



February 2020 Management Case Study Examination Pre-seen material

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Trevel Records (“Trevel”) is a quoted company that creates and sells music to a global market. Trevel is based in Capital City in Fortuna.

Fortuna is a developed country that has a high standard of living. Most of its citizens have sufficient disposable income to be able to afford regular spending on entertainment, whether that be for music, books, cinema or theatre.

Fortuna’s currency is the F\$. Companies are required to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS).

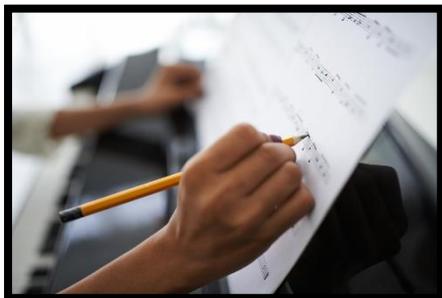
Fortuna is one of the top six countries globally for music sales. Collectively, these six countries account for more than 70% of revenues from the sale of recorded music. English-language recorded music sells well in all of those countries, despite English not being the first language in many of them.

You are a financial manager at Trevel’s Head Office. Your primary responsibilities are associated with management accounting and you report to the Senior Financial Manager who reports directly to the Finance Director.

The music industry is wide-ranging and diverse. Trevel is a recording company (or a “record label”). Trevel generates revenues from recording music for sale, either on physical media such as compact discs or through various digital distribution channels.

The Music Industry

The music industry is made up of a broad collection of individuals and companies who create and earn revenue directly from music:



- **Composers and songwriters** – music is generally written by an individual, who retains ownership of the copyright to that composition. Others who wish to perform that music publicly, either live or through the release of a recording, will usually have to pay a royalty.

Composers sometimes create music in return for a fixed fee, in which case the copyright is sold to the entity that commissioned it. For example, a composer might be paid to write music to serve as the soundtrack for a film

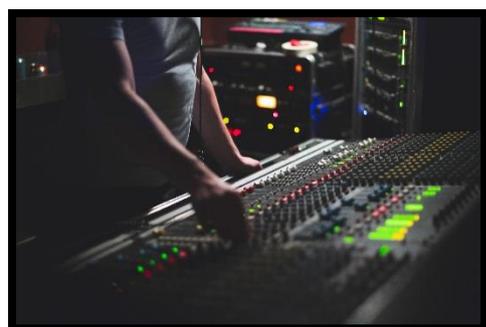
or television programme, or as the background to an advert.



- **Producers and promoters of live performances** – live performances can range from an individual vocalist or instrumentalist, to a group of musicians or full-scale orchestra. Live performances may take the form of concerts, which require audience members to purchase tickets, or they may be provided free or as part of some other attraction. For example, restaurants sometimes pay a musician to provide live music in order to create a relaxing atmosphere for their

customers. Theme parks and cruise ships often offer live musical performances as part of the entertainment packages offered to their guests, with no separate charge for attending.

Live performances create revenue generating opportunities for the agencies who sell tickets, if a separate charge is made for entry, and for the venues that will accommodate the performance. Venues can range from theatres and concert halls to major sports stadia, depending on the nature of the performance and the size of the audience.



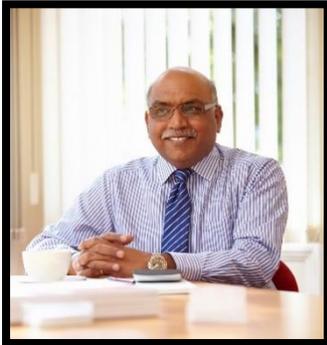
- **Sound technicians and recording engineers** – live performances can be captured as either audio or video recordings. The recordings can either be live or studio-based. Live performances are recorded in the presence of an audience, using recording equipment installed in the venue. Live recordings can capture some of the atmosphere of being an audience member. Studio recordings use carefully engineered recording studios to capture music that is not impaired by echoes or external sounds.

