

THE CURRENT STATE OF THE INDUSTRY

(An Overview and Background to the FACTOR Business Plan)

THE CONTINUING EVOLUTION OF THE MUSIC INDUSTRY REPORT FOR FACTOR KEY DEVELOPMENTS OF 2008, WHAT TO LOOK FOR IN 2009

PREFACE

THE ECONOMIC SITUATION IN CANADA AND THE WORLD – 2008/2009

While it may seem somewhat unusual to preface a report on the challenges and opportunities facing the Canadian music sector in 2009 given all that has happened in 2008, it would seem appropriate to include a short preface on the whole economy and its relevance and relationship with the music sector. In normal times this would not be needed but these are clearly not normal times and some context would seem appropriate which includes the overall picture of the world surrounding the music business.

Last year the report described 2007 as a tumultuous year in the business – one hesitates to assign an adjective to describe 2008 but it certainly wasn't benign! The purpose of this short section is to highlight some facts about the overall economy that have emerged not only from the last six months but also the twelve months before that as well and how these might impact the music sector.

First, are the concepts that are currently being put forward (in very simple form). Governments will have to dole out money in large amounts to solve critical short term problems and to bolster the economy. This concept seems beyond discussion in almost every major economy but many voices are already saying that these monies have to come with performance criteria and a clear assessment of results. These would be the return of effective, efficient lending practices, good access to capital, the end of the possibility of deflation, the return to economic growth patterns plus the end to governments running deficits as soon as possible. Obviously there is room for some debate on how and when but clearly several of these objectives and how well they are achieved in the next two years will have considerable bearing on the music sector, and its growth and prosperity.

It is of course not only major Western economies in North America, Europe and Japan who have or are proposing to 'turn on the taps', but also many of the 'emerging' economies such as India, China, Thailand, Indonesia, Malaysia and Russia as well. Indeed every government appears to be trying to avoid the maelstrom and return to the relative financial calm that prevailed for many years (if one excludes the tech bubble around the turn of the century and the downturn in Asia in the late nineties).

However the consensus amongst governments, media and indeed the population at large in most countries is that 2009 will be a very tough year of retrenchment, and 2010 will not be much better.

A clear example of this is the value of tech start-ups, which is really no surprise as stocks of high flyer market leaders Google and Apple are down by around 50%.

As an example of trends in this regard, over recent years Digg and Facebook and their business concept of persuading users to participate in and to utilize their web site (crowd sourcing) received millions of dollars in investment as they were expected to be the next blockbusters of the Internet and enable shareholders to cash out with significant profits. However with declining valuations the money starts to dry up and many start-ups just close. Even for companies such as Digg that can still raise money, there are many new complications. Retaining the 'best and brightest' with their stock options deep underwater is only one example with merger and acquisition possibilities also rapidly disappearing. The public profile of Digg is

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much larger than its financial might – in 2007 the company lost about \$2.8 million on \$4.8 million of revenues while in the first three quarters of 2008 it lost about \$4 million on \$6.4 million in revenues. Indeed the valuations of tech start-ups continue to drop. Bit Torrent tore up an agreement that would have given it \$17 million in venture money and instead took \$7 million, laid off two thirds of its employees and cut its valuation from \$177 million to \$35 million U.S. dollars.

Indeed a start-up from a few years ago – satellite radio company Sirius/XM - has a stock value that has dropped to pennies and faces major refinancing hurdles in 2009 just to stay in operation. Also one of the bulwarks of the supply chain for its satellite radio devices, GM, is not exactly throwing off giant profits and has a few problems of its own.

These examples have been picked for their relevance to the music sector and new technologies as a whole, not just in Canada, but worldwide. The reality is that in the context of music at the macro business level they are adding yet more uncertainty into the decisions and plans that need to be thought through by participants in music and entertainment.

Also of paramount importance to music sector development and prosperity are the projections and expectations for avoiding a serious recession in most developed countries let alone expecting economic growth in 2009. The prognostications are almost unanimous, with an economic plan led by the Federal Reserve and Ben Bernanke to combat the 'most dangerous economic downturn in decades' by cutting rates to essentially zero with the goal of providing cheaper credit to every part of the economy, starting with housing. However the general consensus is that 2009 will at the very best see house prices at a standstill in the U.S. with only a slow recovery predicted in 2010. "The recession is going to be a long one and the recovery not a big one" to quote a senior economist at Merrill Lynch with this view being echoed by the chief economist at The Economist Intelligence Unit who predicts even tougher times ahead for the world economy and specifically the economic effects flowing from the choking off of credit. His conclusion the 'go go' years of 2003-7 are history and replaced by the 'go slow' years of 2009 onwards. The good news, if indeed it is, is that no one expects a repeat of the great depression. However, equally clear, will be the need for close observation of the financial position on a constant basis. Clearly 2009 will be the year of the CFO.

The U.S. economic editor for the Economist offers three scenarios with two being pessimistic for 2009 and beyond and one offering some hopes for 2010 and beyond, and headlines the article "Pick Your Scenarios", however none turn out to be particularly appealing. Other problems for the essentially youth based music industry in the future are forecast in articles in Fortune and the Economist while reviewing a new book by Matt Miller on economic and social trends.

While the author specifies these as American problems and indeed they are, the three major concerns could apply to the entire developed world. The first is the belief that the individual shapes their own economic destiny. Clearly this concept is much stronger in the U.S. than in Europe, Canada or Japan for example but as the BRIC countries develop and the G20 instead of the G8 becomes a reality, the level of competition for jobs will only grow. This leads to the second and third points which are that the perception of the U.S. population and, by extension that of developed countries, is that they are 'entitled' to endless growth and prosperity, that their children will earn more than they do and they can live beyond their means because everyone can all earn enough later to cover the debts. Clearly this is starting not to be the case, at least for the short term, not just in the U.S., but to varying degrees in many other countries.

To return briefly to technology, lurking on the horizon is a major change in the way business is conducted and people will live their lives, 'the cloud' or (as they are more prosaically called), computer data centers. Indeed to judge by Google searches this is clearly an 'idea du jour' that could suffer from some initial 'over hype' but equally clearly would seem to be a major trend for the future. To summarize; data centers are rapidly evolving into service factories; software will be transformed into a combination of services; the cloud's communications with its clients will become ever more intelligent and interactive; as IT gets 'cloudier', the economics of the business will change; the cloud will make businesses more adaptable, interconnected and specialised and often smaller; the cloud may be the ultimate form of globalization. In

summary it would seem that computers as we know them are starting to evaporate altogether and becoming a global 'cloud', accessible from anywhere. Clearly if this scenario plays out as predicted, there are massive macro-economic implications not to mention some major effects on the music and entertainment industries.

To conclude the brief overview of the macro issues that face the Canadian and world economies in 2009 a quick look at the situation in Canada would be an appropriate way to wrap up this section.

In general economic terms, Canada is a favoured country in that, while it has, like others suffered substantial drops in share prices and in product demand in several key areas – automobiles, resources and forestry for example, generally in terms of deficit, solvency of banks and the Canadian economy in general, things could no doubt be better, but are significantly better than the situation in the U.S. or the U.K. for example.

However equally clearly, the Canadian economy, still strongly resource based, will need to make some substantive changes over the next few years in the manufacturing field – automobiles clearly come to mind as an industry that needs both considerable work and restructuring. While one reads on a regular basis of 'innovation' agendas and the need for this nirvana to happen, the reality often lags behind the words. Indeed if one compares an article in March 2000 in Canadian Business entitled 'Canada Needs More Ideas, More R & D and More Guts' if it is ever to be a leader with one in the Globe at the start of 2008 by Roger Martin, dean of U of T Rotman School of Management that essentially says the same thing eight years earlier and obviously with little effect in the interim period, there is clear cause for concern. To quote the Canadian Business article "...the pervasive mediocrity of Canada is disconcerting" and it generally calls into question the reality of effective government policy making at all levels. Indeed to back up this point in a special section of the Hill Times of November 17th 2008 on Innovation policies, experts in the field are quoted as saying that they doubt innovation, science and technology will top the government's agenda – an area that of course includes Intellectual Property Rights and specifically for the music sector, Copyright.

While Canada by no means brings up the rear in many areas, in the field of Intellectual Property Rights in general it is definitely getting close. It is anticipated that the sentiments expressed by the new Minister and the Department of Industry may result in changes in this regard that will increase Canada's competitiveness in the upcoming difficult times for the economy and for Canadians in general. Once again these macro discussions have a very clear relevance to the Canadian music sector as a whole.

Finally many of the facts quoted are from a variety of sources in the financial field and particularly from The Economist, Fortune, Business Week and Canadian Business.

GENERAL OVERVIEW AND DISCUSSION OF THE 'BIG PICTURE' ISSUES, CONCERNS AND OPPORTUNITIES OF THE CANADIAN MUSIC SECTOR IN 2008

This first section is designed to provide a 'big picture' overview of the Canadian music sector (and of course particularly the independent sector), while Section 2 will be more detailed about specific developments and activities as well as providing an update of the Big New Issues of 2007 and how the sector progressed in 2008. Perhaps first – courtesy of Seth Godin – lets have a quick look back in history to where the music industry has come from and then explore where it is today.

In the past, many respects the music industry was an almost 'perfect' industry and several important factors made it so. A medium – radio – that while it was basically set up to use music to sell advertising also helped to increase public awareness of music in many different formats and genres; the music business was in many respects an oligopoly ie: a small number of key companies (majors) competing against each other. If you were a band hoping to break big in a mainstream genre, you needed one of these companies and this gave them a good deal of negotiating clout; music was a key part of young peoples' lives, it was a 'soundtrack' for different generations over several decades; entire chains of retailers devoted to selling your

product and promoting what you sell; this technology is both cool and cheap to make and you can sell it for a good net profit, you can't copy it and if it wears out you have to buy another one. It's a bad idea to get rid of this; several magazines devoted to promoting the product you sell and a whole TV channel on cable about music; it used to cost a great deal of money to make a recording and again artists needed you to fund it, and last, if it became a top 40 best seller and is listed on the chart, people buy your music because others are buying it, you're popular because you're popular!

