PledgeMusic: Re-Inventing Music Crowdfunding[1]

"If the first frontier was the selling of music, the second frontier was the selling of tickets, the third frontier is the making of those things, that you will then sell. And the fact that 99% of releases don't share the most exciting part is…it keeps me awake at night."

Benji Rogers, CEO and founder of PledgeMusic

Spring is always a magical time in New York City. The tulips were blooming on Park Avenue, and the insanity of the city seamed to pause for a moment as it breathed in new life after a frigid winter. Though the city was in a rare moment of calm, Benji's mind was still racing with questions. His company, PledgeMusic, was in its sixth year and doing well. With offices in both NYC and London, their work reached to across the globe, their website operating in 5 languages. Since PledgeMusic launched in 2009, they had successfully blazed a trail to the third frontier of the music industry, landing Benji and the company on lists such as The Hospital Club 100, Billboard's "Five Digital Startups to Watch" and the Grammy Music Technology Lab.

But what is next? Obviously it was prudent to do one thing well before diversifying to other areas, but when the time came, how should PledgeMusic grow its activities in order to support the artist and disrupt the music industry? What activities were connected enough to their current activities to be a natural move, while being strong enough to be financially sustainable for both PledgeMusic and the artist? And how would Benji know when the time was right?

[1] This material was prepared by Graduate Student Megan Himel and Associate Professor Alexandre Perrin

1. The Music Industry Landscape in 2016

Signing a deal with a record label is the most traditional path for an artist to take. The age-old story of a musician: make a bit of music, get heard by someone at a record label, get signed, and grow your career under the stewardship of a company that knows what it's doing. Record labels traditionally employed artist and repertoire (A&R) representatives to scout for talent; when they found a diamond in the rough, they would polish them up and take them to market. Record labels invested in developing talent, funded artists through the creation and recording process, spearheaded marketing campaigns, and recouped their investments through the sale of an artists' records.

Because of this premise of investment and recoupment, record labels typically own all the recordings (masters) produced as part of a contract, whether or not they are ever presented to market. The label gets to choose *what* goes to market, as well as *when* and *where*. In addition, the label keeps most of the money earned from selling or using the master – artists earns 10-15% of the net revenue as royalty (20% if they have a lot of bargaining power) – and they only see that cash after all the expenses associated with their advance and recording / marketing costs are recouped out of their share. For decades, this model was considered reasonable because the record label assumed all of the financial risk and invested in developing the artist as a performer, not just creating masters.

And there *was* risk involved. Fans are fickle, and artists were often less successful than predicted. In fact, Cann (2007) claims that "*niney-five percent of artists don't recoup their advance, so the royalties on offer are just an illusion. The advance is an amount of money designed to get an artist into debt with the record label and then to keep the artist working for the label.*" Unrecouped artists never see cash from their record label after the initial advance.

Moving forward through time, recorded music earned less money. As a result, record labels tightened their purse strings in order to remain financially viable. Record labels began expecting higher levels of performance, experience, and preparation from an artist before signing them. Sometimes artists were required to have an album ready to go before signing a record deal.

While record sales were falling, and live sales were increasing. A shift was occurring: instead of tours being a promotional activity for recorded music, recording music was becoming promotional material for tours and other artist activities. In response to this, record labels began asking for a share of an artist's other revenue streams, arguing that those revenue streams wouldn't exist without the assistance of the recording to garner attention as a marketing tool. This new contract took on many forms, but became generally referred to as a 360° deal.

As a result, artists got significantly less out of a record deal – less training, assistance, development, and support. Despite being required to provide more on their own and labels assuming less risk, artists began to owe their labels a greater share of their overall income.

Running parallel to this growing issue was the fact that technology was developing. Recording equipment was becoming more affordable: artists could rent studio space on their own, or even create a makeshift studio in their home. Both these alternatives developed momentum as part of a DIY (Do It Yourself) movement, empowered by services such as CDbaby and The Orchard. Since artists were recording independently, these services allowed artists to distribute their music without the assistance of a record label. Artists were able to maintain ownership of their masters, only sacrificing whatever upfront fees or commissions commanded by their distribution service.

