A SUPPLY CHAIN MODEL FOR THE SOUTH AFRICAN RECORDING INDUSTRY

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ABSTRACT

The way companies manage and integrate their business operations is undergoing various dramatic changes. Businesses are competing globally, and traditional barriers between industries are breaking down. One way of coping with the rapidly changing marketplace, remaining competitive and achieving superior performance, is for business leaders to move towards new business paradigms that allow their companies to work more closely together with their traditional and new business partners (including all clients and suppliers up and down the supply chain). The objective of this article is to document the players and processes of the current South African recording industry, and to consider a supply chain model where all non-core business activities are outsourced to an integrated third-party supply chain management partner.

INTRODUCTION

The South African recording industry provides a unique and compelling case for creating value through outsourcing – and ultimately through the total integration of supply. The local industry's dramatic history of growth, its sheer pace, the magnitude of change and increasingly complex and global supply chains have created huge challenges for all participants. Traditional channel structures and behaviours in the industry's supply chains have not kept pace with the changes. Comprehensive management that collaborates with the supply chain as a whole is needed to fulfil the new demands set by players and consumers alike in the markets of the future.

A study of the supply chain of the South African recording industry was thus undertaken, the hypothesis of which, and upon which this article is based, is that record companies in the South African recording industry should consider outsourcing their non-core business activities to a strategic business partner. This article aims to demonstrate the benefits that can be achieved and activities involved when a record company pursues an outsourced supply chain strategy.

PURPOSE OF THE STUDY

The objective of this study is to investigate the players and processes of the local South African recording industry and to consider an improved outsourced supply chain model. The problem researched in this article centres around the extensive backward and forward integration that has been forced on the traditional record company. Table 1 depicts the functions that a record company should traditionally be responsible for (its core competencies). It also shows all the other functions that record companies generally perform in-house in order for their products to reach the market.

Table 1: A simple supply chain of the recording industry

Backward Integration	Record Company	Forward Integration
Additional functions: • Manufacturing • Warehousing • Inventory management • Stock insurance	*Traditional functions:* • Contract artists • Record master CD • Publish music	*Additional functions:* • Marketing and promotion • Sales function • Order entry • Picking and packing • Physical distribution • Debt collection

THEORETICAL REVIEW

Main players and processes

As a background, the five main players currently operating in the South African recording industry are briefly discussed:

(a) The artist

Depending on their contractual obligations, artists worldwide are divided into two major groups. The first group has signed a recording deal or contract with a record company, for a specific period of time or for a specific number of albums. It is then the record company's responsibility to provide the funds and all other resources necessary to manage and market the artist or band's signed career. The second group is the so-called **individual** artist or band which has not signed a recording contract with any record company. These artists manage their own careers and also have to personally ensure that their product is sold and physically delivered into the market. Processes to manage include recording, manufacturing, warehousing, stock control, marketing, selling and distribution of their albums. They also have to arrange their own concerts, tours and other public appearances.

(b) The record company

Locally, record companies are also divided into two groups. The first group comprises the so-called 'Majors' or 'Big Five' which are the five international record companies with offices in South Africa (BMG, EMI, Gallo, Sony and Universal). All other record companies are known as the 'Independents'. The easiest way to define a record company is by defining the main generic functions it performs. It includes the processes that are seen as a record company's core competence, as well as the other logistical processes that are necessary to deliver an album into the market and achieve a return on the investment. Due to space constraints these six processes are only briefly discussed below:

- **Contracting**. Record companies contract artists or bands for a fixed time period, usually two years, or for a certain number of albums that the artist will release through them.
- **Recording**. Record companies are responsible for the recording of an album/albums in a recording studio. It involves many hours of rehearsing, recording, mixing, cutting and editing to achieve the finished end-product, i.e. the master CD (compact disc).
- **Replication**. After final recording, the master CD is duplicated by a specialist CD manufacturing plant.
- **Sales and marketing**. The finished copies are then sold into the trade by a sales team. A vast amount of marketing is necessary to create a demand in the targeted market, especially with the release of a new or unknown artist's material. This marketing effort includes the production and manufacture of marketing collateral such as videos, DVDs (digital versatile discs), posters, pamphlets and clothing such as T-shirts or caps that are procured mainly to create awareness and visibility. Large sums of money are often also spent on TV-, radio- and printed advertisements.
- **Debt collection and royalty management**. This function includes collection of all monies due from the trade for the records sold to the various dealers, as well as management of the payment of all necessary royalties to the industry governing bodies and to all the artists, directors, producers and copywriters involved in the production of the album.
- **Career management**. The record company must manage the professional career of the artist or the band and control public appearances like concerts and tours, in-store performances, photo shoots and autograph-signing sessions.

