2019, there were 381 private radio stations in the country operating in more than 106 cities, as shown in Graph 2. Over 70% of radio is consumed on mobile phones in India. In metro cities, seven out of 10 people listen to radio while travelling. This number is six out of 10 for non-metro cities¹⁴.

Music Is the Backbone of FM Radio



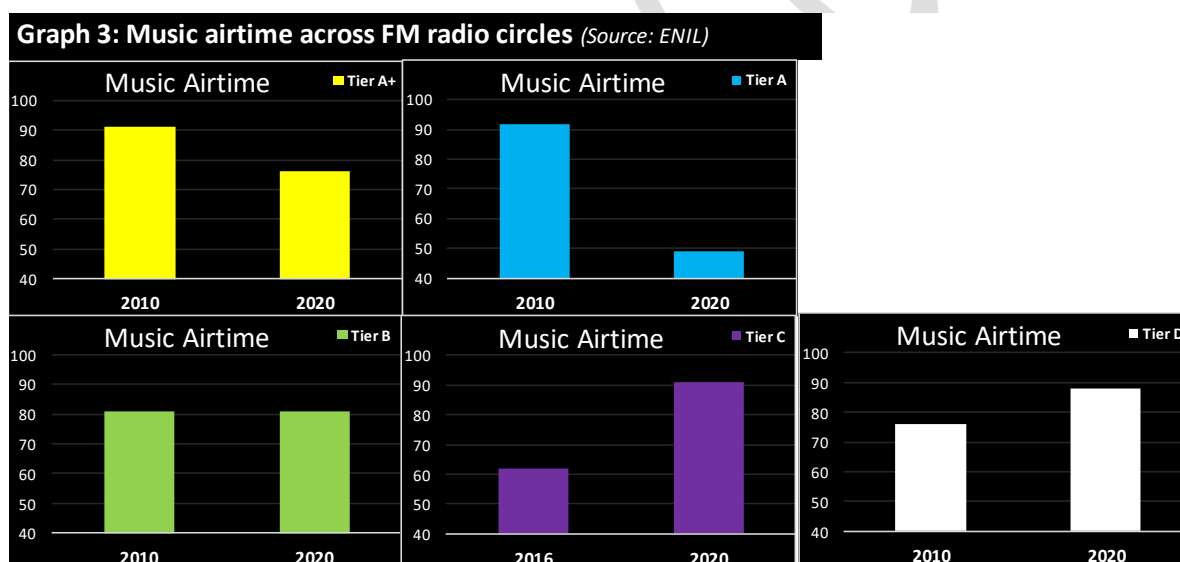
Music is the most dominant form of content in FM radio. A decade ago, music formed 75% of the content for FM radio industry, as shown in Graph 2. As the industry

¹³Thomas, Abraham - . 'Radio continues to evolve in India, grew 7.5 pct in 2018'. Financial Express , 31 July 2019. [https://www.financialexpress.com/opinion/radio-continues-to-evolve-in-india-grew-7-5-pct-in-2018/1661133/#:~:text=Broadcast%20radio%20\(AM\)%20today%20reaches,radio%20stations%20in%20the%20country.](https://www.financialexpress.com/opinion/radio-continues-to-evolve-in-india-grew-7-5-pct-in-2018/1661133/#:~:text=Broadcast%20radio%20(AM)%20today%20reaches,radio%20stations%20in%20the%20country.)

¹⁴ "Billion screens of opportunity". Ernst & Young. <http://www.ioaa.co.in/images/EY-a-billion-screens-of-opportunity.pdf>

matured, music content came down to roughly 55% by 2016. When new radio stations were launched from 2017 onwards, share of music content started rising again. This trend, as visible in Graph 2, clearly shows that music is the foundation on which a new FM radio station is built, a constant, regardless of new developments in the sector. The share of music may go down as the station matures but net advertising revenues start rising with maturity of the radio station. One can impute there is a negative relationship between share of music content and radio revenues which is an important factor to consider while evolving the right license model for music on FM radio.

There is also a wide disparity in use of music content between mature markets such as A+ and A circles vis-à-vis smaller B, C and D circles, as visible in Graph 3. In the mature circles, music content has fallen while in the smaller circles it has remained constant or increased.