However in today's world almost every one of these benefits has effectively disappeared and the way to operate has radically changed and the old model only operates in a much more restricted way today with many of the benefits expunged. In its place are a plethora of new 'models', some of which will be very successful, others less so while still others will be failures.

The trick is, of course, to ascertain as effectively as possible, through research and industry knowledge which have the best chance of succeeding, as opportunities for independents and artists are continuing to grow in a variety of different ways. For example many niche format indie labels can be successful as small business, as Loreena McKennit and Ani DiFranco continue to prove. However it should be clearly understood that 2008, and certainly the last six months, was certainly not 2007 and the year 2009 looks to be a very tough year for indies. The reasons are there in the macro environment, the lack of access to credit in general and investment funds in particular. These were always difficult at best for small labels and artists but in today's world are virtually impossible. The other major impact of the macro economic scenario that has played out in the latter part of 2008, and which looks certain to continue, is the collapse of retail sales in general and of recorded music sales in particular as record chains change their 'product mix' and become more 'entertainment' stores featuring DVD's, electronic games, etc. When this is coupled with the substantial decrease in floor space allocated to records at big box and supermarket outlets and the continuing closures of independent stores, clearly times are very challenging for all involved in the recorded music business and the necessity to have a variety of 'strings to your bow' becomes ever more critical. Then of course there is the economy in 2009 and the potential havoc to small music players that this can cause given their general lack of cash and operating reserves to face these extremely difficult times. It has been said that the music industry is to a great extent 'recession proof' given that people going through tough times still like small luxuries that are relatively cheap such as records (physical or digital) for example. However research conducted in the U.K. shows that in the last major downturn from 1991 to 1993 this was not in fact the case as sales dropped overall more than other financial criteria would have indicated. It is also often said that while the recorded music sector may be in trouble, music publishers, promoters, managers and others continue to do well and that more people than ever spend more time listening to music than ever before.

Again while this fact may be quite true, it of course begs the question - is it being monetized by the music providers in an appropriate fashion? Also it should be remembered that these sayings and beliefs have been propagated in more 'normal' times. The reality of the current situation is more a 'once in a lifetime' scenario and, as many companies and people can attest things that were thought to be outside the realm of possibility this time last year are now occurring on a regular basis. To summarize from a 'big picture' stand point, there are fewer and fewer certainties in the music business and certainly not for the clientele that FACTOR services and supports through its programs, both in terms of the Canadian music sector and the economy as a whole for, at best, the next two years and most likely for considerably longer.

With rapidly changing business models and time, there are many different approaches and opinions as to the best business methods to achieve your objectives. As a brief example of different opinions one can offer those expressed by Chris Anderson – author of the Long Tail – in a Wired magazine article entitled 'Free! Why \$0.00 is the Future' and Professor Deborah Spar of Harvard in her recent book 'Ruling the Waves – A History of Business and Politics Along the Technological Frontier'. Mr. Anderson posits that making money by giving something away for free is not new. Gillette gave away razors in order to sell blades and a similar tactic was employed by Lord Thompson in Northern Ontario plus, according to recent press reports, by Ted Rogers at CHFI-FM of giving away radios to acquire listeners. However as Chris Anderson says, with the Internet, a new type of free has emerged, not based on cross subsidies but in the fact that the cost of

products themselves is rapidly dropping to close to zero – read digital products using IP for example – and this reality is not only affecting the current business models but will inevitably lead to totally new and different business models that are still unfolding but will radically change many content industries not just music, but also video, print, etc. To go back to the original concept it is as if the price of steel production for blades and razors has dropped to zero. Gillette can give away razors and blades but make money in other ways (shaving cream). Deborah Spar on the other hand covers many scenarios from the compass to the Internet. She notes that piracy and non payment that occurred in every example – see for example the British East India Company and also the development of the telegraph in the 19th Century – the end result was that business and government policies in the end subsumed the piracy and they become 'legitimate' and part of 'civilized society'. While she admits that this is clearly not yet the case with the Internet – very much still the 'Wild West' in many markets or perhaps the 'Wild East' in China – her thesis is that acceptance and control will be the ultimate end result.

However just to be clear both Mr. Anderson and Professor Spar do not say that the current status quo will return any time soon, if ever, and both agree that the music business will look very different in a few years. The \$64,000 question is exactly how, and what business model will have emerged to best service the new realities.

Some examples of new business concepts are E-Commerce Transaction based; Music Subscriptions; Ad-supported music systems, etc. However all of these examples have plusses and minuses for different reasons and while some appears to be successful, (iTunes, MySpace, Facebook), it is still hard for ad supported players to build a successful business for licensed music while iTunes is an adjunct to the highly successful iPod. Advertising funded models can also suffer in a downturn as Will Page, Chief Economist at MCPS/PRS Alliance in the U.K reminds us in a September article as costs are often fixed by negotiation while ad revenues are prey to market realities.

However equally clear record labels per se are not going to go away any time soon, and although it seems likely they will continue to evolve and change, some will fail and some will be very successful. To expect them to just collapse is just not a realistic view, not the least of the sufferers in such an outcome would be the current ecosystem of digital and physical music stores, concert promoters, managers, radio stations, etc. It would make much more sense to work towards positive changes to how companies operate and how to make all involved in the chain from artists to consumers happy. This is by no means to deride or degrade the new 'artist driven' models and the approach they bring to the table. In tomorrow's Internet world there is clearly a place for both types of business to exist.

Another area of the music sector and which affects participants big and small from artists to writers to copyright owners is that of effective, efficient clearance of copyright material for users and effective, efficient payment systems of rights licensed through collecting societies. These collectives (except in very rare instances) are non-profit societies owned and controlled by members (creators and copyright owners). However in today's world as changes in objectives and circumstances occur, changes will be taking place in both the structure and the relationships between the various players involved and will no doubt be the subject of considerable discussion at both business and government levels as is already the case in the European Union in the past year. However the end result of the European situation is at best very unclear, as of now, and seems likely to be fluid for some considerable time at least.

Yet another 'big picture' issue that continues to come to the forefront is that of so called 'cloud computing' and private storage clouds and the 'lightnet' and 'darknet' possibilities for the use (or the misuse) of intellectual property that can easily flow from the rapid increase in the use of cloud storage for backup, etc. by business and consumers in general. This technology will soon become easy to use and commonplace. Unfortunately this means that the laws of unintended consequences will almost certainly come into play and many well meaning and innocent people could be allowing access to or passing on yet more movies and music. There are already many sites devoted to this new phenomenon. To quote Shelly Palmer when having just checked out the Apple mobile me site, in turn slightly misquotes Joni Mitchell saying "I've looked at clouds from both sides now and then you'll realize you really don't know clouds at all." This is clearly a

new development with all sorts of potential ramifications for the music sector and one that needs close attention in the future, particularly given its potential macro economic and technological impact for the future on society and business in general.

To conclude this 'big picture' section some facts on the music business then and now, the music business as it may be in the future according to Terry McBride of Netwerk and some thoughts on the music business by economists Will Page of MCPS/PRS and Oliver Bomsel, Professor on Industrial Economics at the Centre of Industrial Economics, Ecole de Mines, Paris.

First a comment from early 2008 regarding Universal/Interscope artists Soulja Boy regarding his 2007 Grammy nomination hit Crank That, a radio staple and the two videos of the song that generated 27 million views and 3 million digital track sales as well as 2 million plus ringtone sales. However he is falling short in album sales with U.S. sales of just under 750,000. Given the revenues from digital singles and ringtones constitute about 10% and 15% of the gross from a CD sales; it's clear there is a major bottom line hit occurring.

When these numbers are compared with Eminem, the 2004 Grammy winner with 'Lose Yourself' with sales of 1.4 million digital downloads and album sales of 4.7 million. A rough estimate suggests that while the two releases sold a comparable number of units' total revenues for Eminem were four times as high. Obviously, as noted earlier in this section the need to acquire alternative revenue streams is now a vital part of the equation for the music sector.

Terry McBride CEO of Netwerk spoke in June '08 in London at a MusicTank event on the issue of the Millennial Generation and his document is both interesting and contains some very valid comments. However the comments and conclusions reached are, in some cases, clearly up for discussion as he particularly notes the ability to monetize sociability as has been done by Yahoo, AOL, Facebook, YouTube and others which many feel strongly has not been meaningfully achieved. There is clearly room for different opinions and views here.

Terry also recommends a plan for artists to develop their profile such as creating additional assets beyond the album, putting assets on as many content platforms as possible, creating a personal web site that collects data and encourages fans to join your tribe, touring with like-minded artists to reinforce your brand, considering Karma pricing on your web site and live shows, plus engaging in as many aspects of brand building as possible. Finally he makes the point very clearly that in the future one model alone cannot support the industry, there have to be many revenue streams.