Recordings are usually created for commercial purposes. They can be sold to listeners on physical media, such as CDs, DVDs or vinyl records or as digital downloads. Music companies can also generate revenues from licensing their recordings for broadcast.

The equipment required to create reasonably good quality recordings is not particularly expensive. It may require little more than a microphone plugged into a laptop and some

basic software. Some musicians use websites and social media to offer free downloads of their recordings in the hope that they can create or develop a fanbase.

The music industry also encompasses a number of businesses that generate revenue from the sale of music or from the provision of services.



- **Agents and agencies** – many musicians are represented by agents, who promote their acts and negotiate with record companies and producers of live performances on the musicians' behalf. The agents usually receive a percentage of the fees and royalties earned by the musicians, which gives them an incentive to find them work and negotiate healthy fees.



- **Lawyers** – some lawyers specialise in the music industry. Contracts can be complicated and so both musicians and recording companies are often forced to pay significant sums to ensure that agreements suit their interests and are legally enforceable. There are also complicated areas, such as copyright, that can lead to complex disputes.



- **Recording companies** - The recording companies (who are often referred to as "record labels") are, arguably, the most visible part of the music industry. Apart from recording and distributing music, recording companies must find and promote new acts, otherwise listeners will lose interest and will stop paying to listen to music. The process of searching for new talent and promoting the resulting acts is often associated with heavy expenditure on advertising and publicity.

Musicians are often encouraged to behave in a manner that attracts the interest of the popular press.

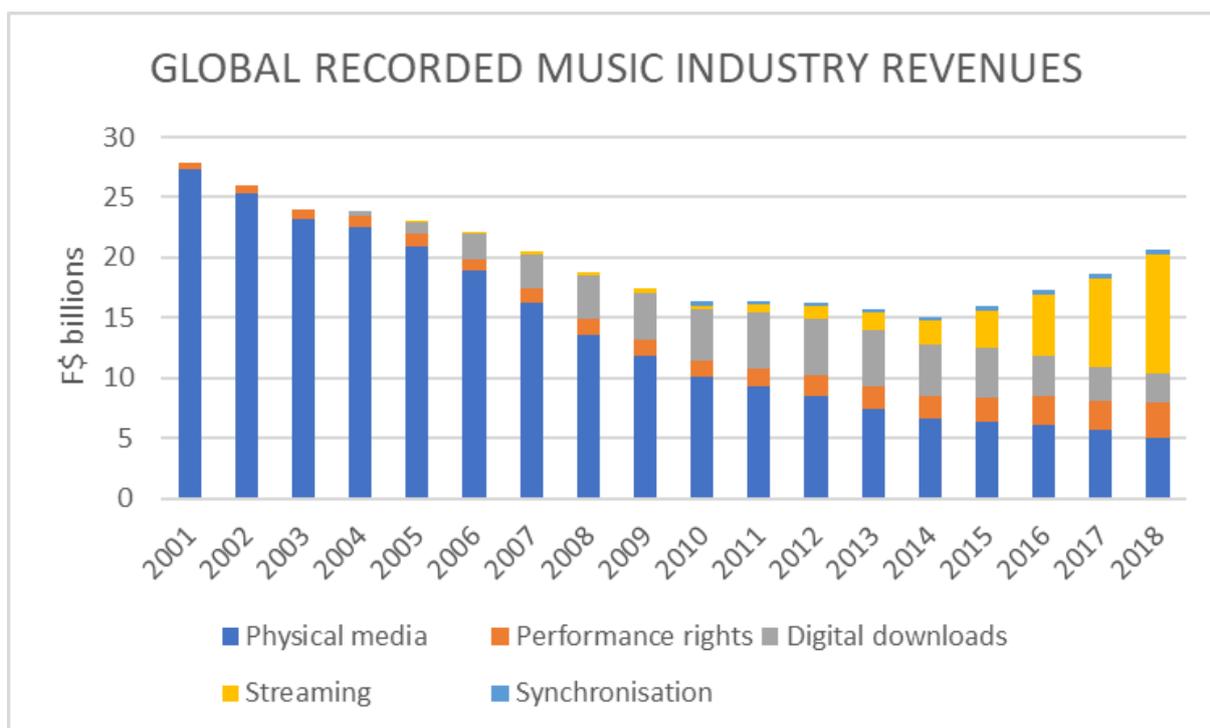
Recording companies' / record labels' business models

