CEMA SPECIAL MARKETS

Evaluation and Strategies

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EXECUTIVE SUMMARY

The purpose of this report is to analyze and discuss the activities and prospects of CEMA Special Markets ("Special Markets"), with a view towards recommending certain changes both in Special Markets' constitution and operation and its relationships with other Capitol-EMI Music activity centers.

Special Markets presently is a $35.3M/yr. business (FY '89 total net sales). Figure 1 depicts total net sales per month for the period 4-85 - 9-89, during which net sales have increased consistently. Figures 2 and 3 depict pre-tax operating profit ("PTOI") per month and return on sales ("ROS") per month over the same period. ROS has been calculated conventionally as the ratio of PTOI to total net sales. As Figure 3 discloses, Special Markets consistently has reported high ROS, averaging 13.3% in FY '89. Profit growth, however, has not kept pace with increases in net sales. Figure 4 depicts percentage contribution to turnover per month during the same period from each of the four main activity centers of Special Markets' business: budget retail sales, Priority Records, licensing, and master use licensing (<u>see</u> discussion, <u>infra</u>, and Table 1 which synopsizes Special Markets' income statements on a yearly basis for FYs 86 - 90 to date).

The role and function of Special Markets remains poorly understood within Capitol-EMI Music. In part this is due to the unusual tasks which Special Markets performs, many of which it has accumulated in the absence of somewhere else to put them. This has two consequences:

> First, because Special Markets essentially comprises a combination of unrelated ventures, it lacks synergy as an independently viable, stand-alone corporate unit. Such a collection is difficult enough to manage consistently on its own terms. Further exacerbating the problem, many of its modes and procedures are hang-overs from the days when it was vertically integrated into the Capitol Records label, confusingly mixed with other activities which it since has originated or nurtured as a profit center in its own right. Special Markets has not yet fully responded to the Capitol-EMI Music decentralization process which began in October 1987. Its primary challenge for the 1990s is to adapt to this fundamental change in operating philosophy, and restructure itself so as to better respond to the needs and requirements of its clients.

> Second, because Special Markets experiences revenue without also carrying necessary expenses, the

true cost of performing its functions is not fully reflected in its income statement. Its income statement, then, does not accurately reflect the underlying economic reality of the activities which it performs. For this reason, comparing its ROS with that of other Capitol-EMI Music businesses potentially is misleading. Furthermore, because of the institutional constraints under which Special Markets has operated, particularly with regards to access to repertoire (discussed, infra), it's virtually meaningless to analyze growth of turnover or profitability, or to attempt to correlate these and other measures of financial performance with those of other Capitol-EMI Music activity centers.

The main conclusions and recommendations of this report are as follows:

1. Special Markets must be restructured to better focus on its main business. Special Markets' primary mission is the assembly or licensure of repertoire owned or controlled by Capitol-EMI Music. Activities which are peripheral to this assignment must be divested to more appropriate groups within the company, so as to better enable Special Markets to focus on this objective.

In particular, (a) budget retail sales of finished goods cassettes and compact discs should be transferred to CEMA, and (b) order fulfillment on behalf of clients such as Priority Records also should be transferred to CEMA. Among other desirable consequences, the transfer of Special Markets' budget retail business to CEMA will tend to reduce the perception of it by other profit centers within the company as a "dumping ground" or "schlock house" for undesirable or otherwise unsalable repertoire.

2. Special Markets is uniquely situated to develop and market our catalog, and must be given the tools to do so. The charter of Capitol-EMI Music's proprietary labels (i.e., Capitol Records and EMI Records) is the origination and development of front-line artists. Frequently, their efforts to exploit catalog material are misconceived or economically inefficient. With zero fixed cost and little in the way of marginal cost outside of product fabrication and mechanical royalties (indeed, in many cases even artist royalties aren't payable against an unrecouped debit balance), catalog projects are the closest thing to being intrinsically profitable that a record company can devise. They are incapable of surviving, however, in an environment where they are (a) accorded low priority from a sales and marketing standpoint, and (b) assessed with the large promotion and marketing overheads of a label oriented primarily towards breaking front-line pop product.