The DIY method is not for everyone though. Without upfront cash, as well as business operation and marketing experience, artists rarely managed to achieve the same reach as they would have through a record label. Labels have teams of people supporting marketing and promotion, and those teams are spread across the globe, allowing for much more reach than an artist typically has on his or her own.

In addition to promotion and global reach, independent funding is a tricky issue. Does an artist pay out of pocket, take out a loan, or ask someone else for help? Kickstarter (a crowdfunding platform) launched in 2009 as a solution to this struggle across several industries. Kickstarter was not geared toward musicians, but many took advantage of it. The service was open to anyone who wanted to create a campaign in which they offered rewards (to be delivered at a later date) in exchange for money immediately.
This became a way to pre-sell products or solicit financial capital in exchange for other activities (a Skype session, dinner, private concert, etc.). The most popular selling price for an item on Kickstarter was $25, but the average spending per pledger per campaign was $70. There was no barrier to entry, making it an appealing choice for DIY musicians. Additionally, Kickstarter only took a 5% commission (compared to iTunes' 30% on any money raised through the iTunes store or a record labels 80-90%), plus any credit card and processing fees (ranging from 3-5%). Campaigns on Kickstarter have an overall success rate of 37.72%; music-specific campaigns enjoy a higher success rate of 52%.

2. The Music Crowdfunding Landscape in 2016

In its simplest form, crowdfunding is the act of taking an item directly to a large pool of consumers (the general market) by way of the internet, rather than trying to pass through traditional gatekeepers. In the general market, examples of gatekeepers are angel investors, venture capitalists, and large corporations that buy small projects for individual or smaller developers. In the music industry the most commonly noted gatekeeper is the record label; but agents, promoters, distributing entities, and even shopkeepers filter out whatever they do not deem as "good" or marketable. Seth Godin explains that the systems of modern day marketing function are geared toward "normal," which is really just the peak of a bell curve, not an expression of what everyone is. When product designers and marketers started gearing products (cars, food, music, etc.) toward the "normal" population, "weird" became something negative – a flaw. Diversity and creativity are stifled because everything has to be reshaped to fit into the mold of normal, and receive approval from the gatekeepers. The internet, Godin maintains, gives rise to the opportunity to break away from the standards of "normal:"

The Internet does two things: First, it lets weird people find other weird people, which amplifies their weirdness… And the second thing it does is it lets marketers like us, anyone who makes something they wanna talk about, reach groups of people who aren't the normal ones. In fact, reaching the masses is too expensive now, but reaching just the people who are into experimental lesbian fiction – that's easy – 'cause you can find those people.

The internet, therefore, becomes the key tool for bypassing the standard of "normal," and the traditional gatekeepers accompanying those standards, in order to reach a targeted market of individuals who are interested in the specific product being offered.

Crowdfunding leverages the internet to empower those specific, "weird," individuals to help a project they believe in come to life. It bypasses all of the traditional gatekeeping entities, going directly to the consumer for funding. Because of this, crowdfunding projects in the music industry are often referred to as *direct-to-fan*.

It should be noted that a close relative to crowdfunding is *crowdsourcing*. Crowdsourcing shares the concept of going directly to the crowd, but asks for a return other than financial capital (such as ideas or services). Examples of crowdfunding platforms include Kickstarter, Indiegogo, and GoFundMe for general projects, and Patreon, Sellaband, ArtistShare, and MyMajorCompany for music/arts specific projects.