Recording companies enter into agreements with artists and composers to acquire the rights to record and distribute their music. The resulting recordings are then made available through a number of distribution channels in order to generate revenues. These channels take several different forms:

Physical media	<p>Historically, recorded music was sold on physical media, such as vinyl records, audio cassettes and compact discs (CDs).</p> <p>The music industry was keen to encourage and support the development of new types of media because they helped maintain demand from customers. The purchase of new hardware for playing music was often accompanied by a desire to build a music collection to play on it.</p> <p>Customers would also replace their favourite recordings on new media that offered greater convenience or improved sound quality. For example, CDs were an overnight success when they were first launched because they were easier to store and handle than vinyl records and had better sound quality than audio cassettes.</p>
Digital downloads	<p>Digital downloads involve customers buying the rights to download music as data files to their computers or phones. The purchase price includes the licence that permits the customer to store and play those files on their personal devices.</p> <p>Digital downloads used to be stored and played on portable music players, using headphones to enable them to be played while walking or travelling. Those specialised devices have fallen out of favour, with the vast majority of listeners now using their mobile phones to store and replay music files through headphones.</p> <p>The recording companies generally grant third party online retailers the right to sell their music online. The retailers create a website that hosts the music that is available for download and enables customers to search for music that interests them. Typically, the retailer pays an agreed royalty to the recording company whenever it sells a download. The retailer charges the customer a fee that covers the cost of the royalty and any other expenses, such as charges imposed by credit card companies.</p>
Streaming	<p>Streaming requires the customer to pay a subscription to an online music company. The customer then uses software, such as a mobile phone app, to access the files held on the site. The customer can access and play the music on the site over an internet connection, which may be provided by Wi-Fi or a mobile telephone connection but cannot download and retain files.</p> <p>Streaming benefits the customer by granting access to all of the recordings on the site. The regular monthly fee makes it possible to listen to the latest music releases or to experiment with different styles of music, all without making any additional payment over and above the subscription cost.</p>