Special Markets is the only group within Capitol-EMI Music capable of exploiting catalog material on an inter-divisional basis. Its stature having been enhanced by the divestiture of its budget sales business, Special Markets can be positioned as a repertoire center within Capitol-EMI Music, on parity with the proprietary labels, charged with assembling single-artist or multiple-artist compilations either for sale by CEMA or licensure to some third party. At present, the labels solely control when repertoire originated by them will become available for exploitation by Special Markets. Rather than simply leaving this to each labels' discretion, firm protocols must be devised defining the circumstances under which repertoire becomes exploitable by Special Markets without label involvement: e.g., if the artist no longer is on the label, or the product is more than ten years old.

3. Special Markets' legitimate resource needs have long gone unmet. Special Markets urgently requires additional corporate resources in order to successfully meet its corporate objectives (either as presently constituted, or as restructured pursuant to this report). Its needs fall primarily into two areas: personnel, and MIS support.

(a) With regards to personnel, a Chief Operating Officer should and must be appointed to (i) gain control over sources and applications of funds, which now presents a serious internal controls deficiency, and (ii) better direct and coordinate the flow of projects through the department, which presently are administered on an ad-hoc basis. For example, no data base exists of Special Markets license agreements. In many instances licenses have expired, yet licensees continue to commercially exploit repertoire, without accounting. Conservatively, Special Markets is owed thousands of dollars in license fees, which (at present) it is congenitally incapable of collecting.

(b) With regards to MIS support, the deficiencies of Capitol-EMI Music's AR-20 and RL-01 systems are well-known and require no further elaboration here. In an environment where decisions regarding availability and pricing of repertoire must be made quickly, Special Markets lacks access to even rudimentary information about the product which it represents. For example, even frequently-used tracks must be manually "re-cleared," a cumbersome process involving a half-dozen superfluous steps. This entire process is susceptible to computerization. Historically, MIS has strived to deliver a "global" solution to group computer requirements; for Special Markets, it never materialized. Special Markets needs a local, detached computer module, independent of our main-frame system, tailored to its particular uses. A data-exchange protocol readily can be devised to periodically update it with current information.

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I. Budget Sales

A. Overview and Summary

One of Special Markets' main businesses is the compilation and sale of budget-priced cassettes. In FY '89 budget retail net sales were $12M; Figure 5 depicts net sales per month for the period 4-85 through 9-89. Even taking seasonal fluctuations into account, net sales have shown no growth over this period. Unfortunately, Special Markets' income statements do not precisely isolate the variable cost centers associated with budget sales. Making some uncontroversial assumptions re the marginal cost of this business as reflected on Special Markets' income statements, and without allocating fixed cost centers, PTOI and ROS over the same period are depicted on Figures 6 and 7, respectively. On this basis, ROS in FY '89 was 5.8%. Note, however, the consistent decline in profitability over the past several years.

"Budget" in this context refers to a separate price category which actually is lower than CEMA's "budget" price, and thus in fact is a kind of "sub-budget" price. This is the basis for a critical distinction: goods sold by CEMA's field sales staff at "budget" price still are thought of as "front-line" merchandise, and are marketed and sold as such, whereas goods sold by Special Markets at its "sub-budget" price comprise a different class of commodity. The main customers for both lines, however, are identical; as, frequently, is the repertoire itself.

Historically, this "distinction without a difference" has created antagonism between Special Markets and CEMA's field sales staff, as they compete for limited customer open-to-buy dollars. It may have been appropriate to divide selling responsibility along price-point lines at an earlier time when Capitol Records was vertically integrated and both "sales" and "special markets" functions were subsumed under its corporate umbrella. However, that rationale (even if it initially was valid) was supplanted with the creation of CEMA in October 1987, the creation of EMI (U.S.A.), the advent of joint-venture relationships between Capitol-EMI Music and SBK, Chrysalis and Enigma Records, and CEMA's resulting mandate to service all of its clients on a non-discriminatory, "label-blind" basis.