To conclude, here are some economic comments first from Will Page and then Oliver Bomsell. Mr. Page, when asked to discuss the big economic issues today, noted first that the industry should understand what happens when the unit value of the 'good' is eroded and why 'scale' and 'bundling' are needed as a result. He feels that there is a lot to be learned from Telco's who he feels are much better equipped to scale their business over the medium term even if ARPU (Average Revenue Per User) needs to fall over the short term. Second, he noted that iTunes business model that dominates the digital market place is essentially an unbundled granular model that erodes unit value from \$9.99 to \$0.99 and the ramifications of this are far reaching for the music business. He used as an example a question whether every iTunes sold be celebrated as a new \$0.99 gain or as \$9.99 lost. Third was the issue of displacement which he feels is a much misunderstood concept in the music industry. As an example he posited that Duran Duran would usually price a show at \$50 but instead would price it at \$250. If the consumer has a music budget constraint, is this \$200 that HMV or iTunes doesn't see? If there is a budget constraint, then ticket price hikes will have an immediate effect on sales, which is important to consider overall. Turning to Professor Bomsell, when asked what he thought the economist's role in the music industry in this new era was, he noted that as the long standing medium for the delivery of music, the record had its own economics but, the branding, packaging and pricing of music has to be re-thought, which is a job for economists.

The second question was the big issue in the music business. In response, Professor Bomsell posed several questions: Will a removal of the DRM's from online retail music sales speed up the end of the CD? How to cope with Apple's dominance in online music distribution? How to enhance alternative distributors? On which bundling, and pricing model? How will the Internet be a competitor to radio, as a means to promote new artists, new products, new brands? How to synergise better live performances and music sales? How to earn more from music publishing?

However there is one thing that can clearly be said about music in all its forms. It's importance to both the human psyche, emotions and enjoyment in general from time immemorial, a fact that was noted on the cover of the year end edition of the Economist – 'Why We Love Music' and what it called one of humanity's strangest attributes its "all singing all dancing" allure. This of course mirrors the thesis of Professor Daniel Levitin in his book 'This is Your Brain of Music' and his just-published new book 'The World in Six Songs', wherein he notes the common history of music and humanity over several thousand years.

This concludes the 'big picture' section and the report continues with the section titled 'Opportunities and Challenges' facing the Music Industry.

OPPORTUNITIES AND CHALLENGES FACING THE MUSIC INDUSTRY

As has been seen over the past few years, the continuing development of technology, with the vast number of changes and opportunities that continue to be created are an ever increasing factor in the overall music, recording, marketing, distribution mix and continue to force companies to constantly adapt and try to think through all of the options and opportunities and challenges in an effort to get ahead of the curve. These are all playing a major role in the directions and evolution of the sector.

Of course this is without even mentioning the elephant in the room – the need to develop efficient methods of monetization of all these new, different and concurrent approaches that are on top of the more 'traditional' systems and their audiences and consumer markets.

Last year the focus of the report was on digital sales, but as the platforms continue to change and expand this report will be more wide ranging and look at the wider selection of scenarios now open to artists and labels both in Canada and around the world.

In line with the comment last year that 2007 had been a 'momentous' year but instead of looking for an adjective that would address 2008 as it played out over the twelve months it should just probably be said that it was 'interesting' to say the least when the many challenges in the music business were overlaid with the major worldwide economic downturn. Or as someone said – with some dark humour – it could be worse, we could have a job on Wall Street!

The essential conundrum the sector faces is that music consumption has rarely, if ever been higher – indeed as Professor Levitin says in the 'The World in Six Songs', "Americans spend more on music than they do on prescription drugs annually and the average American hears five hours of music a day." Clearly the problem is not popularity, but creating and operating new and effective business models to address the problems and monetary issues that flow from these new applications and technologies.

However to first offer some context to this section, it was reported that by The Neilson Company that total album sales in the U.S. fell from 500 million units in 2007 to 428 million in 2008, a substantial decline. Clearly as the major 'engine' of the music business this does not bode well, particularly given the sales drops experienced between U.S Thanksgiving and Christmas on a weekly basis when compared with 2007 sales and on a comparative basis at a faster decline than earlier in the year.

Meanwhile, digital track sales such as at the iTunes store were up 27%, breaking the 1 billion sales figure in a year for the first time. However this continues to be a troubling trend, as digital sales are mainly of single songs, which of course deliver substantially lower net dollar sales. As noted by the director of charts for Billboard, music consumption has never been at a higher clip, it's just a matter of trying to turn it into revenue, he noted.

Also in a somewhat ironic turn of events, vinyl is also making a comeback with more vinyl albums sold (1.88 million) than in any year since 1991. Surprisingly the independent store would also appear to be making something of a comeback, particularly in the selling of vinyl product. However the reality of this format is that, while it adds to the wide variety on offer, vinyl album sales as a whole are still a very small percentage of the total and while interest in music and sales continues to grow annually with Nielsen reporting the biggest sales week in history in the final week of 2008 with sales of 65 million the average retail price per purchase is far below where it was ten years ago.

This section will review both what has happened and look at what might happen in the next few years as technology continues to evolve and the structure and operation of some of the current sectors continues to evolve and change; and look at these and their effects on the sector plus how sectoral players can best seize the opportunities they offer.

While 2009 (and probably 2010 at the very least) will be a challenging time in the bigger economic scheme of things, the events that are occurring in today's world can only add to the continuing challenges currently being faced by music as a whole, there is increasing optimism that the many music issues that have arisen and will continue to arise for the foreseeable future will prove increasingly susceptible to solutions that will result in new business models that serve both consumers and creators, and the music industry infrastructure as a whole will evolve into new models either adapted from today's world, or something quite new.

What is very clear already is that often a new model cannot be 'pigeonholed' and what is happening more and more is that previous boundaries – eg. we do A & R plus production, you do promotion, you do marketing you do distribution, either as divisions within the same company, or contracted out, but still essentially part of the recording contract of a label with an artist, are more and more evolving into the forms, many still experimental but with a very cooperative approach with the artists and a team which can be any one of several business entities. An example of this might well be management who constructs the team or alternatively it could be a music publisher. Things are more and more fluid and experimental with every year that passes it seems regarding who does which task.

As the reader will note, developments and changes even in the twelve months that are contained in this report show very clearly that the whole sector is expanding to offer opportunities in a wide variety of ways. Some of these new developments are already functioning but others are still in embryonic stages or still to come to market in an effective way. These will be included in the technology section.

In the U.K. following the Sky/Universal Music partnership to create a music download service and the prediction that bundling it in with the broadband or set top box subscription will be inevitable, it seems that Virgin Media – Sky's biggest rival – is also looking to partner with a major, or several major labels, but many knowledgeable observers say the obvious partner is Playlouder, the independent that for five years has pioneered the concept of licensed file sharing bundled with ISP subscriptions would be ideal as Playlouder is already set up as a 'white label'. The bottom line is essentially making music feel free by bundling it with high value products such as mobile phones or broadband subscriptions. The real question is whether music fans in the U.K. will prefer the licensed file sharing of Playlouder or more conventional download stores such as Sky or its rival 7Digital.

In the games field, Microsoft says it is providing 38 million downloads per month through Xbox 360 music games and this amounts to more than 80% of all downloadable songs for music games such as Rock Band

and Guitar Hero. More than 2 million copies of Rock Band have been sold for Xbox 360 in the U.S. alone and music is the second most popular console genre, passing sports in the last few months.

Speaking of Napster, Best Buy announced in September that it would purchase the 'New' Napster for \$14 million. However, this problem remains that very few consumers want to rent music. However subscription repackaged into a mobile handset or ISP might well revitalize the concept as Best Buy has the wherewithal to bundle it with devices and sell it in its stores and so become a serious competitor for Nokia and others.

As already pointed out, the year 2008 was noteworthy for the rapid growth of new marketing and distribution approaches pushed by technology. While the music industry had hoped to ride out the recession and used the fact of being a low cost item to bolster its contention, the reality according to year end figures is turning out to be very different unfortunately, with CD sales for the last quarter of 2008 well below those of 2007 and digital sales growth also flattening out. However there is some good news, but unfortunately mostly for major labels, in the deals being cut for major advances for new licensee/digital providers, such as the 'Comes With Music' approach from Nokia Mobile and others like it. The reality in all of these is that the independents see little or nothing of these funds, either actual cash or equity participation as do majors. It is to be hoped that the efforts of Merlin to license these rights on behalf of indies will change this.

Speaking of majors, one of the key events of 2008 was the finalizing of the Sony/BMG purchase in a deal valued at \$1.2 billion with both sides of the deal hoping to come out winners. In particular Sony hopes to harmonize its music and consumer electronics divisions to create new synergies, to quote this somewhat overused phrase!

Hopefully a new sense of reality in the creative process is also taking hold, the concept of the music being the critical ingredient for the consumer is once again taking hold over an 'it's just about the marketing' concept. As Lyor Cohen of WMG remarked at 'In the City' in Manchester England, "these days labels are taking very few chances, and both material and the artists have to show great potential." Indeed at Popkomm 2008, the central themes were the three Cs – Creativity, Communication and Commerce.

In the live music sector, it seems that many indie bands are finding creative ways to survive and prosper. In a recent NYT interview, the Drive By Truckers, a Southern rock band noted their success was achieved from constant touring, attracting a following through the Internet and with ticket and merchandise sales doubling in ten years are making a reasonable living doing it. Obviously a hit record would be nice, but as the old saying goes – if you're not on the field, you can't play the game, and staying connected always gives you chances for a greater success. Ironically this method is easier for the 'indie' approach that's trying flat out for mainstream success that requires a great deal of upfront investment to even play the game! The good news/bad news is that while opportunities such as music use in games, music enabled phones, synchronization usage etc. continues to expand, record sales continue to decline while the music share of entertainment spending as a percentage of the overall continues to drop.

Changes in relationships with major labels, particularly in Canada, are also becoming more evident as independents will partner with majors either across the board or project by project and for those with clout, a record company becomes a partner not an owner, only sharing in revenues and not controlling them. This is particularly a reality in Canada given the access to funding sources not available to majors, which offers opportunities for creative thinking on new ways to cooperate and bring artists to market.

These changes manifest themselves in other ways today. The new label chiefs talk of a 'multifaceted' approach and not just selling CDs but also undertaking merchandising and management are valid approaches if done well.