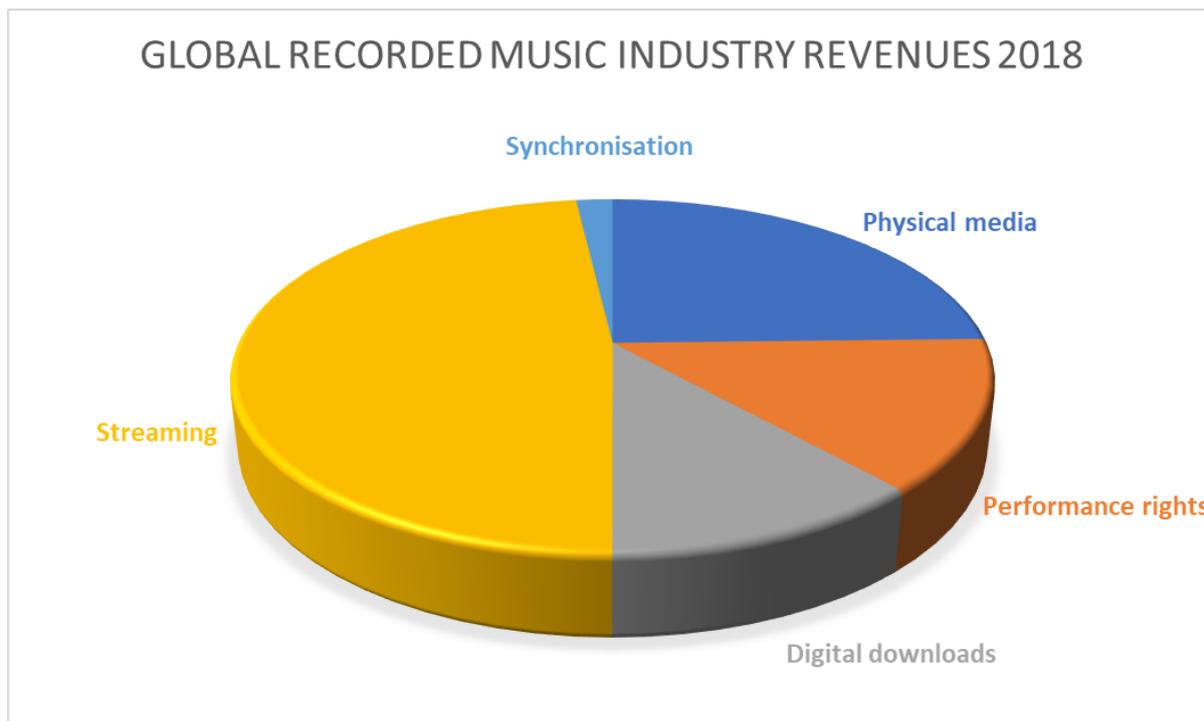
	<p>The online music companies who provide streaming services must pay a small royalty to the recording company for every track played by a customer. The royalty per download is significantly smaller than that paid for a digital download because the recording company does not have to grant a licence to the customer. Indeed, the customer may play the same piece of music repeatedly, in which case the royalty will have to be paid each time the music is listened to.</p>
<p>Performance rights</p>	<p>Broadcasters must pay to play recorded music on television or radio programmes. Recording companies charge a royalty for every time that one of their music tracks is played on air.</p> <p>The broadcasters benefit by attracting listeners, which enables them to sell advertising time between songs.</p> <p>Copyright law also requires a licence before music can be played in a public place. For example, retailers may play recorded music in order to create a pleasant atmosphere in their shops or bus companies may play radio programmes in order to entertain commuters. Anyone wishing to play recorded music in this way must purchase an annual licence that grants them the right to play music without breaching copyright law. There is no need to make a separate payment for each song played.</p> <p>Licences to play music in public are granted by not-for-profit organisations such as the Fortuna Licensing Organisation, which was established by the music industry in Fortuna to grant licences to play music in public places across the country. Any organisation who wishes a licence must pay an annual fee that is based on factors such as the number of potential listeners. The licensing authority recovers its operating costs from the fees charged and shares the remainder between the recording companies in proportion to their revenues.</p> <p>Recording companies benefit both from their share of the annual surplus from the licence fees and from the possibility that listeners might enjoy a song and subsequently buy a copy or subscribe to a streaming service.</p>
<p>Synchronisation</p>	<p>Recorded music may be used as the basis for the soundtrack of a film, television programme or video game. This is a relatively small, but growing, source of revenue for recording companies, who charge a fee for the use of their music in this way.</p> <p>Synchronisation fees are not payable in cases where the music rights belong to the film, television or game producer. For example, a film company will often pay a composer to write the music soundtrack to accompany a movie and have that music performed and recorded in return for further fees. In that case, the music belongs to the film company and can be used as it wishes without further payment. Indeed, the film company may also make the soundtrack available for purchase as an album.</p> <p>The fee for using a piece of music in a film soundtrack will generally be negotiated between the prospective user and the recording company. The charge will vary depending on the length of the musical extract and the potential audience for the completed work. For example, the use of an entire track as the theme tune to a major movie will cost more than a</p>

15-second snatch of music that will be used as background music in a low-budget television drama.
 Recording companies usually agree to share synchronisation fees with the artists who compose or perform music for them. The percentage given to the artist is agreed when they sign the contract to produce music for the recording company and varies according to the artist's bargaining power.