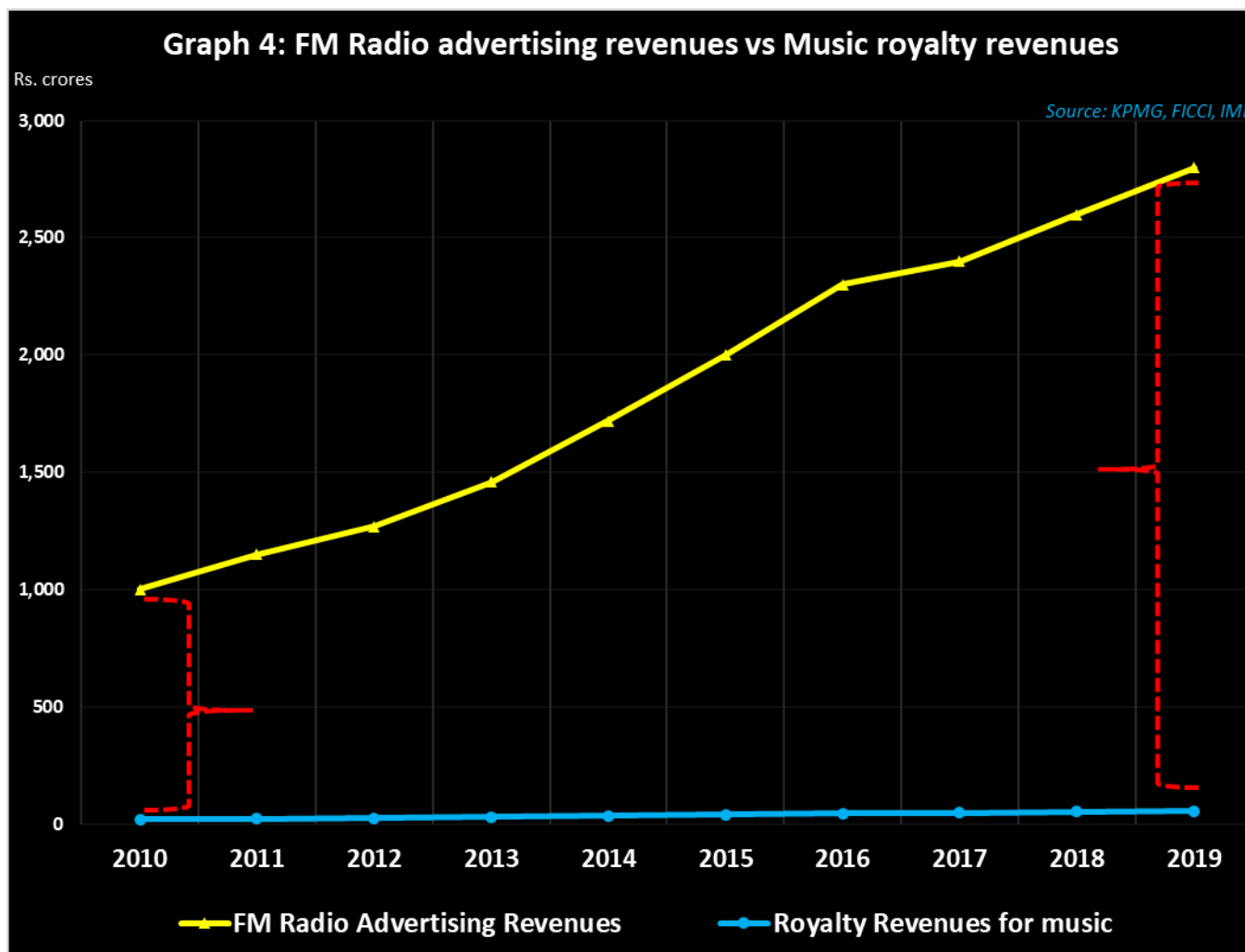


FM Radio's Revenue Model

Advertising is the primary source of revenues for FM radio. Advertising revenues have grown three fold in the last decade for the radio industry. By 2019, there were more than ten thousand advertisers on radio advertising over fourteen thousand brands¹⁵. 40% of these advertisers were exclusive 'radio only' advertisers since radio offers

¹⁵ "Billion screens of opportunity". Ernst & Young. <http://www.ioaa.co.in/images/EY-a-billion-screens-of-opportunity.pdf>

specific geography-based targeting of customers for brands¹⁶. While radio advertising revenues have grown significantly in the last decade, due to the skewed royalty structure, share of revenues for PPL music labels from radio is pitifully small, as evidenced by Graph 4.