Managers are expanding their companies to include other facets of the business including records and are coming at things from a different direction and competing with both record companies and the Live Nations of the world. Indeed according to Terry McBride of Nettwerk, assuming that the necessary funding is in place, managers start off with a clear advantage, given that artists have become essentially masters of their

fate in many areas, and managers and artists often start with over 60% of all revenues generated. To illustrate this shift, Linkin Park's manager noted at Muxexpo in LA that while ten years ago the first priority was getting a record deal, this has now sunk to number five on the list with touring being the key priority. While majors say they still play a big role in artist development, in a large number of instances it is very likely to be the indie company, the manager or the music publisher who does this, a point made by David Vodicka of Australian indie Rubber Records. Indeed, someone joked at this event that instead of concentrating on 360° deals majors should concentrate on selling to an audience from 3 to 60. Given the depth of their catalogues, this is not bad advice if you think about it!

In the world of digital sales, sales have increased but at the same time seem to be flattening somewhat, a worrying trend if it continues. According to Sound Scan data, Canadian digital sales as compared with the U.S. are still somewhat lower. However online services in Canada began about 18 months later than in the U.S. and in both 2006 and 2007 Canadian digital sales grew much faster than in the U.S. and the percentage of digital to physical sales are also catching up. 2008 continued this trend with Canada still running about a year behind the U.S. but closing the gap.

IFPI data to mid 2008 shows digital sales rising by 25%, year over year and accounting for 22% of all recorded music sales compared with 15% in 2007. The growth in digital sales is pretty constant across world markets with digital gaining substantially in all markets.

In other digital news, Amazon has launched an MP3 service to challenge iTunes in some markets. While they are far behind iTunes in sales, their entry in the U.K. has sparked a price war initially with major new album releases at less than half the iTunes price.

However commentators believed that its real advantage is being DRM free, an advantage over Apple that has just been eliminated, but the problem for Amazon, along with other new entrants, is that their revenues come from digital sales, while Apple/iTunes generate most of their revenues from the device (iPod) sales and unless Amazon has a better deal for content than Apple (unlikely) they won't be able to maintain their super discount prices and still be profitable.

Also launching in the U.S. (shortly in other markets including Canada), My Space Music had delivered a million song plays a week after launch. However there were very few indie products included in this number, as the company had gone the usual route of cutting deals with the majors against a big advance and also often an equity stake. Neither of these benefits were offered to indies such as A2IM members or companies represented by Merlin, although deals were cut with The Orchard and IODA where they represented the rights of indies in this regard as their contracted digital distributors.

Another digital service provider, eMusic announced in November it had sold 250 million MP3 downloads since 2003. The service is available in the U.S., Canada and the E.U. in 26 countries and contains over 4.5 million tracks. eMusic noted that the latest 100 million downloads only took about one third as long to reach as the first 100 million. However as noted earlier, downloads in all of their forms do not appear to be giant sales makers. The real beneficiaries seem to be broadband ISPs.

Warner Music Group, like Universal Music Group, saw substantial digital sales growth in the first three quarters of 2008. Warner's were up 27% to \$167 million while Universal grew 33% in the nine month period and also made up for loss of physical sales said Universal. And finally in digital news, Forrester research in a report published in late November predicted that industry digital sales will rise to a 41% share of sales in 2012 from about 20% now but will not fully compensate the sector for declining CD sales in the same time period.

In a recent story on video games, The Economist noted their popularity worldwide but cautioned that while they seemed to be recession proof, 2009 had yet to prove this theory. As far as music related games, the success of both Guitar Hero and Rock Band are almost mythical with over \$1 billion in sales and 50 million tracks downloaded. However while they are serious money makers for music, questions have arisen regarding the monetary worth of each track, with WMG in particular being very vocal in this regard.

While these two games are the big hits, new entrants such as Wii Music, Ultimate Band, Rock free and Pop Star Guitar will also be competing for the consumer dollar as well. However, probably the biggest news for 2009 is the announcement by MTV that, through a deal with the Beatles, it will be releasing a video game featuring the group's music.

Clearly the music business will continue to change and evolve but in today's world it is equally clear is picking the winners and the losers will be anybody's guess. The variety of options from bundling music into current market options in a variety of products, streaming, à la carte sales, access through social networks, etc. etc. are all approaches and mostly based on educated guess work and all of these leaps have to be made to find out which concept (or concepts) will actually work. In a world of disruptive change companies with a model that is currently successful will have to most difficulty in adapting according to 'The Innovator's Dilemma' by Clayton Christensen. Or to quote Seth Godin, "a fearful trapeze artist is usually a dead trapeze artist". Given the realities of CD sales today however there would seem to be little option for companies big and small but to pursue innovative approaches. When this is combined with the current stock market reality of all time lows in WMG, Live Nation and Sirius/XM shares, it is clear that change is not just in the wind but blowing at close to hurricane force for music whether indie or major, Canadian or foreign.

BIG ISSUES ADDENDUM

Last year's report noted several big new issues in 2007 and what follows is both an update on what happened in 2008, and where these might go in 2009.

However, how and in what manner each of these issues will be ultimately resolved in the future given the owner/user/consumer realities in each plus the necessary involvement of governments and regulatory bodies, both nationally and trans-nationally for most of these issues is still a matter for conjecture in most cases.

To run down the issues from last year in order;

1) The response in France to illegal downloading. This issue is still very much on the 'front burner' but clearly has proven more difficult to bring to fruition than at first thought even with the support of the President of France. While the French are still going ahead, the European Parliament has reservations on privacy etc., and as to whether the 'three strikes' proposal would stand up legally and it voted against such a law in Europe. However this vote is non-binding on individual States it would appear, and France has vowed to proceed anyway. Meanwhile in Britain there has been considerable government support on the issue but a different approach has been taken with the government preferring a commercial solution. However this comes with strings as the Minister Andy Burnham has made it abundantly clear to the ISP's that a payment system has to be worked out or the government will go ahead and legislate in 2009. This brought the ISP's to the table and resulted in the signature of a Memorandum of Understanding (MOU) by both sides to proceed with negotiations, with the aim of reaching a commercial solution sooner rather than later.

2) The Microsoft bid to purchase Yahoo was 'on again – off again' during the first half of 2008, but finally was called off both for commercial and regulatory reasons it seems, combined with heavy lobbying from Google and given the current economic turmoil, may or may not be revived in 2009. In the meantime Google can go back to eating Yahoo's lunch said one commentator. However the many issues that surrounded it – the dominance of Google plus the potential major restructuring of the advertising business across the globe in the future certainly haven't gone away and can be expected to become major issues in 2009 and on as technology and national economies continue to evolve and react to 'real world' circumstances and situations.

3) Following on his keynote speech at MIDEM concerning the ISP problem, Paul McGuinness has continued to pursue his campaign and in a major keynote at the Music Matters conference in Hong Kong in June, made a variety of cogent arguments and substantive points to back up his January comments.

In particular he noted that the major record business is at last redefining itself in the face of modern realities, something that the indie sector has been involved in already for quite a while. However while there is enormous interest in monetizing 'access' to music what this all means is as yet not at all clear. In a world where a generation doesn't want to pay for content other, ways to achieve this may well have to be found – the money has to come from somewhere and the simple fact remains that monetizing in an environment awash with unauthorized free content is very difficult. Indeed this problem, that was previously a musical one, is now rapidly spreading across the cultural and creative content world and notably to movies, newspapers and more recently to books and major league sports broadcasts. In his view the answer to 'where has all the money gone' is simple – to satellite/cable operators, ISP's, device manufacturers and P2P software companies and he cites many examples of this. Clearly the McGuinness approach is very well argued but this is increasingly not even just a music problem but a cultural sector problem. Indeed this subject was the basis of articles on 'Digital Socialism' and the 'Tyranny of the Consumer' which strongly criticized advocates of free use and access and their arguments and concluded that Milton Freedman was right; "There is no such thing as a free lunch" and the lunch wanted for free should be subsidized by advertiser, live performances, merchandise, etc. or just about everyone except the majority of individuals actively consuming music!

4) New approaches to sales and marketing continued through 2008 with some working out very well and some not, plus expanding their scope to new and relatively unknown artists but the current reality is that all of these examples continue to be the exception not the rule for a variety of 'business and market reality' reasons. Specific comments and examples of some 2008 projects will be found in Section 5 of the report.

5) The live music phenomenon continues to evolve with Live Nation continuing to expand its 360° concept with further major signings including Canadian group Nickelback. However they appear to be suffering through some internal dissension with the departure of Michael Cohl, while at the same time having their shares battered on the stock market. Obviously in this regard they are suffering in the same way as a wide variety of companies but also there are concerns about the concept itself and the timing involved. This is perhaps an unfair comment given that almost no one predicted the 2008 market mayhem but the reality is that this is a fact of life, and life is very often unfair.

6) While some new approaches are showing signs of success, many did not in 2008 and examples of this whole area both positive and negative will be presented in more detail in Section 3 on New Technologies. However the 'poster child' that we quoted last year – Q-Trax – does not appear to have progressed too far in 2008, once again highlighting the reality that new approaches often sink through hitting unforeseen reefs as they succumb to timing issues of the –'it's often better to be lucky than good' type!

7) The issue of user generated content and the many issues of rights and payments continued to be very much front and centre and continues to grow in both importance and discussions about how best to deal with the plethora of issues involved in a wide variety of industries. Just as an example, a short list of these would include investment, music, video, mobile, radio, newspaper, advertising and technology issues. Given such a wide ranging and inclusive list, obviously these will continue to play a substantial role in both cultural sector, business and policy roles both at government and regulatory levels for many years to come.