These figures reflect the revenue earned by recording companies at point of sale.

Overall, the revenues from recorded music declined significantly from 2001 to 2014 but have recovered slightly since then, thanks in part to the growing interest in streaming services. It remains to be seen whether that recovery will continue. One concern is that customers who subscribe to streaming services already have access to a wide range of music, including the latest releases. There will be little scope for further growth once most potential listeners are subscribing to streaming services. If the market becomes saturated in this way then there will be little room for revenue to increase further unless the market is prepared to tolerate an increase in the prices of subscriptions.



Digital purchases, combining streaming and downloads, now account for more than half of all global music revenues. Sales of physical media are declining steadily, although there is a residual demand for CDs remains strong, generally in countries that have a poor internet infrastructure. There has also been an unexpected resurgence in demand for vinyl records, which is welcome, but insufficient to arrest the overall decline in demand for physical media.

		2017	2018
CD	Millions of units shipped	445.8	317.5
	Value in F\$ billions	3.7	2.6
Vinyl	Millions of units shipped	148.5	212.1
	Value in F\$ billions	1.5	2.1



CDs are plastic discs, typically 4.7 inches or just under 12 centimetres in diameter, that have a thin layer of reflective aluminium. Music is copied onto the disc as a digital file by using a powerful laser to make “pits” in the plastic with a powerful laser. When the CD is played, the player spins the disc and a low-powered laser scans the pitted plastic to read back the data. The CD player converts the data back to sound, which is played through headphones or speakers.

CDs quickly became very popular after their launch because customers found them easy to store and handle. The fact that music was stored digitally meant that sound quality did not deteriorate over time, even if the disc became grimy or scratched with use (although badly damaged CDs might not play at all). Record companies were keen to promote CDs when they were first introduced because they were significantly cheaper to manufacture and distribute than competing media, including vinyl records.



Vinyl records are made using discs of a relatively soft plastic, typically 12 inches or just over 30 centimetres in diameter. The vinyl disc is pressed mechanically, leaving a spiral groove embedded in the plastic. Ridges within the spiral groove carry the music as an analogue recording. The records are played on a turntable that spins the disc whilst a metal needle runs along the groove and picks up the vibration caused by the ridges. The resulting vibration of the needle is amplified electronically and played back through headphones or speakers. Music is pressed onto

both sides of a record, which means that a listener has to play half of the album before removing the record from the turntable, flipping it over and playing the second half.

For many years, vinyl was the only available medium on which recorded music could be purchased. It lost most of its popularity when CDs were launched. Vinyl records are much larger than CDs and so are more difficult to store. The sound quality deteriorates with use because finger marks can muffle the sound picked up by the needle and specks of dust and scratches caused by careless handling are picked up as “crackles” or “clicks” during playback.

Despite its problems, vinyl has recovered some of its popularity amongst music lovers who believe that vinyl records offer superior sound quality to digital formats.

Singles vs albums

When recorded music was sold primarily on physical media, recording companies often released popular music in two formats. Singles were pressed as a small record that was seven inches in diameter, usually containing two songs. Albums were pressed on larger, 12-inch discs that contained more music, perhaps ten or twelve songs (usually referred to as “tracks”).

Recording artists generally aimed to release albums at regular intervals, so that their fans remained interested in their music. Whenever a new album was released, the recording company would select one or two tracks to release as singles. Typically, the first single would be released to coincide with the album’s release. If there was to be a second single from the album, it would be released a few weeks later, when interest in the first single was dying down.

Singles usually had a designated “A” side, which was intended as the primary song on the record. The “B” side was usually a weaker track taken from the album and was intended to be secondary, to fill the space on the reverse side of the record.

Broadcasters concentrated almost exclusively on singles and so they often generated more publicity than the album from which they were taken. Some fans preferred to buy albums because they were keen to own all of the tracks that had been released by their favourite acts. Others purchased only singles because they often felt that they were the best tracks and so they had less interest in owning the remainder of the album.