(c) The trade

The trade buys finished goods (CDs, tapes, videos, and DVDs) directly from the above-mentioned major or independent record companies, or sometimes from each other (dealers buy from wholesalers). They add a substantial mark-up to the product and then sell it on to the public. The four types of South African music traders and their characteristics are as follows:

- **Wholesalers** buy in bulk, with the main purpose of selling-on to other buyers in the trade. Because of the large number of units they buy on an almost daily basis, they have the most bargaining power and generally receive the best prices from the record companies – they are thus mainly price driven. They sell goods directly to the public out of their factory-like warehouses, but their main objective is to be a 'middle-man' and sell-on to other dealers.

- **Dealers** buy either directly from the record company, or from the above-mentioned wholesalers. They are also price driven, and will buy from whoever can offer them the lowest price.
- **Retailers** buy exclusively and directly from record companies. They generally have one head office with many outlets throughout the country, and often also in South Africa's neighbouring countries. They are more service driven, and their required delivery lead times are very short.
- **Independent stores** operate on a much smaller scale than the previous three groups. They buy small quantities, either from the record company or from the above-mentioned wholesalers. They buy specifically for their local demand and keep as little stock as possible. They have very little bargaining power and generally have to pay much higher prices than any of the other players in the trade.

(d) The consumer

The South African public is known for its diversity in preferring different kinds of music. Examples of some of the more well-known and popular genres are rock and pop, rap, dance, hip-hop, soul, R & B (rhythm and blues), 'kwaito' and gospel. The worldwide sale of music has declined in the last five years, but in complete contrast to worldwide figures, the sales of local South African music have **increased** over the same period of time. According to the Recording Industry of South Africa (www.risa.org.za), in 2000, local music sales totalled just over R139 million and in 2001 nearly R157 million, which is an increase of almost R18 million in the one-year period. In 2002, sales topped R192 million, giving an even greater increase (in excess of R35 million) in the one-year period. Record sales figures were recorded in 2003, with a value of R225 million – nearly R33 million higher than in 2002. These figures are summarised in Table 2.

Table 2: Increases in local music sales

	2000	2001	2002	2003
Local music sales	R139 million	R157 million	R192 million	R225 million
Increase from previous year		2000-2001 R18 million	2001-2002 R35 million	2002-2003 R33 million
% Increase from previous year		12.95%	22.29%	17.19%

In 2002, 7 390 800 local music units were sold at a total retail sales value of R192 165 934. This implies a sales value of R26.00 per unit, which is an average figure for all music formats. In 2003, 8 318 083 local music units were sold at a total retail sales value of R225 090 965, which works out to a retail sales value of R27.06 per unit (www.risa.org.za). This per unit sales amount is very low compared to the worldwide industry, mainly because of the large number of cassette tapes still sold in the South African market, and which have a much lower retail sales price than for example CDs or DVDs. The RRP (recommended retail price) of international music sold in South Africa (once again for all music formats) is on average between R51.47 per unit (in 2002) and R55.26 per unit (in 2003), as reflected in Table 3. Even when local music is sold in a CD or DVD format, it still retails at a lower price when compared to a CD or DVD released by an international artist.

Table 3: Comparison of sales value per unit

	2002	**2003**
Average recommended retail price of international music sold in South Africa	R51.47 per unit	R55.26 per unit
Average sales value for all music formats in South Africa	R26.00 per unit	R27.06 per unit
Difference	R25.47 per unit	R28.20 per unit

The South African sales cycle is highly seasonal, with the highest sales always occurring in the month of December (the traditional Christmas holiday period). Coinciding with a general and all-over lower consumer spending rate, the lowest monthly music sales every year occur in the month of January.

(e) South African governing bodies

The fifth group of players in the local recording industry comprises the various bodies responsible for the development and protection of the rights of the South African music industry. Three of the major organisations that look after the interests of the local industry and its players are:

- **South African Music Rights Organisation (SAMRO)**. SAMRO is the largest of the five copyright organisations and it controls all broadcasting and public performing rights in South Africa.
- **South African Recording Rights Association Limited (SARRAL)**. SARRAL has been operating since 1963 and is a non-profit society looking after the rights of composers of musical works. SARRAL licenses and collects mechanical royalties on behalf of its members.
- **National Organisation for Reproduction Rights in South Africa (NORM)**. NORM is the association of South African music publishers and is a negotiating body that

represents the collective rights of its members. NORM has the authority to negotiate and collect royalties on all usage of copyrighted musical works in accordance with the mandates of its members. All South African music publishers, including SARRAL, are members of NORM.

