CD Price Cuts Could Mean New Artists Will Suffer

By DAVID D. KIRKPATRICK

About three weeks ago, a Universal Music salesman arrived at Looney Tunes, an independent music store in West Babylon, N.Y., bearing what he presented as entirely good news. He came to explain Universal's plan to cut the prices of its CD's, and he brought an eight-foot-wide banner promoting Thursday, an up-and-coming New Jersey band.

The response was disappointing, to say the least. "Take your banner and put it away," the store's owner, Karl Groeger Jr., said.

Initially delighted by the promise of lower CD prices, Mr. Groeger and other independent retailers quickly soured on the details of the plan, which he says will hurt independent music stores and developing artists. The plan squeezes stores' profit margins on each CD and ends promotional subsidies to retailers to push new albums like Thursday's.

"I care about that band a lot, and I care about developing artists more than anyone," Mr. Groeger said Saturday in a telephone interview. "But I told him it is a two-way relationship. They are hurting me with these new policies. I don't see why I should help them out."

This week, Universal begins making the first of its new price cuts, starting with new CD's by Sting and Ludacris.

While the company received widespread praise for reducing prices, lesser known, developing artists — like Thursday or the Yeah Yeah Yeahs, who both record on Universal labels — are already finding themselves caught in an unfolding battle between specialized music retailers and Universal over the details of its new pricing plan.

Universal's executives say the lower prices will help all stores and artists by luring more consumers back. And the executives say that Universal will make up for taking away the promotional subsidies to stores by spending more to advertise directly to consumers.

But specialized music stores, midtier artists and small record labels argue that aspects of the new policy may in effect make it harder for new acts to get attention or sales.

In addition to ending various promotional subsidies, these critics say, Universal's new pricing system further squeezes the profits of the hard-pressed independent music stores and specialized chains like Music-land or Tower — the places that typically give artists their start. Such stores have already been closing in droves, with hundreds more expected to shut down this year.

"Emerging artists are going to be shut out because of the fewer dollars flowing to independent retailers," said Robert Haber, founder of CMJ Network, which tracks new performers and college radio playlists. "Things that are not good for independent retailers are not good for emerging artists."

If the policy thwarts the development of new talent, it could boomerang to hurt the major labels as well. Building audiences for the new acts that might become next year's blockbusters is a growing problem, label executives say. The swift consolidation of the commercial radio business and its use of more scientific market research is making it harder to get air time for unfamiliar artists. Meanwhile, mass merchandisers like Wal-Mart Stores and other chains like the electronics giant Best Buy, which seldom stock any unproven artists, increasingly dominate music sales. Mass merchandisers and chains together now make up more than 80 percent of the market.
"If this plays out in reality, it does make it tougher for developing artists and labels who are trying to develop artists," said Ian Montone, who manages the rock band The White Stripes. "It is real tough for the indies, and for the Stripes, in the beginning, that was really where we sold most of our records, at the small mom and pops, not at the chains," he said.

"Anything on the periphery or the fringes will be sacrificed," said Carrie Brownstein of the band Sleater-Kinney, which records on the independent label Kill Rock Stars.

But Universal also faces a market dominated by the mass merchandisers, said Michael Nathanson, an analyst with Sanford C. Bernstein. "It is going to be ugly for the independent stores," he said, "but the music companies are in a no-win position right now."

Universal's power as the largest music company, with about a third of CD sales, means that most retailers and eventually the other major labels are likely to play along. But at least one retailer, Virgin has refused to comply with requirements of the plan in time to participate in the fourth quarter, according to a Universal executive.

And the plan's lower margins could spur retailers to shift shelf space from CD's to other products. Wal-Mart has already told music companies it may reduce its space devoted to music by 15 percent next year because of slow sales and low profits, music industry executives said. (Representatives for Wal-Mart and Virgin did not respond to calls seeking comment.)

The retailers main complaint about the plan is that it squeezes their profits. Under the plan, Universal is cutting the standard suggested consumer price for its new CD's by $6, or almost a third, to $12.98 from $18.98. But it is cutting the standard wholesale price much less. That price was about $12, or in effect about $10 after standard discounts and subsidies. Under the new plan, the standard wholesale price will be about $9 for most titles, with no additional subsidies or discounts — essentially lowering the effective wholesale price by a dollar, or about 10 percent. After an initial outcry from retailers, Universal scrapped a plan to post the suggested retail price on each CD, although stickers will still refer to the new lower prices.

Independent stores and music chains complain that the cut in the profit margin hurts them more than it does chains like Wal-Mart, Best Buy or Target. The specialized stores have fewer economies of scale and less chance to make additional money from sales of other products, like refrigerators or apparel.

In recent years, Universal and other labels have also sought to increase sales of promising new artists like The White Stripes, from BMG, or the Yeah Yeah Yeahs, from Universal, by selling their CD's at effective wholesale prices of about $6.50, with additional promotional subsidies. Universal executives say they will still offer a "developing artists" price of about $6, but without additional subsidies. Independent store owners point out that the developing artists will have much less of an advantage next to more establish acts, especially without promotional subsidies.

The biggest battle between Universal and its retailers is over store space. Although it is scrapping its promotional payments and subsidies for placement in stores, listening stations and advertisements, Universal is still demanding that retailers commit about a third of their total space and promotions to its artists. And it is requiring that retailers give Universal's developing artists about a third of the space and listening stations devoted to such artists. Universal also would have control of which of its CD's get promoted. To placate independent stores, which sell fewer CD's from major labels, Universal dropped the requirement to 27 percent of total space.

Retailers, however, say that they will have little incentive to push new artists, which are typically less attractive to consumers that marquee names like Madonna or Eminem.

"If Universal tries to come to us and say, we are not going to give you any support at all, well, yeah, they are going to have a lot of trouble getting their developing artists in here, at least the ones that we are not sure about," said Steve Wiley, co-owner of Hoodlums Records on the campus of the Arizona State University in Tempe, an influential store owner who has been an outspoken advocate of lower prices.
But Steve Berman, who is in charge of marketing and sales at Universal's Interscope Geffen A&M unit, said the company's new investment in consumer advertising would make up for the difference. "I think we will give our artists a much better chance in terms of developing their message," he said.

Instead of paying stores for promotions, he said, Universal will spend part of that money on consumer advertising to help get attention for developing artists. And, he said, in some cases its advertisements will mention an influential local independent music store, since independent stores are the main outlets for developing artists.

"If I am trying to break my artist in Austin, I look at Waterloo Records, which is an incredibly strong and powerful voice in Austin," he said. "I am going to be able to push the message about the artist as well as tying it to our low price and a store, which, in that case, would be Waterloo."

But John T. Kunz, owner of Waterloo Records, said he was not convinced. "We have a network of local connections to make it happen, and if they try to handle it from New York or L.A. I don't know how it is going to flow as smoothly."

Others wondered about the potential influence of the retail giants. "There is no way they are going to put Looney Tunes in that ad," Mr. Groeger said.