The shift to digital distribution has not affected the distinction between albums and singles. Artists continue to record and release music as albums. The recording companies continue to designate one or two tracks from each new album as singles. Sometimes singles are made available online before the whole album is released, in order to build anticipation. Broadcasters continue to focus on singles in their shows.

Many musical genres, including pop, soul and country, lend themselves to listening to individual tracks and so are released as both singles and albums, despite the fact that customers who buy digital downloads or subscribe to streaming services can purchase and/or

listen to any selection of tracks from any album, in any order, regardless of whether those tracks are designated as singles or album tracks.

There are some musical genres that do not lend themselves to the release of singles. Classical orchestral music and operas are generally listened to as an entire symphony or opera and so are recorded and released exclusively as albums. Similarly, some styles of jazz music are generally played as entire albums.

New releases vs back catalogue

Recording companies depend on new releases to keep their artists in the public eye. New singles are particularly important because they are played on radio and discussed in newspapers and on television. Singles generally remain popular for a few weeks, although the length of time they spend in the charts varies tremendously.

Albums tend to follow a similar pattern, with an initial demand created by fans who wish to own the latest release by their favourite acts. That initial demand may be boosted or prolonged by advertising. It is, however, almost inevitable that sales will decline.

Recording companies continue to make recordings available, even after they have lost their initial popularity. Many recordings remain popular for years after their release and some recordings retain their popularity for many years, being referred to as “classics” because they are played and enjoyed by new generations of listeners. Revenues from such albums involve very little additional cost to the recording companies, other than the royalties that will continue to be payable to the artist and the songwriter.

The growth of downloads and streaming services has eliminated most of the cost that had previously been associated with maintaining back catalogues. There is very little cost associated with keeping digital copies of existing recordings available for download or for streaming.

From time to time, recording companies attempt to stimulate sales of back catalogue albums. There are various techniques for doing so:

- The original tapes on which the albums were recorded can be processed with a view to creating a higher quality digital version than has previously been available.
- Compilations of tracks can be put together to create a themed album, such as “best of ...” albums that showcase a particular artist’s singles or a collection of tracks that might be suitable for, say, playing at a party or as background music when driving.
- Permitting the use of a piece of music as, say, part of a movie soundtrack, a theme tune for a television programme or the background to an advert can stimulate interest in the artist or the album.
- The impact of these opportunities to make sales from the back catalogue can be enhanced by advertising and by other promotional techniques that might be applied to new releases, such as encouraging the artist to appear on television chat shows or to perform live. The active involvement of the artist is often crucial to boosting sales.

Music charts

For many years, the music industry has published charts to show the relative popularity of recordings. Typically, these were updated and published weekly, often to coincide with the publication of weekly music industry magazines or weekly television or radio shows.

Fortuna Pop Chart		
	Artist(s) and song	Change since last week
1	Walso Plain – Leopard Clash	↔
2	Bentana – Hold My Hand	↑
3	Butter'n'Cheese – Both Together	↑
4	Makkon Ditty – Robot Spark	New entry
5	Doranna West – Best Friends	↓
6	Tomm Taylorr – Maybee Babee	↑
7	The Durridders – Fiddles a Strummin'	↓
8	Crystal Weapon – Keep Your Head	↓
9	Daisy Wander – Sit Right Up	↑
10	Blenderbuss – The Stone Orchid	↑

The charts reflect the popularity of the recordings that are included during the weeks or months for which they were compiled. Charts can include up to 100 recordings, although most attention is devoted to the top 10 items on the chart.

Music charts generally rank recordings according to a complicated formula that takes account of several factors, including sales

revenues from physical media and downloads, radio plays, and number of plays on streaming sites.

Chart rankings often receive a great deal of attention in the popular press and on radio shows devoted to popular music. Artists who had previously dominated the charts but are now failing to reach the coveted number 1 spot are viewed as being in decline in terms of their careers. That often leads to speculation as to whether or not their record label will continue to support them.