It makes no sense to have two different entities within Capitol-EMI Music charged with selling finished goods, particularly given the complete overlap in their respective customer bases. Special Markets therefore should divest itself of responsibility for "budget" sales of cassettes and compact discs. That function should be transferred instead to CEMA National Sales, either (a) to be handled nation-wide by a single person within CEMA, or (b) made available for sale by CEMA's field sales staff simply as another product line which CEMA distributes. This latter alternative suggests the possibility of considerable marketing synergy, as CEMA field sales staff could evaluate each customer's particular needs and requirements, and direct that customer to the product line which would do best with the consumers which it services. Furthermore, CEMA National Sales could take steps to promote better fit between various Special Markets sales programs, and those which are offered on front-line goods.

The remainder of this section examines issues affecting this proposal, including: a brief history of Special Markets' budget business; the budget business as now constituted; access to repertoire; and Special Markets' role in catalog development.

B. A Brief History of Special Markets' Budget Business

Budget retail (in the specialized sense defined above) formerly was not the provence of Special Markets. Rather, (what then was) Capitol's sales group was responsible for all sales at all price points. Special Markets was directed primarily towards licensing contemporary hits packages to companies that television-advertised for direct consumer response and subsequent mail-order fulfillment, such as K-Tel and a concern called Ronco. These firms frequently guaranteed sales of 250K and even upwards of 1M units. Due to the increasing cost of television advertising, however, Ronco left the business, and K-Tel subsequently filed for bankruptcy. This created a void in the marketplace for budget-priced "impulse" items.

At the time, Special Markets also experienced a radical fall-off in its "premium" business, which consisted of tie-ins with advertisers (for example, a compilation cassette with performances by various Capitol artists would be in the tape player of a new Ford). The demise of the premium business can be traced to several factors, including the arrival of implicit cross-endorsement restrictions in artist contracts, as performers captured these revenue-generating opportunities for their own; decreased use of recorded music as a promotional device by advertisers; the centralization of what business that remained in New York; and Capitol's lack of desire to staff sufficiently in order to capture it.

These two factors combined to create a business opportunity which Special Markets moved to fill. The marketing concept behind the line was that familiar titles by familiar artists could be attractively repackaged for sale at a competitive price, primarily by mass-merchandisers (such as Wal-Mart and K-Mart) serviced by rack-jobbers (such as Handleman and Lieberman). Special Markets' initial release was 36 titles, and since then its catalog has expanded to several hundred items. The line's success is based not only on repertoire, but also merchandising elements such as new artwork and use of a clear C-0; the goods look like front-line merchandise.

C. The Budget Business as Now Constituted

Special Markets has approx. 100 domestic customers, 50 of which are important; the top 5, lead by Handleman and Lieberman, account for over 50% of the business. Except for seasonal merchandise, all product is sold on a "one way, no returns" basis, and is subject to minimum order requirements. Camelot is the only central warehouse retailer customer, the main inhibitor of additional CWR volume being the "no returns" policy.

Presently, there are three releases each year, each comprising approx. 25 titles (depending on availability): a winter NARM release, a fall release, and a Christmas release. Most (if not all) goods are sold on program in connection with one of these releases. For example, Special Markets' 1989 Fall Program runs from August 1, 1989 through December 15, 1989; requires a minimum order (which can be split among various titles) of 10,000 units; with one or two exceptions, the program price is $1.42 per unit, net 60 (note, no 2% invoice discount for timely payment); and dating options are available for a higher price. These goods typically are sold at retail for $3.98 or $3.99. Another example, the 1989 Christmas Program runs from March 1, 1989 through November 30, 1989; also requires a minimum order of 10,000 units; invoices are due in February 1990; and the basic cost price is $1.31/unit (though some titles sell for as low as $.85/unit). Christmas goods typically are sold at retail for $2.99 to $3.99. Up to 30% of Christmas goods can be returned, however with a 15% penalty.