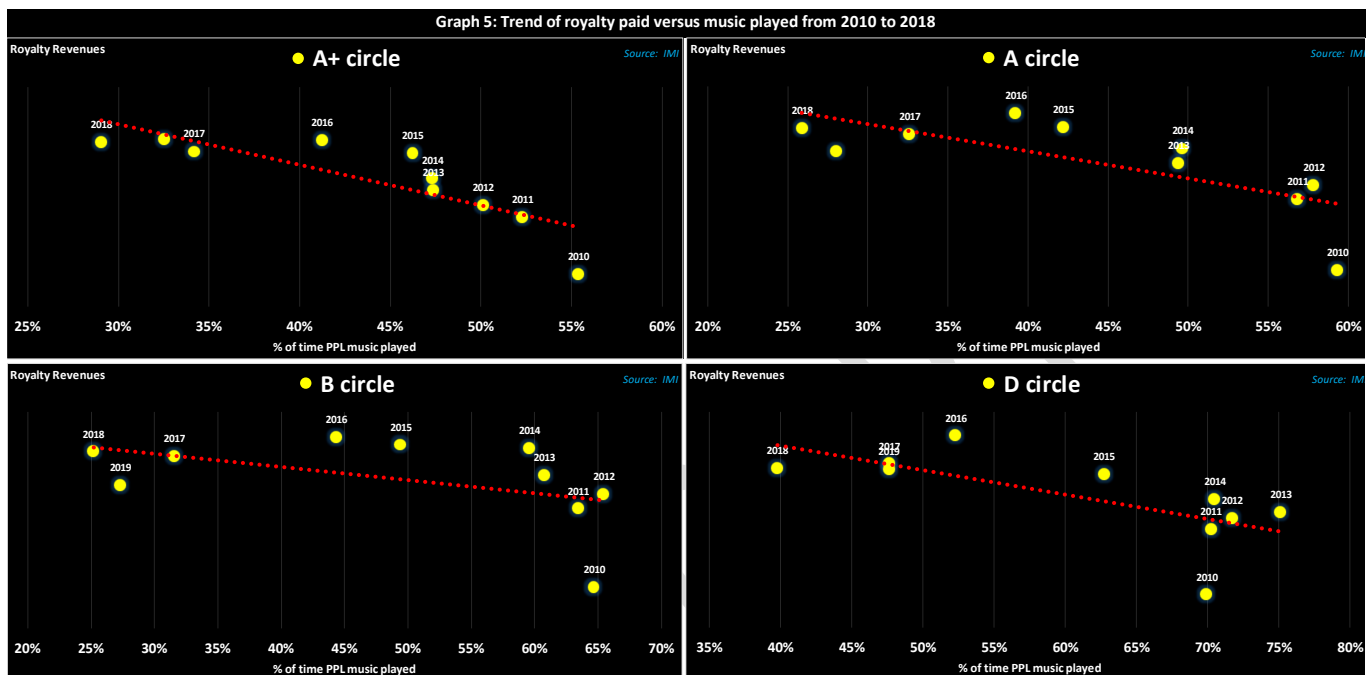


Advertising rates vary widely across markets and are very dynamic. For instance, in 2019, ad rates for Mumbai were 10 times higher than ad rates for Lucknow for one radio company. Generally, the ad rates for A+ circles are at least five times higher than ad rates for D circles¹⁷. But music played in D circles is 50% higher than in A+ circles. Moreover, as seen in Graph 5, even within a circle, the trend is very clear that as the radio station matures, share of music content comes down while advertising revenues

¹⁶ "Billion screens of opportunity". Ernst & Young. <http://www.ioaa.co.in/images/EY-a-billion-screens-of-opportunity.pdf>

¹⁷Primary research

go up. This means that a radio company that operates in all markets can subsidise its C and D markets through revenues from A+, A and B markets



Diversification of revenue streams for FM Radio

While advertising remains the most dominant source of revenues for FM radio, new technological developments have propelled a significant diversification of non-advertising revenue streams. Nearly one-fifth of radio revenues are from non-advertising sources now, up from just 7% in 2018¹⁸.