8) Finally a review of the EMI Music purchase by Terra Firma and a short update on what has happened in 2008. First the basic numbers followed by a brief commentary based on the Annual Review (AR) of EMI's performance by Maltby Capital, the entity that enabled Terra Firma to buy EMI in August 2007 through a highly leveraged \$8 billion deal. Again timing is everything as getting the money in August 2008 could have proven somewhat elusive to say the least! The report covered the last four months of 2007 and the first eight of 2008. It contained major criticisms of previous management in terms of both operations and

corporate governance and offers a radically new vision of a modern record company with a new executive suite with many from outside the music industry. While details of the implementation strategy were not disclosed, Billboard reported that it involves four key elements – consumer focus, innovation, strengthening artist/fan relationships and digital.

In raw numbers, revenues were down about 25% while expenses (due to write downs, write offs and settlements) were up 25%. Gross operating profit was also down by 25%.

The AR has several objectives – to emphasise the clean break between the old and new EMI, to indicate and establish the new priorities and to offer key comparisons between old and new but as the report clearly states, 'this will not be a quick fix'. Indeed first informal indications are that a turn around in both expenses and revenues is occurring, however market share in the U.S. and the U.K. in the first three months of the new financial year are still marginal at best.

The AR also makes comments on previous management practices and while some of this can be attributed to 'distancing itself' it is also interesting to note the lack of effective metrics in many areas to guide management. At the heart of this critique is the accusation that EMI, while presenting itself as a 'fast mover' failed to digitize its catalogues and failed to understand changing consumer behaviour.

TECHNOLOGY ISSUES – CHANGES/DEVELOPMENTS

Change and evolution of varying types and degrees in the Canadian and world music sectors is an ever present constant in today's world given the continuing flow of new products, technology and models which cause the changing environment that Canadian artists and their representatives constantly face in getting attention for their work and also in competing with works emanating from around the world. They are working to reach out to a consumer faced with a multiplicity of choices plus in 2009, a new part of the equation - a major turndown in the economy.

As noted in previous reports, if one briefly reflects it seems that more and more the only constant in the equation is change. That said, it seems reasonably clear that change will continue for the foreseeable future to be a factor in all areas of music from creation to marketing to distribution. The key issue will continue to be consumer acceptance of changes. The whole sector is in the middle of working through enhancing current models and effectively assimilating new models that are products of technology.

This section will endeavour to give a brief but hopefully comprehensive overview of what happened in 2008 and where things might be heading in 2009 plus at least a sense of the market potential. The major news of course is the announcement by Apple that by April they expect that iTunes will introduce variable pricing for its downloads as well as removing DRM, thus matching non Apple services such as Amazon etc., that are already selling DRM free. However first some comments from a recent Pew Associates survey on the Internet today (Internet 2 and what an Internet 3 might look like in 2020). The survey conducted with about 600 leading internet activists, builder and commentators and 600 stakeholders entitled 'Future of the Internet III' not surprisingly produced a wide variety of opinions, predictions and suggestions far too numerous to go into here about the coming changes in society and its structures around the world from a vast number of perspectives. However in the context of this report, the focus is on music, and to some extent allied cultural industries. It appears pretty clear that Pew feels that change will continue until 2020 as society transforms itself and leaves the 20th century behind in many first world countries to begin with and then in other markets. Indeed the expansion of the Internet seems inexorable. A Cisco Systems report projects that by 2012 the annual volume of IP traffic will reach half a zettabyte. To clarify, a zettabyte is 1000exabytes, which already allows access to a phenomenal amount of data, but a zettabyte will be the new milestone beyond 2012. The Cisco report also predicts growth by a factor of six for IP traffic between 2007 and 2012. In fact there seems to be a close analogy between the start of the 20th century and this one. There were also many major inventions occurring around the turn of that century – automobiles, electricity, movies, telephones, radio, etc. but all of which only

really 'took off' in the 1920's as citizens, government and society in general became comfortable with all of these and they become just another part of life. A similar pattern seems to be evolving now with the well known generational divide of the Net Generation and the other generations as described by author Don Tapscott in his books 'Growing Up Digital' and 'Grown Up Digital' and how this new generation thinks and operates compared to previous ones. Again this is a much bigger picture than just music, but one that has profound ramifications for music nonetheless. This new generation are already 'changing the game' in many respects and as they enter the workforce in numbers will also cause a revolution there as well. However a simple look at generational dynamics shows that this change-over will continue to grow over the next ten years and by 2020 will be a major societal force. This fact is already clear in news reports that younger and younger kids are asking for electronic and tech 'toys' such as Nintendo Wii, iPods, iPhones and digital cameras, plus they consider emailing to be outmoded and only text message plus they have contributed substantially to helping to create the new buzz word of 2008 – twittering.

A recent article in 'Wired' magazine lists some 'disruptive' technologies in music making; the iPhone and its competitors such as the Blackberry Storm that go beyond music playback and into music creation; open source audio software such as Audacity and Koblo Studio, by using open source anyone can now record, edit and produce music for free; virtual synthesizers that allow musicians to customize their sounds in ways unimaginable in the old hardware world and finally portable digital recorders that contain many advanced recording features and are virtually distortion free at any level.

With its launch of the second generation iPhone in the U.S. Apple sold over a million units the first weekend and with the iPhone and the newly announced Blackberry Storm products that are in direct competition, music through phone devices will definitely be one of the stories of 2009. However, for a variety of reasons, uptake of mobile continues to be slower in North America than in Europe and Asia.

New projects/products announced in Canada in 2008 include the MuchMusic and Rogers Multiplatform Musical Experience with a live concert show at "Live in the Lot" featuring 'Fall Out Boy' available cross platform and with ancillary tie-ins and promotions. Also in October, Corus Radio launched a new music discovery service – Music On Air and Online with Alan Cross on its rock stations. Cross will also bring his expertise to Splice Interactive, the interactive arm of Corus Radio.

In another development Toronto based GlassBox is launching AUX, a new multiplatform channel, which is a mixture of music content videos, live performances, interviews, profiles dedicated to emerging music in Canada. It has plans to showcase both new and established artists and will be available via mobile, VOD, podcasts and conventional television. It will add to the already operating BITE TV which is currently available on cable, satellite and IPTV as well as mobile carriers and leading broadband services.

In a recent interview a Jupiter Research analyst commented on DRM uses in general and stated that it isn't going away anytime soon even though Napster and Amazon are selling à la carte without it. He cited two reasons – the 'lost generation' of consumers accustomed to getting things free and also the continuing dominance of iTunes in the à la carte sales field. However although we now know the iTunes circumstances will shortly be changing, he feels that these sales may remain a relatively niche business, particularly with new concepts coming on stream such as the Nokia Comes with Music "all you can eat" approach. There are many different variations on this concept but the reality is that they all need DRM to work and he fears that DRM may end up being even more complex in the future. No one has yet discussed an 'all you can eat' DRM free approach and is frankly not likely to in the immediate future.

However in this context one should certainly not forget the 'other side of the coin' to technical protection measures, that of rights management information (RMI) otherwise known as digital watermarks, which could well be a substitute in many circumstances for DRM. Let us not forget the WIPO treaties oblige signatory nations such as Canada to enact legislation dealing with the circumvention not just of DRM but RMI as well.

Eric Garland, CEO of Big Champagne, states that analyses of watermarked (RMI) traffic can be done with 'forensic precision' and would be a huge benefit to owners in establishing a burden of proof that their businesses are being damaged and therefore to their bargaining power with ISPs etc.

A new study by the Economist intelligence Unit sponsored by the Business Software Alliance places Canada in sixth place in the world in IT competitiveness up from ninth last year, but noted that despite good scores in IT infrastructure and human capital, Canada lags behind other markets when it comes to fostering a legal environment that gives strong copyright protection. The survey looks at more than 60 countries worldwide.

In a recent press release iLike of Seattle, the leading social music discovery service says it now has over 30 million users and has unveiled a new ad platform for concerts and full song playback through Rhapsody, plus concert promoters, venue agents, booking agents and indie bands can now use iLike self service advertising tools to reach music fans across the top social networks in a wide variety of ways, plus developers will also be able to conveniently add music to their websites via iLike. Music fans can enjoy the enhanced experience of full length song playback with a monthly threshold of twenty-five uses. At the same time, for artists and labels iLike and Rhapsody are deploying a new model that will monetize music consumption.

In competing announcements Apple announced its new iPod Nano while Microsoft announced a new version of Zune with new features. To no one's surprise, Apple got about 99.9% of the press! Depending on which report you read somewhere between 200 and 600 online music services of various types and business objectives will be coming on line in 2008 and 2009. However the overriding opinion is – no surprise – that most will fail, something that seems very likely anyway in today's environment, but which given the increasing power and control of the major players would appear to be an even more likely outcome.

To give an overview the following are a few of the better funded examples that at least stand a chance of getting established.

Amazon owned Createspace has added an MP3 distribution service that will enable indie musicians and labels to sell downloads through its Amazon MP3 online store with no set up fees involved. Artists would receive about 60/65 cents per track depending on the pricing at retail. This would undercut other services but CreateSpace doesn't offer distribution to iTunes and others.

A gaming powerhouse is coming to Canada with the merger of Silverbirch with Lighthouse Industries. The GM of Silverbirch Gaming notes that up until now it's unprecedented for a Canadian company to become a fully integrated developer and publisher of games for all platforms and genres and expects this new company to be a big benefit to Canadian creators and artists.

Google announced the launch of a new browser in September which is also effectively a new operating system. It would appear that Chrome is a declaration of war against Microsoft and Netscape, and while the odds on Google in this contest are good, it is certainly by no means a slam dunk. Google believes that the future is running applications on the web and already runs the biggest and most efficient data centers on earth. However given the power and resources of the two protagonists a short term definitive outcome, unless it is negotiated, would seem unlikely.