The Fall '89 release was the first to include CDs (17 titles), which have met with favorable customer reception. [CD sales account for the inconsistent spike in net sales, PTOI and ROS at 8-89 shown on Figures 5, 6 and 7.] The basic cost price for CDs is $3.35; unlike other product lines, this was the first to include some slight margin for advertising. Special Markets believes that its cassette business is mature and not likely to experience significant volume increases, which rather must come from its new CD line. Significantly, CDs are not being manufactured by Capitol Manufacturing, due to its relatively higher cost (e.g., $1.30 ex insert as opposed to $1.39 or thereabouts from other vendors, including insert).

As far as competitor activity is concerned: (1) MCA has a line of budget cassettes which it sells for a basic cost price of $1.25/unit; (2) CBS budget cassettes are individually priced in a range from $1.20 - $1.80/unit; (3) PolyGram is in the budget cassette business but faltering; (4) BMG licenses most of its budget repertoire; and (5) WEA does not have a budget cassette line.

Special Markets does not use invoice discounts, free goods, advertising (with the exception for CDs noted above), dating or returns factors as sales tools. All sales pretty much are for the price, without adjustment. If CEMA was to take over Special Markets sales functions (as recommended), some examination would have to be made of pricing, program, returns, minimum order and other sales and marketing policies. If these elements were restructured so as to appeal to a larger base of customers, it's not unrealistic to estimate that turnover could be doubled.

A number of modifications also should be made in order flow, information processing and fulfillment. For example,

1. Customers presently transmit orders directly to Special Markets, where they are "re-written" before being sent to the appropriate DC. This cumbersome intermediate step can and should be eliminated for certain larger accounts.

2. Except for CDs, which are manufactured outside, the DCs place production, not Special Markets. This has lead to inventory imbalances, dramatically inhibiting Special Markets' effectiveness in its marketplace. For example, at one time, Capitol Manufacturing was more than 1M units behind in manufacturing Special Markets' product. Special Markets should control and coordinate all production, just like other repertoire centers. Inventory should be centralized at the Jacksonville DC to facilitate timely fulfillment.

3. Until recently, customers were manually billed, which lead to massive reconciliation problems. Special Markets now is using billing software adapted from the former Capitol Magnetic Products, which apparently has solved this problem on an interim basis. MIS should review the entire order entry and billing cycle, however, to insure that all customer orders are billed upon fulfillment at the correct price.

4. Special Markets still is in the dark ages when it comes to computer utilization. While it receives a daily D70-40-D report (which is like the IN-41) re sales and inventory, apparently this system is incapable of generating useful tools such as a Customer Performance Report. This in turn leads to imprecision in forecasting and budgeting.

5. Each item in Special Markets' catalog should appear in a data file, which could be installed locally

at Special Markets. Changes in artist or mechanical royalties, standard manufacturing prices, or other cost centers easily could be plugged into such a data base, and correlated with other important data such as sales, inventory, and turns per year. This would enable Special Markets to exploit its catalog more accurately and efficiently, and possibly divide it into different price points based upon gross margin.

D. <u>Access to Repertoire</u>

At the beginning, access to repertoire was not an issue. Capitol was highly vertically integrated and there was no organizational division between Capitol marketing, sales and the Special Markets group. Thus, Special Markets' budget cassette line was perceived simply as another phase in a project's life cycle, and no special label "permissions" were required, since Special Markets was part of the "label" itself.

Special Markets always was Capitol's agent for the licensure of its repertoire to third parties. With the increasing success of its budget line, however, Special Markets came to be perceived by Capitol as less of a licensing entity, and more of a sales entity. Thus, in one of many earlier corporate reorganizations, Special Markets began reporting to the "core" marketing and sales group. This in turn created artificial barriers to Special Markets' use of repertoire for use in budget cassettes. Capitol's marketing group came to insist that its consent be obtained for the inclusion of any repertoire in the line (in addition to artist consent, when necessary, to re-couple or price at budget).