Crowdfunding is traditionally broken down into four categories. Each operates on the principle of going directly to the crowd, but each offers something different in exchange for financial capital. The attitudes can be summarized as such:

1. *Donation*: "give money to this project as an act of generosity"
2. *Rewards*: "give me money now, and I'll give you a product later"

3. *Equity*: "give me money now, and you'll own a share of what I create"
4. *Lending*: "give me money now, and I'll pay you back at an agreed-upon interest rate and timeline"

Regardless of what is given in exchange for financial capital, all crowdfunding campaigns typically require a budget and target amount of money to be raised. There are two main payout systems:

1. *All-or-nothing*: The owner of the project sets a financial goal, and is unable to withdraw any money until the goal is met.
2. *Flex (flexible)*: Money can be withdrawn at any point in the campaign, and is kept by the project owner regardless of whether the goal is met.

Traditionally, crowdfunding platforms have skirted the issue of copyright in several ways in order to avoid paying royalties and mechanicals to collecting societies. Some companies do not host content on their own servers, while others build a release or waiver into their service contract. The most common method, however, is to strategically place the digital company as a "service provider" as defined in US law by the Digital Millennium Copyright Act in 1998. Service providers are defined as "an entity offering the transmission, routing, or providing of connections for digital online communications, between or among points specified by a user, of material of the user's choosing, without modification to the content of the material as sent or received". Examples of service providers include: Google drive, dropbox, wordpress, Whatsapp, and bandzoogle.

Most crowdfunding platforms, including PledgeMusic and Kickstarter, position themselves as service providers: each campaign is essentially the online store of whoever is raising funds, making that person responsible for any copyright or payment issues at play. It can be likened to being a property owner: if the landlord rents out a property to serve as a store, the renter and storeowner is responsible for all costs and licenses related to the business of that store, not the landlord. In order to maintain this status, however, these service providers must uphold strict standards and earn their revenue from their services (hosting, distribution, consulting, etc.), rather than through advertising money (the way YouTube does).

3. About PledgeMusic

At the age of 34, Benji Rogers was living on an air mattress in his mother's spare room and doing the traditional musician's struggle: odd jobs and bartending in London. As he describes it, he awoke in the middle of the night with a realization that he couldn't shake. Benji recognized that an artist is more interesting when they're making something than when they're selling it after the fact. Consider the appeal of VH1's "Behind the Music" programs, and the thrill people get from watching reality TV:

Look at the success of reality TV, right? You don't know what's gonna happen, it's happening in real time, it's moving along. Well the making of an album is that way: it's got all those elements. It's uncertain, you don't know the outcome, it happens only once and in real time, and if you will, it's almost as if you create an event out of 'the making of.'

If the appeal of reality TV could be applied to the music creation process, it would be rewarding (and addictive) for fans. Beyond that, Benji knew that a particular subset of his fans would do *anything* for him, including paying a premium for a deeper experience than the traditional album and t-shirt sale. This group of fans, referred to as *superfans*, make up 17% of music consumers and represent 61% of all music spending.

What if there was a way for an artist to let their fans pre-order an album, unlock access to a special video stream or audio stream or photo stream while it's being made, only for them? They finance the record, and then when it comes out you sell it to everybody else… and that same superfan will still buy it or stream it once it comes out.

Of course, it took months of questions, drama, and struggles to get the company up and running, and there was a lot of uncertainty. There were legal issues left and right, as there was no precedence for the business model Benji was proposing. Benji wanted to go directly to the fan far in advance of having a product to deliver. This would allow artists to bypass gatekeepers and bureaucracy (all of which traditionally take a cut of funds earned) and create their albums without debt. When explaining the concept of fans pledging a payment amount but not being charged until enough money was pledged to fund the project, the closest parallel he could make was in the hotel industry: you can book a hotel in advance, but you are charged when you check in. Benji also came from a musician's background, not a business one. He had a huge network within the music industry, but finding the right team of business, legal, and tech was crucial, and developing a business model to pitch to investors was a new adventure for Benji.

Eventually, Benji put together a team, secured financial capital, and dove into development. PledgeMusic hired a developer in February 2009, and launched with Benji's own project that July, two months after Kickstarter.