And to conclude this section a few thoughts, facts and comments on a couple of issues.

The first is mobile phones. If they are indeed to be the future of the music industry independent artists should be worried. Unlike the major labels, until recently the only access option for many indies was to go through aggregators such as Orchard or IODA as one on one deals with wireless operators are rare to say the least and the final deal on offer is just not as good financially as the majors get. Maybe the intercession of indie owned collecting agency Merlin will accomplish new and better payment regimes in the future but for now this is very much a work in progress.

Compounding the problem is that often system operators are turning to third parties in many markets to manage this part of their business and by so doing are cutting off yet one more slice of the pie. Export markets are a vital source of total revenues for Canadian indie artists and companies and there is clearly a problem if total revenues received from these markets suffer a further diminution from this practice.

Finally there is also at least for the moment 'the Long Tail' problem. While online it seems that this concept has benefited indies in the sale of their products that by definition is often niche product, this option seems to virtually be non-existent in mobile phones as purchases are driven by radio airplay or the 'What's Hot' menu of the operators. The Long Tail of lesser known tracks simply plays very little part in the current world of mobile.

Another recent major announcement was that of the entry into Canada of MySpace and MySpace Music. While that should be of considerable benefit to the music sector as a whole, the reality of 2008 and something that, given the current state of the economy, merits serious consideration is that given the amount of money spent to build or acquire services such as MySpace, YouTube and Facebook, advertising is not being attracted in the amount that was expected and financial projections are just not being met.

While this will not of course spell financial doom for any of these extremely well financed companies any time soon, MySpace is generally regarded as a bellwether for the industry as a whole given its size, however it, along with social networks such as Facebook and Bebo are just not 'producing the goods' in projected ad revenues and seem even less likely to do so in 2009 given the state of the economy in most key markets. "The jury's still out on MySpace's ability to monetize" said Michael Nathenson at Sanford Bernstein, a fact agreed to by Peter Chernin, President and CEO of News Corporation in a summertime conference call that preceded all of the fall financial mayhem. The same situation is occurring at YouTube. Google paid \$17 billion to acquire this property but even with the 'best brains' running the operation and a global audience, it could only manage \$31 million in earnings in 2007 with projections only reaching \$175 million in 2012, with very low earning 'page rates' at present. The present situation and the inability of this entire high powered new media to monetize these assets would seem to be a benefit for more 'traditional' media, at least for the foreseeable future.

As is noted every year, new technology is usually very beneficial to the sector with the new opportunities it offers, but as was also noted in last year's report, the 'devil is in the details' and often predictions of success for a particular product or application even by major players with very substantial funding just don't work out as planned. Perhaps to end this section it might be appropriate to use a saying often attributed to Mark Twain that is certainly relevant when it comes to any specific technology application – 'predictions are very hard, especially about the future'!

CANADIAN ARTISTS AND CREATORS

Other sections of this report discuss in more depth many of the issues that confronted Canadian independent artists, creators and their representatives in 2008 and will continue in 2009 and while their talent and determination to succeed in an increasingly complex and difficult environment is without question, the need for united approaches and positive and constructive thinking regarding funding issues, industry relationships with both creators and copyright owners as well as users and the need in these increasingly difficult times is clear for both the music sector and Canada in general, all must work together for the best interests of the sector.

Some of the comments made last year would probably bear repetition regarding the changes being wrought by technology plus legislative and regulatory actions. Also, as noted last year, the competitive environment amongst countries wanting to promote and develop their music sector and increase exports continues to grow and given today's economic realities is becoming ever more competitive. The need for all parties

involved to work together as much as possible and to combine to make the best and most effective uses of funding dollars, using both best practices and reasoned rational approaches and programs backed by good research and information will be increasingly important in 2009 and onwards.

However while the environment generally is a challenging one the good news is that Canadian artists continue to be recognized and respected by critics and consumers not just in Canada but also markets around the world. Canadian success is being recognised not just in the U.S., U.K. and France but other major markets such as Germany, Italy, Japan and the Netherlands, not to mention a host of smaller markets around the world. 2008 was a mixture of old and new for Canadian artists with such stalwarts as Neil Young and Bryan Adams touring during the summer and playing many sell-out dates in a variety of different locations and countries.

However, clearly the biggest Canadian success was, to no one's surprise, Celine Dion in her return to her hometown of Montreal for an extended series of sell-out concerts at the Forum in Montreal, which proved to be one of the top concert dates of the year according to Billboard magazine.

Leslie Feist continued with another very successful year and followed her Grammy nominations with a string of Juno wins, continued to sell lots of records not just in Canada but also in many other markets, as 'The Reminder' and the song '1,2,3,4' continued their popularity. She also increased her exposure through a solid touring schedule as well.

The Polaris Music prize launched its third edition and the depth of talent in Canada was yet again demonstrated with such artists as Kathleen Edwards, the alt-country singer, the very literate rock group from Winnipeg the Weakerthans and psych-rockers from Vancouver, Black Mountain being amongst the nominations, there was substantial media coverage from the mainstream media and not just music oriented media.

On a different level of highly successful rock group Nickelback joined Madonna, Jay-Z, Shakira and U2 on the Live Nations roster and it will be interesting to see how this plays out in the future, particularly given the departure of Michael Cohl who was clearly a key player in the equation.

Two labels who continued to clearly believe in and support their artists very closely showed up regularly in 2008, namely Arts and Crafts, home to Feist, and Nettwerk, who continued their many innovative approaches to the music sector in two new ways by partnering with leading game creator Electronic Arts to form a new company, Artwerk with the objective of signing new and established artists in the recording, publishing and distribution areas to expand the resources and opportunities available to both companies but now with a combined approach that can only benefit artists both Canadian and foreign. On a totally different note, Nettwerk Music Group has joined with Naxos Music Library the streaming audio resource with the result that the Nettwerk catalogue of Canadian artists will be available through the Naxos Music Library.

Turning to year end numbers, the name to mention is clearly that of Celine Dion, not only did she sell out a series of concert dates in her home town of Montreal, but also performed sell-out concerts in Toronto and Vancouver as well as many other venues. Indeed of the top 10 concert dates for Canadian artists she had 9 with the only exception being Leonard Cohen in Dublin who had the third best concert earnings in the top 10 dates. Celine Dion also featured with the top selling album with 'Taking Chances' selling 319,000 copies. The top song on the Hot Hundred by a Canadian was 'Dangerous' by Kardinal Offishal, Hedley had three chart entries, with 'Don't Call Me Baby' by Kreesha Turner also achieving a high Hot 100 ranking. The same artist was also the number one emerging Canadian artist while the Vancouver group State of Shock on the Cordova Bay label placed two songs on the emerging artist lists.

The music critic from the National Post listed albums by four Canadian artists amongst his album of the year choices – In Field and Tower by Hayden on Hardwood Records, Roberto Occhipinti on Alma Records, Plants and Animals on Secret City Records and Point Blank on Koch Records. The choices ranged from hip hop through the ballads of Hayden to polyrhythmic jazz and the intricacy of the songs of Plants and Animals.

As every year demonstrates, the talent of Canadian artists continues to shine through however the fact remains that strong and enduring financial and program support is critical to expand their success outside Canada.

To close this section, speaking of success in any year and in any time it would be almost impossible to top the success in the U.K. at Christmas of a 74 year old Canadian writer/singer, albeit a greatly renowned one from Montreal, Leonard Cohen who on the extremely competitive Christmas week chart had not one, not two, but three versions of his song 'Hallelujah' at No. 1 and No. 2 with different artists performing cover versions, but also his own version at No. 30 on the chart as well. If anything shows the talent and diversity and success of Canadian creativity, it is this example which there is little doubt will be very hard to surpass in the future!

MARKETING AND PROMOTIONS, CHANGES AND DEVELOPMENTS

As already noted, 2007 was a 'momentous' year of change but was easily surpassed by 2008 as new providers entered the market and new and innovative marketing methods continued to gain traction amongst consumers. While many of these had their genesis in the Internet, these were not the only source of inspiration as the music sector continues to offer ever growing numbers of opportunities.

While some of these opportunities are restricted to primarily major players, some as will be seen, are more open to smaller players and can produce very positive results. Given the opportunities on offer, the issues involved with each from many directions – financing structural development, market appeal, marketing budgets, etc., etc., this section could approach the level of a long report in itself. Consequently the editor's pencil will be used in a substantial way to try to fit into the structure and concept of this particular report!

While the need for new and evolved versions of older systems are clearly needed to market effectively, what shape these will take is still a very open question as we enter 2009 and answers may well not become clear in many cases until two or three years have elapsed.

This being said, the following is a relatively brief look at marketing thoughts and concepts as they have evolved in 2008 and their relevance to 2009 and onwards. However to reiterate a previous comment, the old style 'silo' system of marketing and promotion as a distinct entity is being subsumed into a more holistic approach with a concept that crosses many boundaries, and while these concepts are open to discussion and opinion as to what these initiatives actually involve, as noted above they are a result of a more holistic approach that the internet has brought to the record business particularly as the various 'installed bases' and interests jockey for position in the new set ups. However, whatever the outcome of any individual initiative, the need for effective new revenue streams and sales/marketing opportunities is becoming an absolute imperative for Canadians if artists, creators and all of their diverse representatives will continue to be both viable and successful in the second decade of this century. The most likely outcome is probably that many different products, revenue streams etc. will become part of the overall package for artists and copyright owners in the future and monies will be generated in varying amounts from a variety of sources with results ranging from large cheques to a few dollars. However as noted earlier, in today's world it is very unclear which service or product will be a success and indeed they may very well vary from year to year as circumstances change and providers and products evolve. To give some examples of what might occur the following are some current examples followed by some comments on each regarding their future potential.