In time, Special Markets came to report to CEMA, which from a historical perspective is the successor entity to the old "core" marketing and sales group. Capitol (and CEMA's "front-line" field sales staff) started viewing Special Markets as a competitor, actually displacing sales in the marketplace (or, a variant of this, causing them to migrate to lower price-points). This further isolated Special Markets in its search for appropriate tracks. For example, Capitol always had been concerned about selling a compilation of "hits" at budget, on the theory that they'd yield better margin at front-line. Paradoxically, though, a competing front-line package never would be released, thus the option being preserved was theoretical at best. In the meanwhile, Special Markets had to work with lesser-known tracks, undermining the effectiveness of the marketing insight that gave the budget line whatever vitality it had to begin with.

As an empirical proposition, it's doubtful that sales displacement occurs; in fact, budget repertoire can peacefully co-exist with front-line repertoire, on a separate but parallel track. Budget repertoire appeals to a different consumer, who typically is an impulse-buyer at a mass merchandiser such as Wal-Mart or K-Mart, and thus primarily is price-sensitive. The reason why "greatest hits" packages of older material are successful with these buyers is because they remember what was contemporary at an earlier time in their lives when they had more discretionary income to spend, and basically pick up where they left off. Such a person is best contrasted with a "music buyer," who shops at a central warehouse retailer, and primarily is oriented towards repertoire as opposed to price. The success of Rhino Records, for example, is based upon its ability to assemble and merchandise "oldies" packages for a front-line price. Rather than displacing or diminishing from front-line sales, budget sales more likely extend the life of fully-amortized product.

Thus, Capitol's (and later, EMI's) concerns re this point are misplaced, and in any event probably have more to do with who books the revenue rather than who uses the repertoire. Significantly, even this latter point should have been resolved with the commencement of FY '90 when CEMA Finance began breaking out all net Special Markets revenue to the labels; evidently, the implications of this fact never trickled down to their respective marketing groups.

E. Special Markets' Role in Catalog Development

1. Background of the Problem

Because their predecessors were successful, our proprietary labels have access to strong repertoire from previous decades -- over 75K masters altogether. One of the many challenges facing Capitol-EMI Music is how best to exploit this catalog. Unlike current product, which typically experiences a short and volatile life cycle, many catalog titles continue to sell at a more or less predictable (though possibly low) rate. As a corollary to this proposition, sales not made now may not be recoverable later. One way to express this phenomenon colloquially is "use it or lose it." In this sense, catalog is a wasting asset.

Catalog cannot, however, simply be reactivated in its original format. With limited exceptions, re-releasing old albums and lowering the price isn't the answer. Rather, catalog must be knowledgeably re-compiled and attractively re-packaged so as to maximally enhance its potential consumer appeal. Just because it's old doesn't make it good, even if it is by a recognizable artist; for example, Nat Cole had approx. 72 chart singles during the period 1943-1964, but it would be facetious to contend that all of them are appropriate candidates for re-release. With limited exceptions, music is as perishable as a trainload of cantaloupes in the hot sun on a Bakersfield train siding, and depends for its success at any point in time on consumer demand. Even though an artist formerly was successful, his masters may have limited value in the contemporary marketplace.

Another factor is what the competition's got. Re-recording restrictions were not common in earlier artist contracts, which left artists free to deliver to other labels often-indistinguishable versions of masters originally recorded for one of our labels. The presence or absence of this material in the marketplace must be carefully evaluated before any catalog release.

2. Greenline's Relative Commercial Failure

Poor tune-stack selection and out-dated artwork is one of the main reasons for the relatively poor performance of Capitol's "Greenline" series. For example, in FYs 1987, 1988 and 1989, total Greenline net sales were $10.9M, $9.3M and $8.9M, respectively -- a net decline each year. Over this same period, CEMA album sales were $187.9M, $221.6M and $244.8M, respectively -- a net increase each year. Percentage of Greenline business, then, declined from 5.8% to 4.2% to 3.6% of total album sales. This performance is unacceptable by any standard, particularly in light of the commercial potential of Capitol-EMI's catalog.