The current local supply chain

The seven main functions currently being performed in the South African recording industry supply chain are:

- the manufacturing process (procurement)
- inbound freight (from the manufacturing plant to the record company's warehouse)
- inventory management and stock control
- the warehousing and physical distribution of the stock (outbound logistics)
- the marketing function
- the selling function
- debt collection and the management of these receivables.

In the results of the study, some of these processes are redesigned and re-allocated to a third-party outsourced supply chain management partner.

OUTSOURCING NON-CORE BUSINESS ACTIVITIES

Record companies in South Africa have been forced to integrate their business operations both backwards and forwards, purely due to a lack of suitable supply chain management or logistics companies that can manage their non-core business processes on their behalf. It is proposed that the supply chain can be much better managed by implementing an outsourced business principle. However it is important to consider the activities involved.

The nine activities around which the model, for outsourcing the non-core business activities of record companies in the South African recording industry to one strategic business partner, is built are as follows:

1. Contracting the artist

In the new outsourced model, artists or bands are still contracted by record companies, in the same as what is currently happening in the industry. The record company's biggest responsibility must be directly towards the artist – in other words the management and promotion of their individual careers. Most other functions will be **outsourced** to one specialised supply chain management (SCM) company. The remaining eight proposed processes follow the contractual phase.

2. Manufacturing

The record company, in consultation with the artist, decide on a suitable number of units to be manufactured. The buying of the best product at the best price is one of the main functions then performed by the SCM company on behalf of its clients, the record companies.

3. Warehousing

Once the master CD has been replicated by the duplication factory, the stock is delivered to the warehouses of the SCM company. When the stock is received, the units are subjected to a very strict quality control process. When the receivers are satisfied with the quality and quantity of the consignment, the goods are received into the warehouse, both physically as well as onto the warehouse's MIS (management information system). The goods are stored in the pre-allocated bins for easy and efficient inventory management and control.

4. Marketing

Since marketing is an integral part of any company's business, it remains the responsibility of the record company. The activity should be contained as a detailed description in the record company's business plan (www.be.up.co.za/buisnessplans).

5. Selling

While the above-mentioned marketing of artists and their titles is performed by the record company, the responsibility of the sales effort falls into the hands of the SCM company, which must employ nation-wide sales executives to sell the titles of its record company client. This sales team must be highly motivated and knowledgeable about the product (i.e. the specific music titles) that they are selling.

6. Inventory management

The huge task of stock control and inventory management rests squarely on the shoulders of the SCM company. What makes this an even more daunting responsibility is the fact that the company is not managing its own stock, but that of its various record company clients. If the SCM company has a fully integrated MIS, this task becomes much more streamlined and easier to manage. The following processes regarding stock must be executed and/or controlled:

- creating new album titles on the system, i.e. assigning part-numbers and descriptions and building BOMs (bills of material)
- ordering these items from the relevant suppliers (placing purchase orders through procurement)
- checking and receiving the stock into the warehouse and onto the MIS
- frequent stock counts to control and verify stock movements and quantities (inventory management and control)
- entering sales orders from music wholesalers, dealers and retailers (order entry)

- picking and packing of sales orders to be delivered
- generating the necessary documentation to accompany the delivery (e.g. the invoice and delivery note)
- generating stock and sales reports as management information for the benefit of the record company.

7. Physical distribution

The establishing, maintaining and enhancing of a company's distribution network, in order to provide a reliable and cost-effective service to its clients, is of utmost importance to the SCM partnership. The way in which the final product reaches the market strongly influences the success of its introduction into the retail and dealer channel. Important aspects in this respect are short lead times, good condition and competitive pricing. For most SCM companies, road transport is the only means of transport that is relatively easy to own and operate as part of their in-house own-account sector. It does however happen on some occasions that the SCM company cannot handle all aspects of distribution successfully on its own. This often occurs in peak seasons when orders increase dramatically. This function is then outsourced to companies that specialise solely in physical distribution. This so-called **third-party logistics**, where certain elements of logistics are outsourced to third-party service providers, is a fast-growing trend internationally. It is also an area of logistics in South Africa that has seen significant changes in recent times, particularly so in transport and distribution. How information is traded with these carriers directly affect the level of service the SCM company can expect and deliver.

8. Debt collection

This value-adding service offered by SCM companies is utilised because the consignment of stock received from the manufacturer or supplier is not delivered back to the primary client (the record company), but rather to the appointed SCM company's warehouse from where the physical distribution to the appointed music dealers are managed and executed. As noted before, the SCM company is also responsible for the sales function and will call on all customers that fall into the record company's target market (i.e. music wholesalers, dealers, retailers and others). These customers will not place their orders with the record company but directly with the SCM company. The orders that the SCM company delivers into the trade will include a delivery note and an invoice. It is then up to the SCM company to collect the payments from these dealers and, after deducting its fee, forward the balance to its primary client, the record company.