Most interest is shown in singles charts for popular music, although there are also charts for albums and for virtually every genre of recorded music. Charts are generally compiled locally for national markets, reflecting the fact that they are essentially promotional tools.

Interpreting the charts can be complicated because there are annual cycles in the market for music. Fewer recordings are released during the summer months because many potential customers and listeners are away on holiday and so the market is thinner. The major record labels are also careful to avoid creating competition between their more popular artists. Releases from different artists may be staggered over a period of a few weeks so that the label's recordings are not in direct competition for airtime or customer spend. That may mean that a recording that reaches, say, number 5 in the charts could be more popular with listeners in terms of purchases and plays than one that reaches number 1 if the latter recording was released at a quieter time of year.

Trevel's History

Trevel was founded in the 1980s by the owners of a music club located in Fortuna's North City. The club had a reputation for attracting talented local bands, which led to it becoming a popular venue for music lovers. The club started to attract Artist and Repertoire (A&R) managers from record companies, which led to some of the acts who had played at the club obtaining recording contracts.

The club's owners were encouraged to create their own small recording company, hiring local studios and production staff whenever they believed that an act who had played at the club had the potential to be successful as a recording artist. The recording company grew steadily through the 1980s and into the 1990s thanks to the club owners' ability to identify commercially viable acts. Sales of recordings generated revenue and also generated good publicity for the club as a music venue.

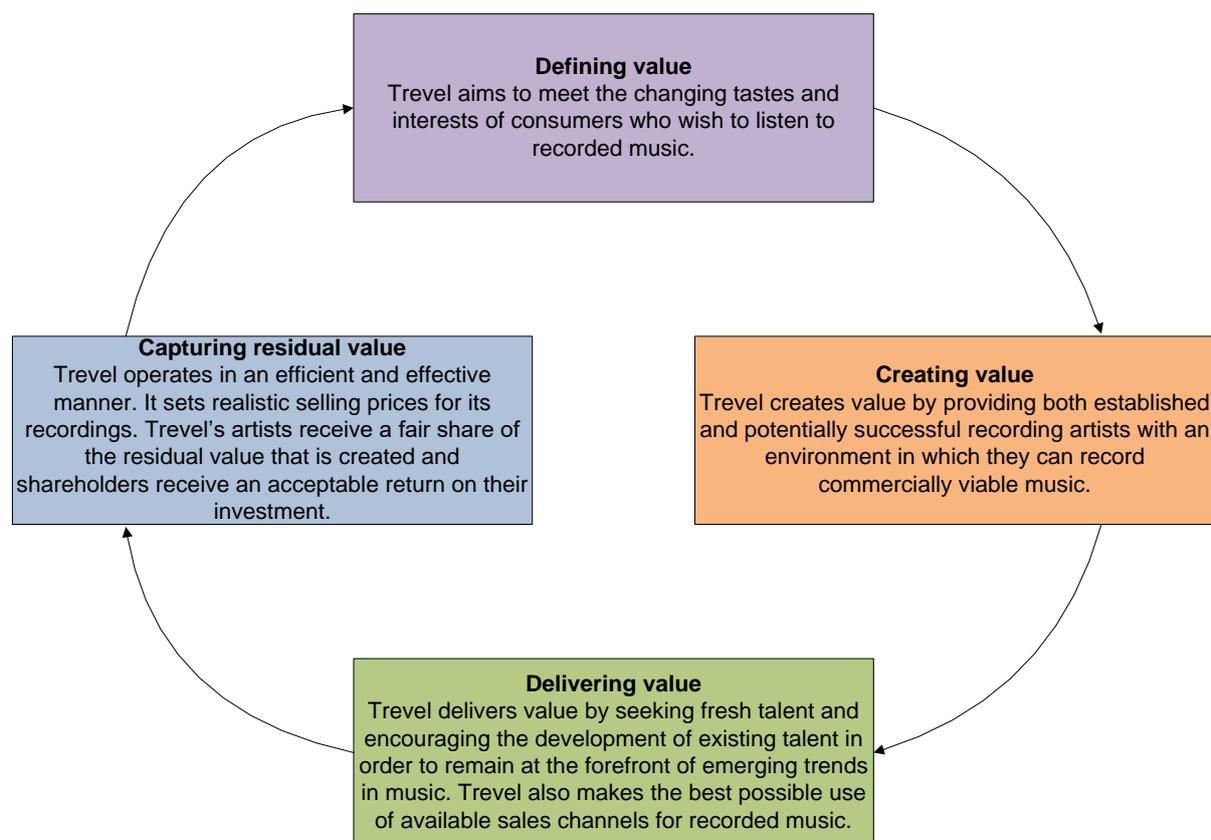
In 1994, the founders sold the recording company to a large recording company, who wished to have a commercial presence in the music clubs that were spread across Fortuna. The company was renamed Trevel and was operated as an autonomous entity, acquiring a number of smaller recording companies over the next few years.