Greenline, in fact, presents a good example of how not to exploit catalog. The marketing point of view for many of these releases was to "stretch" the material as far as possible. Thus, for example, "greatest hits" packages do not include greatest hits, but rather are a curious mixture of hits and ordinary album cuts, the remainder of the "hits" being reserved for some subsequent (often hypothetical) release. Even if this approach formerly worked, it certainly doesn't work in either of the two markets identified here (i.e., price-driven or repertoire-driven). One good "greatest hits" package has more artistic integrity -- and commercial viability -- than three bad ones. In contrast, the current Capitol "Collector's" series is a good example of a successful catalog release effort, albeit of esoteric material at a front-line price.

3. The Role of the Labels

In order to exploit its catalog successfully, Capitol-EMI Music needs a philosophy of catalog development. When properly expounded, this theory will avoid both the Scylla of randomly throwing re-releases into the marketplace, and the Charybdis of expensive, archival packages which appeal only to a narrow segment of consumers.

The proper role for catalog is best revealed when contrasted with the true nature and function of the labels, which is to originate and develop front-line repertoire. Creative functions such as A&R, for example, can be performed only at the lowest possible level of corporate bureaucracy. They are labor-intensive, can't be systematized, and aren't amenable to economies of scale. A&R (and everything else having to do with artist cultivation and development) is a classic "label" function.

So is promotion at radio, which presents what might be referred to as a closed-loop system. Radio adds are a scarce economic commodity, in that there are only so many of them available at any given time, and one competitor's success in capturing them automatically precludes some other competitor from doing so. This activity therefore requires a dedicated cadre of "shock troops" who owe their allegiance or loyalty only to one venture -- the label by which they are employed. In summary, by their very constitution, labels are best at dealing with the here and now -- product in the initial phase of its life cycle.

4. The Role of Special Markets

Marketing and sales, on the other hand, are good examples of activities which depend for their success on a continuous, active presence in the marketplace -- precisely the type of "critical mass" that any single label will find difficult if not impossible to achieve. Unlike the confines of a top-40 play-list, they occur in relatively more elastic markets, bounded only by the limits of customers' open-to-buy and competing alternatives for the consumer entertainment dollar. The apparatus of manufacturing and distribution is capital-intensive. Additional turnover not only enables the fixed costs which it necessarily entails to be amortized over more units, but also creates a balanced portfolio of assets which, because it is more diversified, per se is less volatile.

This division of priorities along functional lines suggests that catalog development never will be, nor should it be, the primary focus of label attention. Rather, the labels' attention should and must be directed towards originating and developing front-line artists. Put differently, catalog development is far more like sales and distribution, than A&R or promotion. By diverting their limited economic resources to catalog development, the labels in fact detract from their charter. Significantly, as the Greenline experience shows, the labels' efforts to develop catalog on their own are unsuccessful, even if well-intentioned. As a result, group capital is inefficiently deployed, and potential opportunities in the new artist marketplace may be lost.

The solution to the problem is to redefine the mission of Special Markets, and transform it from a sales organization into a repertoire organization -- albeit one with a "special" mandate. Instead of originating new artists, its assignment will be to originate commercially successful single-artist and multiple-artist compilations, at all price points, either for sale by CEMA, or for licensure to third parties. At present, Special Markets must compete with its client labels to use catalog. As a result, neither is able to function successfully. With the transferring of its sales capability to CEMA, Special Markets will be in a position to resume its former role as a repertoire center, as opposed to a sales generator.

Significantly, this is the role of Warner Special Products ("WSP"), one of Special Markets' main competitors. WSP doesn't sell a line of budget goods; all Warners "budget" product is sold by WEA in its "Super Saver" line. Rather, WSP's primary function is repertoire assembly for licensure to third parties, several of which (e.g., Jeito Concepts) are captive to this endeavor. The proposal set forth here is an improvement on the WSP model, because it would permit Special Markets to originate compilation packages at all price points for sale either by CEMA or some third-party licensee.

