Company helps calculate complex royalties for digital music sales

by Kathryn Balint

The music industry - upended by Internet piracy and new forms of digital distribution - now faces another hurdle in the era of iTunes, MP3s and ringtones: how to divvy up income from those sales.

THEIR SHARE - Scott Holcombe (left) and Steve Grady worked in the online music industry in San Diego before helping found RoyaltyShare, a Web-based service that calculates record companies' royalty payments to songwriters, singers and publishers. CNS Photo by Earnie Grafton. Some independent record labels are still using Excel spreadsheets to calculate royalties. Not the most efficient method.

Here comes Bob Kohn, the guru of music royalties.

He thinks he has a solution for music royalties in the Digital Age. It's RoyaltyShare, a Web-based service that he helped start in San Diego.

"Digital downloads have vastly increased the complexity of royalty processing," Kohn said. "The old systems were not designed to deal with these kinds of complexities."

Kohn is no stranger to the digital music industry - or to the intricacies of music royalties, for that matter. In 1998 he co-founded eMusic, a pioneer in digital music that was selling song downloads a year before piracy enabled by file-sharing services such as Napster wreaked havoc on the music industry.

Kohn also co-authored with his father a 1,636-page opus called "Kohn on Music Licensing," which is widely regarded as the bible on music royalties.

As Kohn describes the history of royalties, calculating the payments used to be relatively straightforward when most music was sold as albums in the form of records, cassettes or CDs.

All that changed with the advent of digital music. Downloadable tunes, ringtones, streaming music and online subscriptions have resulted in an avalanche of transactions as consumers opt for singles instead of albums. On top of that, the number of digital distribution outlets has exploded.

The result: a mountain of paperwork for record labels calculating royalties.

"There's now a need to deal with hundreds of millions of transactions instead of the old way of doing it in the music business," Kohn said.

The move to digital sales is changing the way Americans buy their music.

Sales of music CDs in the United States fell almost 13 percent in 2006, the sixth consecutive year of decreases, according to the Recording Industry Association of America. Digital music sales were up 63 percent for the year, but they failed to offset the decline in compact disc sales.

"The CD has been the music industry's core product, and we're seeing the CD business decline rapidly at the same time that a whole range of new digital music products is being developed and offered to consumers," said Susan Kevorkian, program manager of consumer markets: audio for market research firm IDC in its San Mateo, Calif., office. "It's a challenging time for the music industry."

Kohn put his background in selling digital music and his expertise in music royalties to work when he decided to come up with a better way to tally royalty payments.

He got together in 2005 with Steve Grady and Scott Holcombe; both had worked at eMusic and were living in San Diego after Vivendi Universal bought the company and San Diego-based MP3.com.

Kohn, Grady and Holcombe built a Web-based software service capable of reading sales lists and calculating royalty rates. The service calculates digital as well as CD sales.

It sounds easier than it is.

Songwriters, artists and producers all get a share of the proceeds from the sale of a song. But some songs have more than one songwriter or more than one artist. The rise in popularity of sampling, in which snippets of one song are used in the creation of a new song, also adds to the number of people who need to be paid in the sale of a track.

"You could have four band members, there could be five songwriters, all of whom need to be paid," said Grady, who is president and chief operating officer of RoyaltyShare. "In some cases, you could have 10 payees on one single track."

Royalties might vary depending upon which country the song is purchased in, whether it was sold at a military base or in a store, or whether the song was streamed online or downloaded over the Internet.

Further confusing the issue is how distributors, such as iTunes and Rhapsody, account for sales. Each might report different data. Some specify the album on which the song was released. Others don't.

"You've got complexity upon complexity," Grady said.

Kevorkian, the IDC analyst, said technology historically has been a secondary consideration for music companies.

"Technology wasn't - and still isn't - the strong suit of the music industry," she said. "Companies like RoyaltyShare offer to music labels the possibility of farming out some of those technological processes in order to speed their time to market. That's very important."

Peter Wright, chief executive of Virtual Label, a Brooklyn-based aggregator of music for online services, was among RoyaltyShare's first clients a year and a half ago.

Until then, Wright said his employees were spending an increasing amount of time using spreadsheets to calculate royalties.

"It was to the point where we were spending two or three days a month just creating royalty statements," Wright said. "It was excruciating. Now it takes probably a couple hours a week."

RoyaltyShare takes about a 3 percent cut of the revenue it processes.

Most of the big record labels have their own software for calculating royalties.

But some of the older, off-the-shelf programs do not accommodate new forms of digital distribution, Grady said. Because RoyaltyShare is a Web-based application, it is continually updated to account for changes in the industry.

RoyaltyShare has grown to 30 employees and counts more than 150 customers, almost all of which are independent record labels. RoyaltyShare boasts one of the major record labels as a client but has not identified which one.

In 2006, the first full year of sales of its RoyaltyShare service, the company brought in more than $250,000 in revenue. Grady said revenue is expected to grow fivefold by the end of this year.

Kohn, who is RoyaltyShare's chairman and chief executive, works out of New York City and visits the San Diego headquarters every three months. Holcombe, RoyaltyShare's third founder, is the company's chief technical officer in San Diego.

In the past eight months, RoyaltyShare has acquired Los Angeles-based Independent Digital Entertainment and Arts, a provider of online services to record labels, and Musicalc, a British provider of royalty accounting software for the music industry.

RoyaltyShare received its second round of funding - $5 million - from Trident Capital, a Palo Alto, Calif., venture capital firm, in April. Trident had earlier invested $5 million in the company.

And RoyaltyShare is in the process of establishing an office in New York City.

As digital music sales make up a larger share of the market, Grady expects sales of RoyaltyShare's service to grow, as well.

Last year, about 8 percent of the $11.5 billion in U.S. music industry revenue came from digital sales. But each year, digital sales account for a bigger slice.

"Calculating royalties is only going to get more complicated," Grady said. "That's why record labels need our service."

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