It was a phenomenal success. Within five days Benji could walk into the studio and record, completely debt-free. The money raised already covered the studio and additional costs.

The business model still had questions though: would taking a 15% commission on all funds raised be enough to cover all their expenses? They were undercutting iTunes dramatically while providing more services at cost to themselves. At the same time, PledgeMusic's commission appeared significantly larger than Kickstarter's; what if that gap drove potential users away? Yes, PledgeMusic ate the credit card and 3rd party processing fees and provided hands-on assistance through campaign managers for each project, but would artists consider this valuable enough for the extra percentage commission?

The biggest question: could fans really be counted on to engage, or was Benji's project just a fluke?

Over time, PledgeMusic's business model proved to be sustainable: 15% commission kept them in business, and fans engaged more than Benji could have hoped. Instead of earning an average spend of $10 per fan per campaign (the cost of an album), the average spend per fan per campaign fell in the $54-$61 range, depending on the active campaigns, as of 2013, the average pledger spends $1004 on music a year. Compare this to the other consumers in the music industry, who spend average of $68 per year on music, across all mediums and artists, and it is clear that Benji was right: the superfans wanted more than just an album, and were willing to pay for it.

Of those who use PledgeMusic, 82% of their spending is on physical products (PledgeMusic and Nielsen, 2013). The majority (51%) is spent on CDs, followed distantly by vinyl (10.1%) and T-shirts (9.43%). Other items for sale include credits on albums, Skype lessons, and handmade artifacts.

Over the past 6 years, PledgeMusic has grown rapidly. Though they originally launched one or two campaigns a month, now they launch between four and six campaigns a day. In the past few years (2011-2014) PledgeMusic has experienced an average 37% annual increase in artists who have launched projects, and the user base has grown at an average rate of 78%. Despite this fast-paced growth, only 4% of all music consumers are early adaptors of direct-to-fan activities such as PledgeMusic and its peers, which means that there is still incredible room for growth.

4. PledgeMusic Strategy

Artists using PledgeMusic enjoy a 90% success rate. Much of this can be credited to PledgeMusic's strategy and involvement in the process.

<u>Hands-On, Artist-Centric Approach</u>

One of the biggest distinctions PledgeMusic has is its hands-on and personal assistance when it comes to running campaigns. Every artist has a campaign manager within the PledgeMusic office; Benji describes the team as some of the most talented people you've ever come across. Campaign managers work closely with the artist to develop they types of products that will be listed for sale, as well as the behind-the-scenes content that will be made available through the AccessPass. Campaign managers counsel artists on best practices overall and within their genre, and walk with them through the entire process.

Although a campaign manager is highly involved in the process – everything ultimately falls into the hands of the artist. A campaign on PledgeMusic is a relational activity, so it is essential that anything sold or shared must ring true to who the artist is. This means that the artist has ultimate creative control, rather than an A&R or marketing representative from PledgeMusic. Campaign managers are helpers and consultants, not the final word.

PledgeMusic's policy is not to launch every project that comes to them, but only launch campaigns they know have the best chances of success. When an artist comes to PledgeMusic, they share their financial goals and timeline with their campaign manager. These are weighed against an artist's footprint on email, Facebook, Twitter, YouTube, and other social media platforms; the campaign manager then makes a recommendation. Artists are not blatantly turned away, but they'll be advised if their goals are not in alignment with their footprint. From there, PledgeMusic helps and artist to either (a) reevaluate his/her financial goals, or (b) run a promotion aimed at increasing the artist's reach (such as a NoiseTrade promotion). The goal is not to turn artists away, but rather to prepare them as well as possible for success.