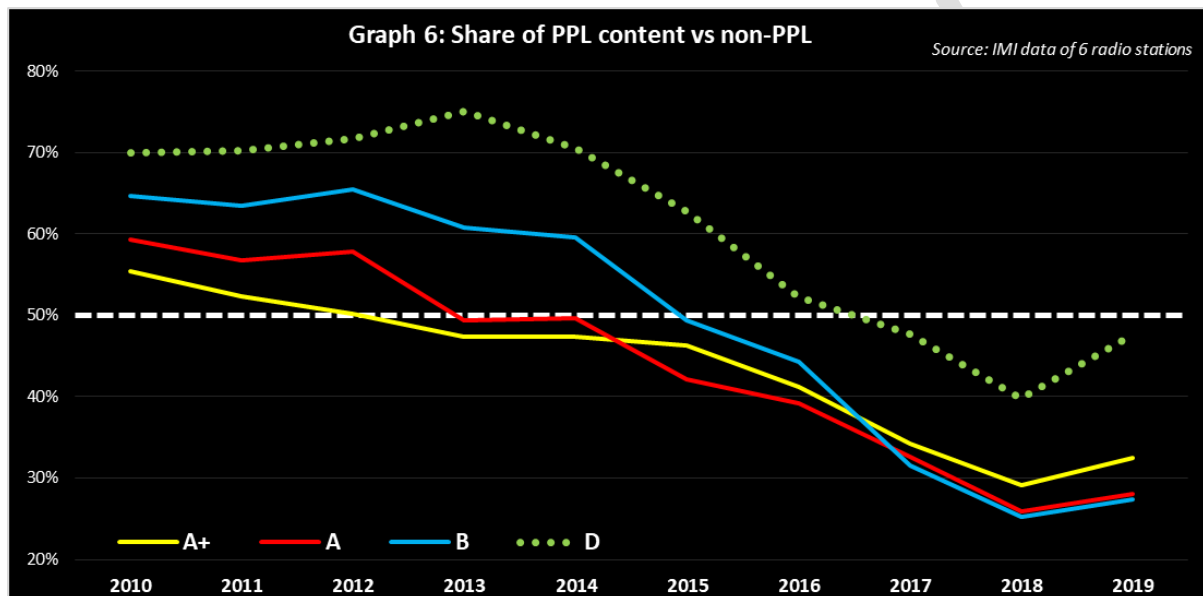
Digital streaming is the biggest disruptor of the traditional advertising-based revenue model of radio. Digital streaming lends itself well to subscription revenues since music choices can be customized for every individual and not for a generic audience. It is growing rapidly in India and is poised to disrupt the industry even more.

Radio companies have also embarked on various other sources of revenues such as curated events and concerts. This is also a fast-growing source of non-advertising revenues for radio. This apart, there are multiple other revenue models that are being tested and tried. These may be small today but they can certainly threaten the

¹⁸ "Billion screens of opportunity". Ernst & Young. <http://www.ioaa.co.in/images/EY-a-billion-screens-of-opportunity.pdf>

traditional advertising model of revenues. This is how a genuine free market should operate, in terms of new technologies and developments disrupting existing order. It is the famous Schumpeterian creative destruction economic framework that is at play in the radio industry. In this context, a royalty arrangement based on a traditional share of advertising revenue is outdated and unsustainable.

Trend of PPL versus Non-PPL music content on FM Radio



Recall that the music industry is divided between music labels that are under the PPL ambit and those that are outside PPL. To be clear, all music content for FM radio is subject to statutory licensing, however no statutory rate has been set by the Intellectual Property Appellate Board. Since the Copyright Board order of 2% of net advertising revenues as royalty rate in a compulsory licensing regime was applicable only to PPL, non-PPL music companies have not been subjected to these terms and have evolved independently negotiated terms with radio companies.

As Graph 6 shows, the share of music content on FM radio between PPL and non-PPL has completely reversed in the last decade from 70/30 to 35/65. Analysis of total royalty revenues paid by radio companies for music content reveals that the independently negotiated rates by non-PPL members is significantly higher than the 2% of net advertising rate fixed by the Copyright Board. This shows that not only is the royalty rate higher for non-PPL music companies but their share of music is also

higher indicating that there is an optimum market determined tariff rate that can be imputed through the commercial terms negotiated by the non-PPL music companies.

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CURRENT REVENUE MODEL

The copyright board, in 2010, set a rate of 2% of net advertising revenue to be paid by radio stations to PPL member labels until 2020. The royalty rate of 2% and the line item of net advertising revenues were not market determined outcomes but rather a model predicated on the infancy of the FM radio industry, its perceived public good nature and the desire to grow the radio industry.

Problems with the Current Revenue Structure

The current model of compulsory licensing at a fixed rate of royalty of a specific line item of net advertising revenues is extremely distortive and skewed. It already has, and will continue to, lead to abuse of market power. It is an economically inefficient revenue structure and is unsustainable in the long run. It has skewed power in favour of licensees which has not only limited the incentives for music creation but has also deprived consumers of true music choices. The disproportionate revenue share between the FM radio owners and music owners has distorted the market structure and its efficiency.