A very specific area is that of retail exclusives. These clearly only apply to major successful artists looking for a big and guaranteed pay day. The key U.S. releases so far have been The Eagles, AC/DC and Journey through Wal-Mart, Guns 'N' Roses through Best Buy and Christine Aguilera through Target. Sales have been mixed to say the least varying from a low of 140,000 to a high of 3,140,000. It would seem that while

these will continue in the future for specific artists, they will have to have high recognition going in and therefore will be limited in numbers to known names and given they are a product of an old style record business just may not have enough 'big names' in the future to use this approach, even though Bruce Springsteen will release a Greatest Hits through Wal-Mart in January 2009 prior to his appearance at the Super Bowl February 1st. Time will tell but it may well be a version of the Starbucks concept of cross merchandizing that has been discontinued, one assumes due to non-profitability.

DIY approaches to this way of marketing have included both Radiohead and Trent Reznor / Nine Inch Nails concepts and packages that have been extremely successful for both artists but again these are products of the old style 'hit making machine' that gave both a tremendous recognition factor in the market place and enabled them to do what they did. The same thinking would apply to this concept as to the Wal-Mart and Starbucks concepts. There are only a limited number of artists who exist with the recognition factor from old style marketing, and while obviously this might be done again by these artists and a few more could come out of contract, the future is not tremendous in this regard. The same might be said of the Live Nation concept of paying very large sums to major names such as Madonna, U2, Shakira, Jay-Z and Nickelback! However even more directly these options are just not available to the FACTOR funded artists and creators and they must look towards much simpler, cheaper and direct methods. They have to look elsewhere and to emulating some of the concepts that these major players have thought out and apply it to their business plans and aspirations.

A good approach could be for example, to emulate a DIY plan that can be of great help to new and emerging artists. First don't go it alone but look for partners. There are companies that specialize in selling directly to fans and can be of help, others allow clients either artists or companies to sell directly from their own web sites. The main strength of labels has always been marketing. Artists or small indies will need to work hard in this area establishing a good email database and a viral campaign to offer hardcore fans the chance to promote to others. This approach is offered by various companies. Another way maybe would be to promote through an iPhone app for example. The artist or label should also set prices but these can vary both in amount and style of payment depending on the market and also offer a variety of purchase options for fans to buy or subscribe to. Clearly this is the polar opposite of the Wal-Mart, Live Nation or even major label approach, but the joy of today's Internet world is that these options are available. Indeed it was predicted that this was the way things would be in the future.

While this is not often the case, according to a recent Wall Street Journal, this scenario has essentially played out with Wisconsin based artist Justin Vernon and his band Bon Iver. His starting point was posting songs he had recorded on his MySpace page. It proved so popular that he has sold about 87,000 copies of the album, is touring to good crowds and has even appeared on the David Letterman Show to discuss how he did it and play his music. As the WSJ article notes, clearly small unknown artists can gain fame via the Web without having the big budgets and backing of a major label and how bloggers, consumers and viral marketing can 'spread the word' through good music and a compelling story and though he didn't, musicians can use some of the companies mentioned earlier such as Tunecore, CD Baby and Sonic bids to connect with both consumers and industry. As the CEO of Sonicbids Panos Panay says, the Internet has been like the French Revolution for the music industry as the costs of distribution, production and getting connected have dropped and anyone with talent, a niche and devoted fans can make a living.

Of course the many, many new digital distribution system and ideas being launched (currently around 200 it is estimated) – only a few of which will probably ultimately be successful – but all will need product to sell. These new models, of which recent major examples are MySpace Music and San Disk, will have in the case of MySpace a variety of options to get paid from advertising to MP3 downloads through Amazon and ringtones through Jamster, publishing royalties for each interactive stream and MP3 download. Services such as Lala.com also provide service in this instance streaming to small and large alike, although it must be admitted that large is more likely to get attention first! However in between these extremes contained in this section, there are many other options to new and developing artists and their representatives from establishing a solid working relationship with a brand or a games manufacturer for example, though usually brands will usually look towards more established artists to partner with, but there are brands who are

looking for the gritty indie experience. Mountain Dew is one example. The same certainly cannot be said of games if the right connection for indies can be made and the same applies to TV placements and commercials, the opportunities are out there for both promotion and revenues and of course there are all of the accepted promo channels from YouTube, MySpace, Facebook, Bebo, Imeem and a 'blast from the past', a new version of MTV through MTV Music.com.

In this and other sections we have tried to highlight both ends of the spectrum and also tried to indicate, if only briefly, the opportunities that have become available across the spectrum, quite apart from the recognized marketing methods and plans regularly employed by key indie and major labels to get their artists' music to the consumer. All that can be said is that more, and more different opportunities are available and being utilized than ever before as technology continues to provide many opportunities. Ultimately, as always, only time will tell which will be the successful businesses and which will become a historical curiosity. The only thing that can be said with certainty is that new ideas come from within the music sector and some from third parties who wish to establish profit making businesses that are essentially based on music and the overall pace of innovation continues to grow and looks set to continue this growth in the foreseeable future.

DISTRIBUTION – CHANGES AND EVOLUTION

Distribution at retail and wholesale levels in the physical world or melded in the digital world continued to change, evolve and often surprise in 2008, a trend that is clearly set to continue in 2009. Regrettably it seemed that surprises were, more often than not, negative rather than positive. This was the case particularly in the physical realm but the uncertainty of many start ups, for a variety of reasons, was certainly not unknown in the digital milieu as well. The day to day reality was also impacted in the second half of the year by worldwide financial problems and this reality will clearly remain in 2009 and increase the difficulties as sales for all forms of music may well suffer declines. This phenomenon is already happening as year end sales figures become available. Christmas is the time for giving and the giving of music still generally includes a CD or two, rather than digital. However, even with a solid schedule of new releases for the last quarter of 2008, there has been no great optimism amongst music purveyors of all descriptions regarding great sales numbers. At the same time numbers were released showing that electronics sales were off by 20% in 2008 and with a majority of 2009 consumers planning to spend less on electronics, including of course such music related items as iPods and mobile phones. At the same time there are many changes continuing to occur both due to technology and now the economy as well in this important sector.

The problem of physical floor space continues to grow from different directions, first the re-vamping of chains such as HMV to include new products, combined with the de-emphasizing of music CDs, the downsizing of music sales space in the so-called 'big box' sellers Wal-Mart, Costco, Future Shop, etc. and the decline in numbers of independent stores plus the fact that they too are diversifying their product mix away from just recorded music. The days of powerful chains such as Sam The Record Man and A and B Sound and Music World are now completely history with the removal of the iconic Sam The Record Man sign on Yonge Street in Toronto plus the November 7th announcement of the bankruptcy of A and B Sound for the second time following the closure of their main store on Seymour Street in Vancouver in September. At its height, A and B was responsible for \$300 million of business annually, since its beginnings in 1959 with stores across Western Canada. With Virgin and Tower gone as well, the pressure on physical product continues to grow and clearly given the economy will be an issue in 2009 onwards as well. To slightly paraphrase English philosopher John Locke in his comment on an economic crisis in England in the 1690's, -'people don't want to borrow or buy, if their perception of what they see around them dictates this action – even if personally they have the money to do so.' Given reported year-end opinion polls, this would seem to characterize Canadians thinking for 2009 almost exactly. As noted elsewhere, time will tell if music is a 'recession proof' small luxury product or not, but early indications are very divided on this.

The Canadian wholesale situation is also under considerable pressure in many ways as well with two current examples of this being the recent Wal-Mart decision to cut back the amount of 'value oriented' music sold in its stores by eliminating an estimated 40% of titles, a decision that will radically affect Canadian

Budget distributor Madacy. Madacy states that it already has planned on changes and expansion into new areas such as licensing of its catalogues as well as making them available digitally to offset such situations as that of Wal-Mart. Also, late in the year came news of problems at key indie distributor Justin Time combined with layoffs and ongoing plans for reorganisation and restructuring.

It should be noted that this trend is not just a Canadian one but is occurring in the fields of retail and wholesale distribution in most major markets with examples such as the Hastings chain in the U.S. evolving from music into entertainment stores, while distributors in key markets such as the U.K., Germany and Australia have either ceased business or are going through major restructuring. This trend is not restricted to locally owned companies, but to the distribution arms of majors as well who are looking to rationalize their operations, and in several instances cooperate with each other to 'cross-promote' services and thus lower costs.

As usual U.S. figures are far more detailed and substantive than those in Canada, but while numbers – and surveys done – are far fewer there is little reason to suspect that trends are much different and the same would generally apply with some variations to most other major markets as well.

In a recent consumer survey in the U.S. by NPD Group, it was found that the top five music outlets in order were iTunes, Wal-Mart, Best Buy, Amazon and Target. In particular, it noted the growth of Amazon not just from launching its digital store, but also the fact that CD online sales were holding up better than bricks and mortar stores. Similar scenarios are playing out in other markets such as the U.K. where supermarket chain Tesco competes very heavily with more music based chains such as HMV and Zavvi.

Another U.K. retail trend that is certainly causing concern is the recent ultra discounting as Woolworths closes its doors after 99 years and Amazon enters the market. This is resulting in heavy 'loss-leading' on the premium in-demand album over the holidays – the new Take That album - selling at very discounted prices (for the U.K.) of \$11.00 Canadian at ASDA and Morrison's (supermarket chains) and the unprecedented \$6.00 Canadian per album at Amazon as part of their launch. The fear is that consumers in 2009 will not understand or ignore the principles of 'loss-leaders' or 'customer acquisition strategies' and expect these to become the norm in the U.K. for 2009. And in a final note in the 'old world' of distribution, BMG Music Services announced that at the end of 2008 it would stop accepting new members into the record club, thus marking the end of the once ubiquitous 12 free records for the price of one opening offer to new members that the club was known for.