5. <u>Advantages of this Proposal</u>

The main advantage of this proposal is that it will result in the more timely and efficient exploitation of catalog material, resulting in direct financial benefit to Capitol-EMI. Higher catalog sales not only are good in their own right; because of their inherently lower volatility, they can in effect anchor or stabilize the efforts of our proprietary labels to originate and develop new artists. Put differently, aggressive catalog exploitation can "take up the slack" at times when, for one reason or another, the labels are "cold." Proper catalog development, however, is a long-term growth process, and can't be viewed as a "quick fix" for short-term earnings fluctuations -- which is one of the main criticisms of previous label catalog release programs, which basically consisted of dumping old titles on the market without enough thought to their selection, programming or merchandising.

Only Special Markets can adequately fulfill this role. Special Markets, for example, is the only group within the company with stature to compile inter-label multiple-artist compilations (those structured around a particular theme or marketing angle). It's knowledgeable about "concept albums," which could include previously-unavailable tracks. Furthermore, because it is specialized in post-prime repertoire, Special Markets is in the best position to identify optimal stages in any particular project's life cycle for its release at various price-points, a process which now frequently is a hit-or-miss affair. For example, some question attends the viability of CEMA's current $6.98 price-point, and the titles sold in that line, particularly in light of the demands of CEMA's rack-jobber customers for increased gross margin.

Another advantage of this proposal is better matching of costs to revenue, thus more accurately reflecting the underlying economic reality of catalog development. Our labels, for example, presently incur extraordinary expenses to hire marketing "consultants" for catalog projects, when in fact we have these personnel resources in-house. This literally puts the labels in the position of re-inventing the wheel. Furthermore, while they may be highly knowledgeable about arcane masters, many of these consultants frequently are insensitive to the commercial potential of the projects which they propose or initiate. Archival projects can't occur in a vacuum. Rather, they must both articulate and reflect the cultural context of the time when the masters which they embody originally were released, in a manner calculated to appeal to the contemporary market, such that the whole becomes something greater than the sum of its parts.

If adopted, this proposal also would facilitate interaction between CEMA and a responsible repertoire center with regards to catalog development. For example, at CBS Records, catalog marketing is the exclusive provence of CBS Distribution, which even accrues its own 5% advertising budget on catalog sales, dedicated to this purpose. Because it necessarily detracts from their front-line priorities, our proprietary labels are reluctant to fund catalog advertising at sufficient levels, if at all, further diminishing their impact in the marketplace.

In summary, our catalog is analogous to a library of motion pictures or television programs. Its value lies in the present discount value of the income stream potentially derivable from its utilization in many different forms of media, some of which may not yet have been devised, or are in inaccessible markets. Only through a coordinated, inter-company approach will the true value of this asset become susceptible to realization.

6. <u>A Weaker Variant of this Proposal</u>

If for various reasons it is thought inadvisable to implement this proposal in its entirety, it still is critical that Special Markets be granted unrestricted access to certain types of repertoire, free from the requirement of label consent. As discussed <u>supra</u>, label consent came to be imposed primarily for historical reasons and matters of perception, which no longer are valid (if they were to begin with). Objective criteria would eliminate the problem of too much label discretion, which has impeded Special Markets in its efforts to assemble attractive compilation packages. It's not uncommon for Special Markets to propose upwards of 30 or 40 single-artist compilation packages at one time, only to have one or two approved. In many cases, the labels simply ignore Special Markets' requests.

An example of such objective criteria is if the artist who recorded the master which Special Markets seeks to use no longer is on the label. Surely at this point the label has no on-going relationship interest to protect. This particularly is true if the artist is in debit balance. Another example might be the age of the master, even if the artist still is on the label. If it was recorded more than 10 years ago, for example, surely it ought to be considered an appropriate candidate for Special Markets' usage.

The propounding of objective criteria in this vein will reduce many of the delays and frustrations which Special Markets experiences, and reduce jurisdictional friction between Special Markets and the labels.