The FM radio industry is now three times larger than the entire music industry, growth primarily driven on the foundation of music content.¹⁹ Private FM radio is now allowed to broadcast non-music content like the news. This has evidently affected the share of music as a total of the content aired. Using a simple pay per use model for mature markets which grew on the basis of music, therefore is not a fair revenue structure.

Further, as discussed in the previous chapters, radio stations now have new revenue streams, other than advertising, such as concerts, events, subscriptions, and digital communities. Moreover, digital streaming such as podcasts and interview shows are also growing rapidly.

This inefficient market structure was put in place a decade ago with the express objective of helping the FM radio industry develop as a public good. It has served its purpose well. The radio industry has now matured, with growing non-advertising revenues as well as non-music content, all built on the back of music which has led to a massive shift in the balance of power against music owners and creative artists. Time

¹⁹KPMG, FICCI, IMI

is ripe to correct this distortive structure with a newer, simpler and more efficient revenue model.

The current model where PPL receives 2% of net advertising revenue exhibits the following problems:

- *It is subject to disruption:* Given the constant innovations, advertising revenues may not remain the main source for revenues for radio companies. This system unfairly ties the revenues of PPL to a specific revenue line item such as net advertising, regardless of diversification of revenue streams of radio companies.
- *It leads to information asymmetry:* There is no way for PPL to know what the actual advertising revenues of the radio companies are. This leads to information asymmetry and provides incentive to the radio companies to under-sell their advertising revenues
- *Causes Distrust:* This model leads to distrust causing a “peak in the book” behaviour by the music industry.

RECOMMENDATIONS

This report suggests a simplistic model of royalty based on gross revenues that will be efficient. The guiding principles for this recommendation are:

1. Music is like any other creative product that belongs to its creators.
2. FM radio is no longer in infancy and has matured and evolved continuously.
3. Simple model to minimize disputes and remove current complexity.
4. No transfer of risk from radio industry to music and vice versa.
5. The need for “peeking into each other’s books” has to be eliminated.

Analytic Rationale

The Indian music industry is broadly divided into two broad groups for the purposes of radio licensing – PPL music labels and non-PPL labels. All music is subject to statutory licensing terms for terrestrial broadcast such as FM radio where the music labels are mandated to license their content to these mediums, subject to the conditions set by the appropriate authority. This is the first distortion of a free market structure where the right to sell has been taken away from the producer. Presumably, the rationale for this is the public good nature of the radio industry and the perceived nature of its maturity.

Given that music labels do not have a choice for licensing their content to FM radio, the next question is if they are free to enter into market pricing norms with radio companies or subject to statutory commercial terms too. This is where the distinction between PPL and non-PPL music companies is stark. PPL labels have been subjected to a 2% royalty rate of net advertising revenues while non-PPL companies have been able to negotiate their own terms for licensing their content to FM radio. This has led to a wide disparity in royalty revenues received by PPL and non-PPL music companies.

1. In the initial years from 2010, the share of PPL music content played by FM radio companies was 70% with non-PPL music content being 30%.
2. PPL music was subjected to 2% of net advertising revenues and in the initial years where the radio companies were still trying to establish their business models, the low royalty rate proved handy. Music royalty costs were as high as 13% of overall costs in the years of 2010-11 for some of the bigger radio companies.

3. As the radio industry established itself and began to grow rapidly, the royalty costs came down to 5-6% of overall costs by 2015 and earnings before interests and taxes shot up to 35-40% for big radio companies such as ENIL.
4. This spectacular growth came entirely on music content and gave the radio companies the confidence to expand their wallets for music content.
5. But PPL music labels were bound by the 2% of net advertising revenues order of the Copyright Board. Sensing the opportunity, music labels outside the ambit of PPL began to grow rapidly.
6. By 2019, the share of non-PPL music content went up to 65% and PPL content came down to 35%.
7. Non-PPL music labels were also able to negotiate better commercial terms for the music content. Our analysis of royalty revenues of large FM radio companies show that on average, non-PPL music companies are able to negotiate rates of 6-7% of overall revenues. This can be imputed to be the market clearing rate for music content since at 6-7% royalty rate of overall revenues, the consumer of music, FM radio in this case, and the producer of music, non-PPL music companies, are able to prosper.