9. Royalty payments

The money received from the sale of a single unit has to be divided into many receiving channels. Duties or royalties that need to be paid are:

- **Ad Valour**, which is a duty payable to the South African Receiver of Revenue. This duty is payable on the manufacturing cost of each music item manufactured.

- **Mechanical royalties**, which have to be paid to one of the South African governing bodies discussed earlier (i.e. SAMRO, SARRAL or NORM).
- **Artist royalties**, also called the PPD (price per dealer), which are calculated as a percentage of the album's selling price into the trade. This percentage is negotiated when the artist was contracted to the record company and is included in their contract.

In the outsourced SCM model these duties still need to be paid and it is proposed that the payment thereof remains the responsibility of the record company. If for instance a title is sold into the trade at a PPD of R50.00, the SCM partner company will collect these monies due from the music dealer and will then subtract an agreed percentage as its service fee, whereafter the balance will be paid over to the record company. It is proposed that the SCM company charge a single percentage fee for its combined service offering, but the fee can also be split if the record company is only outsourcing some and not all of its logistical or business activities. If it is assumed that the PPD of a title to be sold is R50.00, a typical example could be calculated as follows:

Sales fee or commission:		
(paid by the record company)	10% of PPD	R5.00
Handling fee:		
(paid by the music dealer)	15% of PPD	R7.50
Total SCM service fee:		**R12.50**

Payable to record company: R50.00 – R12.50 = R37.50 per unit sold

The following services are included in the above fees:

- The sales commission includes all aspects related to the selling of the product, i.e. the cost of employing sales representatives to call on the dealers in the trade, as well as the cost of employing order entry clerks who must capture these sales orders onto the company's MIS.
- The handling fee includes all costs related to the handling and physical movement of the stock, i.e. warehousing, inventory management, picking and packing, physical distribution and delivering of the invoice and delivery note or POD (proof of delivery).

Out of the R37.50 that the record company receives for the sale of one of its music CDs, it must firstly pay the duties or royalties mentioned above, whereafter the remaining balance will be the record company's gross profit before expenses.

DISCUSSION

This article has been the result of the study (Burgelman, 2002; Hoare, 2003; Mariotti, 2002) of supply chain management in the South African recording industry. It was found that most record companies continue to perform most business processes in-house, even those which are not part of their core competency. Mainly because of a lack of alternatives, record companies have been forced to integrate backwards and forwards in order to deliver their products to market. Managing the logistical and other processes involved in manufacturing, selling and distributing a music title is a complex process that involves all the skills one can expect from experienced managers in the various logistical areas. Keeping an in-house supply of such qualified and effective experts in all fields of logistics management is a very costly task requiring continuous skill-upgrades and industry and best-practice education (Lloyd, 2003: 1-2). In tight economic times it comes as no surprise that the number of logistical experts in businesses is decreasing while their workload is increasing – with the obvious negative effects on quality and customer service.

It is important to remember that only developing value-building partnerships and strategies is no sure recipe for success. Gathering the correct information, making good decisions and then implementing those decisions are the three basic steps in strategic decision-making (McNeilly, 2002: 29-33). As with any plan, the execution thereof remains one of the most critical aspects of success. Sterling (2003: 27) claims that the effective implementation of an average strategy still beats the mediocre implementation of a great strategy.

A new collaboration up and down the supply chain can thus be successfully achieved by outsourcing all non-core business activities to a third-party business partner, which in turn will lead to an improved integration through supply chain management (Linder, Cole & Jacobson, 2002). Supply chain leaders should be reconsidering the linkages, not only between functions within their own companies, but also with other organisations up and down their supply chain (www.supply-chain.org). The main advantages of the proposed outsourcing process is that the company is then able to focus on its core competency, which in this case is simply the recording and publishing of music.

CONCLUSION

This study proposed a change in the way in which record companies handle their logistical and other business operations. It is proposed that all non-core business activities, especially those related to their supply chain such as manufacturing, warehousing, inventory management, sales, physical distribution and debt collection be outsourced to a third-party SCM partner. Outsourcing these processes will lead to an improvement in quality of work, customer service and ultimately cash flow. The SCM company should be able to add enormous value to the business operation of its record company client. Managers will be free to concentrate on what it is they do best and will not have to worry about the logistics of getting their product to the market. It is concluded that the greatest amount of value can be added when all (and not only some) of a record company's operational or logistical processes are outsourced to one third-party value-adding SCM service provider.

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