At their height, BMG and their rival Columbia House contributed substantial revenues to the value chain, but in recent years have become close to irrelevant. Columbia House continues in a reduced, revised form but is only a shadow of its former self.

An example of the power of key retailers of music such as Wal-Mart can be seen as an all-star lineup of major artists played over three nights at the University of Arkansas arena for the benefit of who else but Wal-Mart executives, staff, their guests and selected members of the public.

While everyone is looking to maximize the lifespan of the CD while substantially increasing digital sales, a trend (albeit a small one) in the 'who would have thought it' category, is the return of vinyl – both the LP and the 45 rpm. This began with dance electronic singles but has now spread to other genres with majors such as EMI announcing a reissue program of major artists. The appeal is both 'retro' plus the fact that they sound 'warmer', especially on high end equipment, have the full graphics package and sell at premium prices in the \$25 - \$30 range. Sold mostly at indie stores EMI noted that sales in 2007 increased 80% with U.S. shipments up 37% to 1.3 million units. However on the other side of the coin, music DVD sales in the U.S. have dropped considerably from 8.55 million units to 6.97 million in the first six months of 2008 with a similar drop in the U.K. However, worldwide these drops seem to be less pronounced with 2007 sales of 110 million units.

Indeed as Terry McBride, CEO of Nettwerk remarked, “shelf space has shrunk so much over the past five years that for anyone to give you shelf space and exposure is a big deal.”

As noted in the previous section of this report, Wal-Mart continues to exclusively market a few selected releases by major artists with heavy promotion, good prices and excellent sales, but it is essentially a ‘major name’ market. In the area of digital the focus in this report will be on the two key players in the field – Apple and Amazon with overview and comments on new delivery systems and their potential plus some of the problems.

While iTunes is far and away the biggest digital seller with 70% of world wide digital sales by 2012, if digital sales projections hold up, Apple is on track to get 25% of all sales worldwide by 2012 according to forecasts. However, some questions as to its validity as the best possible sales tool for all types and genres of music remain and whether it will substantially increase sales with its new policy of variable pricing plus removal of all DRM by April this year.

There are two schools of thought on this, both with strong proponents but if one stands back and looks, the evidence seems to be that in a particular circumstance either can work, but a third option that is available will probably be less successful. The two successful approaches are the old line rock artists of which the most recent examples are Kid Rock and AC/DC with their latest releases who insist that their albums be sold ‘whole’, something that iTunes refuses to do. As a result, both are not available on iTunes, but are two of the year’s biggest album sellers. As Eric Garland of Big Champagne notes, Kid Rock may have left some transactions on the table, but in the end it is very hard to make the case that he left money on the table by his actions, a comment that also applies to Black Ice by AC/DC as the fourth best selling album of the year in the U.S. at 1.6 million.

The opposite approach is that of Leona Lewis with the best selling digital single of the year at 3.3 million tracks with 140,000 digital albums sold apart from about a million CD sales. Counting ten tracks as an album the total sales convert to around 1.5 million, very similar in numbers to Kid Rock and AC/DC.

However for emerging artists the results could easily be far less successful, as evidenced by the American Boy/Estelle single from the album Shine. The track was a top 10 iTunes download with the album at #38 on the chart when Atlantic removed the single from iTunes in a bid to force album sales. However album sales dropped rapidly and the label changed tactics pretty quickly and restored the single.

However it should not be expected that Apple will hold still to be attacked by Amazon and others and indeed they have several options – to beef up the ‘Complete My Album’ approach for single track buyers, start a music subscription service or an ‘unlimited music’ iPod just as examples, on top of their new pricing and DRM approach that has just been announced. Turning to Amazon, while it still trails far behind iTunes overall, its percentage of digital album sales to single sales is twice that of iTunes with labels hoping that it will expand the overall market as Amazon customers are mostly male with one third from 28 to 35 and one third 36 to 50, substantially older than iTunes. However for Canadians, it does not exist here and does not have any immediate plans to open. As noted earlier, it has just opened in the U.K., its first foreign market.

Overall, digital sales for the first nine months of 2008 continued to grow according to Nielsen Sound Scan numbers with U.S. digital track sales reaching 795.8 million in the first nine months of 2008, up 30% from a year earlier. Digital album sales grew 32% to 47.3 million or 16% of total album sales compared with 11% for 2007. Amongst digital albums the top seller was Coldplay’s Viva La Vida at 548,000 and in the first nine months four albums passed 200,000 digital sales compared with two last year. Thirty four digital tracks reached the million or more sales mark during the first nine months and seven sold over 2 million compared with 2007 totals for nine months of 26 tracks selling more than a million and two more than 2 million. However while this is good news generally, the fact remains that combined sales continue to decline year over year.

As was noted in Section 3 – Technology, several new approaches were launched in 2008 and while several of these described there did pay substantial fees to be licensed – primarily by major labels – the reality so far is that their actual distribution revenue flows in whatever form they take are difficult to ascertain and while advance payments are welcome to companies' bottom lines there continue to be considerable problems with distribution revenues and issues for many indies and this subject needs considerably more light shed on the actual sales outcomes and much more information than currently seems to be available and should be considered as a work in progress for 2009.

INTELLECTUAL PROPERTY – COPYRIGHT ISSUES

Copyright and Intellectual Property Rights in general continue to be a vital part of the policy realities of a modern developed country in the 21st century and the need for efficient, effective and modern legislation that reflects the realities of today continues to be a necessity. The lack of it over a period of many years in Canada as delay was followed by delay on the part of successive governments is highly regrettable. No matter what one's views are about various issues in the copyright file, the need for an effective modern Copyright Act is surely incontestable in today's real world.

It is therefore pleasing to see the government's words on the subject contained in the recent Speech from the Throne that –

“Cultural creativity and innovation are vital not only to a lively Canadian cultural life, but also to Canada's economic future. Our government will proceed with legislation to modernize Canada's copyright laws and ensure stronger protection for intellectual property”.

The message seems to be clear that the government expects public and private industry to pull together and work to make Canada a leader in innovation.

However in the 'real world' there are many 'usage' problems not to mention ownership problems that need discussion and clarification legally. While there may well be disagreements about the best course of action to take, doing nothing is essentially counterproductive to effective commerce and good governance in this very important area in the 21st century.

While FACTOR is clearly not the body to discuss and address these complex and varied issues on behalf of its clients, equally clearly it has to be aware of the great number of real world situations that are occurring almost on a daily basis that could affect its decisions both in general and specific terms regarding appropriate, properly constructed and funded support programs.

CONCLUSION

As always it seems there are many, many issues for the Canadian indie sector to deal with effectively and each passing year seeming just adds to the list of music sector concerns, as technology continues to drive the bus and provide more problems than solutions. The pace of change continues to be inexorable and the need to respond and adapt always remains a big part of the puzzle. It will be no different in 2009 except that the world of the music business is becoming increasingly complex and involved both nationally and trans-nationally. However what is clearly true is that the consumer everywhere values music more highly than ever. While music is constantly evolving and changing, the growth in consumer appetite is probably an outgrowth of technology that encourages discovery and acquisition. Unfortunately for creators this is against a backdrop of big declines in CD sales and in paid content only partially compensated by digital sales.

As to digital delivery the reality whether it be Orchard, Pandora, Napster, Rhapsody or eMusic let alone major players in the sector such as iTunes, Sony Ericsson or My Space Music few are making much money as yet and many others are swimming in red numbers. All of this is of course a fact even before the

economic mayhem of late 2008. Where things are going in 2009 in the worldwide economy is anyone's guess but the financial prognoses are not generally good.

And yet the power of music, coupled with its Darwinian 'sexiness', maintains a constant interest for entrepreneurs in looking to harness and monetize the phenomenal desire consumers worldwide have for music.

In truth the simple desire of the entrepreneur is very much in sync – consciously or not - with the reality that music is one of civilization's key cultural artifacts that define a people and their human value with immense economic and cultural benefits if the works are commercially successful both to individuals, companies and nations, now and in the future. Examples of this are everywhere in music from the classical music of the eighteenth and nineteenth centuries to jazz and the peoples' songs have stood the test of time for decades. Movies are yet another example of this from classic movies to just plain popular fare. To give just two examples from the recent holiday season, are the movies 'A Christmas Carol' and 'The Wizard of Oz' which have, for different reasons, a timeless appeal every holiday season although both are more than 60 years old. Clearly art and cultural products of all descriptions add immeasurably to a country's worth to the human race and Canada is certainly playing its part in this regard by producing a continuing flow of excellent and popular works in many musical genres.

There is little disagreement these days that part of the prosperity and success of any country and its citizens will flow from its ideas and products, whether it be a hit song or a Blackberry. If all of the underlying royalty streams flow back to Canada, the economic benefits, no to mention the cultural ones can be immense. It is a concept that has to be grasped, understood and properly acted upon by governments sooner rather than later, as the country's underlying economic structure changes in the 21st century.

Indeed if one looks at a 2007 study by Kirk Hamilton, a World Bank environmental economist and lead author of the study 'Where is the Wealth of Nations', Hamilton posits that when measured properly 'natural capital' (land, oil, etc.) and 'produced capital' (factories, iPods, roads, etc.) are less substantial than 'intangible capital' (education, the rule of law, ideas etc.) which accounts for the biggest share of a developed nation's wealth. In the United States, he suggests less than 20% exists in the form of material goods while in Switzerland (clocks, ski chalets, watches, timber, etc.) it also amounts to less than 20% of the wealth. To put it in the vernacular, the wealth of a country is 'between our ears' or to be slightly more elegant – what we know is more valuable than what we make.

It is suggested that this simple statement should be the basis for FACTOR policies and programs to endeavour to make the most effective use of the monies available from the different sources, so as to benefit both the music sector and Canada as a country.