Recommended Revenue Model

This revenue model explained in this section is only for terrestrial broadcast of FM radio content and does not include non-terrestrial broadcast, television, digital streaming and other forms.

For a decade, PPL music content was subjected to a 2% of net advertising revenues tariff rate. As explained in previous sections, it is evident that the current tariff regime needs a revision. A revised regime needs to be fair and equitable to both FM radio companies as well as music content providers.

As shown in Graph 6, 35% of content played by FM Radio is PPL content while 65% is non-PPL content. For non-PPL content, there is no regulated tariff structure and it is left to individual negotiations between the content provider and the radio station. So, the tariff that is set for non-PPL content can be assumed to be the market rate for music content since non-PPL content is a negotiated rate, has a share of 65% of content in these circles and the market is flourishing. The rate for non-PPL content that has been agreed to by radio companies can be the overall tariff rate for all music content, since that is the market determined rate.

Radio companies account for royalty expenses in their financial statements. These royalty payments include royalties for music under the PPL order of 2010, royalties paid to music labels that are outside the PPL ambit, royalties paid to negotiated content arrangements and so on. This can be a useful basis to impute market behaviour for music content.

ENIL, the largest radio company accounts for nearly 15% of the entire radio industry revenues²⁰. ENIL's negotiated tariff rate for non-PPL content can be assumed to be the market rate since it is the largest radio company.

ENIL's total royalty payments is about 4% of their total revenues. This is higher than the 2% of net advertising revenues for PPL music content which shows that the non-PPL royalty rates are a lot higher than PPL rates. This is a clear sign that the PPL rates are much lower than market rates.

²⁰ENIL financial statements

So, the following facts can be established for ENIL:

1. ENIL's total royalty is 4% of gross revenues
2. ENIL's music content is 35% PPL and 65% non-PPL content.
3. For PPL content, the royalty rate is 2% of net advertising revenues or significantly less than 1% of gross revenues.
4. **It can then be calculated that royalty rate for non-PPL content is roughly 6-7% of revenues.**

Since, non-PPL tariff is a negotiated tariff agreed to by both parties, it can be established that the market rate for music content is 6-7% of gross revenues. This is much higher than the 2% of net revenues prescribed for PPL content and clear evidence that it is much below market rates.

It is also interesting to note that total royalty payments made by ENIL is just 6% of its total costs. Which shows that royalty payments are not a big cost item for large radio companies such as ENIL.

A 7.5% of gross revenues, as royalties for music content is our recommended revenue structure.

The 7.5% royalty rate is a market determined rate currently and has proven to be efficient since the share of non-PPL music content at a 6-7% rate has grown much faster than PPL music content licensed at a 2% of net revenues. This shows that the incentive to innovate and produce better content which is more acceptable to consumers is higher for non-PPL music labels that receive higher royalty payments than PPL music labels.

As has been argued, a royalty rate based on a specific revenue line item such as net advertising revenues is very inefficient, breeds mistrust and distortive. The new model would have the following advantages:

- It has a simpler structure that requires an overall figure, not the knowledge of a specific revenue line-item.
- It accounts for inflation and for non-advertising revenues, earned on the back of music.
- It is fair for both parties and affordable for the radio companies.

CONCLUSION

Ten years ago, it was important for the FM radio industry to flourish, and it was therefore that the Copyright Board ruled in favour of them, ruling that PPL would have to compulsorily license to the radio companies.

A decade later, the radio industry has grown three-fold in terms of advertising revenues and penetration, on the back of this highly subsidised music from PPL. It is now time to realign the market in a way that is more equitable, economically viable, and sustainable in the long-run.

It is in this light that this report recommends a revised revenue structure of **7.5% of overall radio revenues**.

The adoption of these models would make the royalty more equitable and efficient, providing the right incentive for the larger FM radio industry to flourish on the back of music content.

AUTHOR



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Praveen Chakravarty is an eminent public intellectual, scholar and the Chairman of the Data Analytics department of the Indian National Congress.

Immediately prior, he was a Senior Fellow at IDFC Institute where his research focus was empirical research on India's political economy and economic policy. His work has been published and cited in all mainstream and research publications in India such as the Economic & Political Weekly, The Hindu, The Hindustan Times, The Economic Times, Mint etc. and in foreign publications such as The Economist, Bloomberg, Foreign Affairs, South China Morning Post etc. He is a frequent contributor in The Hindu, Hindustan Times and Mint. He wrote a popular column titled NoiseToSignal in Bloomberg Quint.

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