Codifying the Fan Experience

PledgeMusic taps into the reality TV experience for fans while giving them a taste of what happens behind the scenes. Although PledgeMusic doesn't require a specific number of updates from artists, the standard number of pledgers-only updates is 17 (Rogers, 2015). There's an ecosystem at play in PledgeMusic: 40% of transactions come from within PledgeMusic's own user base (Rogers, 2015), implying that fans enjoy the experience enough to use PledgeMusic as a discovery platform or return for other artists' campaigns. By building this ecosystem and standardizing the way content is distributed to superfans, PledgeMusic takes some of the uncertainty out of marketing. Artists are still in control of *what* is shared, but they don't have to stress about the *how*.

Syndication Technology and Other Outreach

PledgeMusic strongly believes that email is essential as a tool for correspondence. Fans who hand over their email address *want* information, and direct emails avoid both the costly "boost" tool on Facebook and the transient nature of Twitter.

Not only does PledgeMusic have the ability to inform its entire community of users about new campaigns through their website and newsletter, they have found a way to spread the word through pledgers' own social networks, allowing awareness of an artist's campaign to grow exponentially:

When a fan pre-orders an album, they unlock access to that special part of the site. But in doing so, they get to syndicate all of the artist's updates to their own personal networks without pushing a button. So basically: an artist does a video from the studio, I as the pledger can auto-share a 30-second clip of that video to my Facebook or Twitter wall without pushing a button. No other platform has that piece.

Increase Marketing Time & Reach

While the syndication technology uses social networks to increase the reach of a campaign, another factor is at play: marketing time. Traditional marketing campaigns in the record business begin 1-3 months prior to release, and are usually dependent on a finished product. Rarely does any major marketing take place during the creative process.

PledgeMusic turns the creative process into the Third Frontier and uses it as marketing time. A finished product is not required, because the engaging factor of the marketing comes from the uncertainty of what will happen next. Running a campaign on PledgeMusic can triple the marketing time. And since a wide variety of items are available to purchase at several price points, there is always an immediate call to action for the fan. Using this technique, artists make far more money than they would otherwise.

<u>Data</u>

[PledgeMusic is] the only platform… that creates a community for superfans that the artist can withdraw from when they leave.

Perhaps more valuable than the hands-on assistance is the data an artist receives. Artists not only know exactly what was sold to whom and where, they also gain any of the relevant contact information for their pledgers. This isn't just a Facebook like or twitter handle – it's direct email addresses, contact information, and user information that the pledger has chosen to share.

Artists not only can view this information, but can also take it with them when they finish a campaign in order to use however they see fit outside PledgeMusic. Compared to other companies, this is a goldmine. iTunes, for example, keeps user data to themselves, as does Amazon. Spotify shares broad information, but passes demographic and psychographic data on to labels, not artists. None of these companies provide a way for artists to contact their fans directly; artists are forced to go though the platform in order to communicate to fans acquired there. This is a problem for artists, because if forces dependency on these platforms, and therefore loyalty based on cost of abandonment rather than the quality of the platform

Even Facebook keeps contact information to themselves – and charges artists in order to reach their audience by boosting posts. When artists use these points of purchase and dissemination, they are giving their valuable data away, while the companies are making huge profits off of selling the data at a premium.

PledgeMusic believes that the data an artist generates belongs to the artist, and protects it as such. Should an external entity (such as a label or brand) request information on an artist (which happens occasionally, usually in order to inform the decision of signing or working with an artist), PledgeMusic seeks the artist's approval before passing it along.

<u>Charity</u>

Finally, PledgeMusic positions itself as socially aware by incorporating a charity aspect. Artists have the option of donating a portion of their campaign earnings to a charity of their choice (PledgeMusic, no date). This allows an artist to be socially responsible and philanthropic, while inviting their fans join them in a cause they believe in.

What's Next for PledgeMusic?

How can Benji grow PledgeMusic in a way that aligns with his company's values and strengths?

Use all the tools at your disposal as well as your understanding of both music and crowdfunding landscapes to make a recommendation for additional business activities.

Lay out a plan for implementation and monetization, including potential obstacles and ways to avoid or overcome them. Be sure to consider and explain how your recommendation aligns with the institutional logic and current activities.