Trevel was responsible for discovering several successful musical acts. By 2000 it had contracts with several major recording artists whose music was sold worldwide.

In 2001, Trevel was sold to its management team. In 2006, Trevel was listed on the Fortuna Stock Exchange.

Trevel is now one of the World's ten largest music recording companies, in terms of sales revenue. Trevel is a global company, with more than 60% of its revenues coming from sales to customers in countries other than Fortuna. The company is, however, firmly based in Fortuna, with its head office located in Capital City.

Trevel's business model



Trevel has contracts with many leading recording artists. Trevel invests heavily in A&R, looking for potential new acts by visiting music clubs and listening to the many recordings that are submitted by hopeful musicians who are hoping to be offered recording contracts. Trevel has always aimed to be at the very forefront of emerging trends in the different styles of music that it records and sells. The company is generally prepared to pay more than its competitors in order to sign a contract with an innovative performer who can be promoted as offering a “new” sound. Experience suggests that unusual acts that differ from the norm can become established as best-selling artists, although Trevel has also had some disappointments with acts that never achieved great popularity with music audiences.

Trevel works to develop artists' music careers in a number of ways, including becoming involved in areas that are not directly related to recording. Trevel's support extends to areas such as:

- Live concerts
- Fan clubs
- Merchandising
- Soundtracks for films, television and video games
- Rights to use images, video and music in advertising
- Acting and guest appearances in films and television programmes and on television chat shows
- Publicity and brand development for the acts

The overall objective of this support is to enable these artists to become well-established and to record many albums with Trevel over the remainder of their careers.

Trevel's standard contract gives the company the right to manage all aspects of an act's career. The company has a reputation for treating its acts fairly and for developing them in ways that are mutually beneficial. Most acts are signed at an early stage in their careers, when they have relatively little ability to negotiate contract terms, but there have been very few cases where acts have subsequently complained that Trevel has been greedy or treated them unfairly.

Trevel's standard contract gives each act a royalty, which is a percentage of the revenues generated from the act's recordings. Royalty payments are usually calculated after the recording company has deducted "recoupable costs", which are defined in the contract and usually include recording and studio costs, manufacturing, promotion and marketing. Each act's royalty percentage varies, with larger and more successful acts being able to negotiate a more attractive percentage.

Trevel's contracts are designed to be fair to both the artist and the company. Typically, a contract with a new artist gives Trevel the rights to take control of the artistic production and subsequent sale of that artist's first album, with an option for Trevel to produce and sell a specified number of subsequent albums. Established artists' contracts are usually for a specific number of future albums, with the recording company having the option to extend the contract to increase the number of albums. Trevel will sometimes renegotiate a contract while it is still in force to increase the number of albums, in return for an increased royalty rate.

Contracts give Trevel exclusive rights to any recordings made for commercial purposes, but Trevel does not generally require payment from the proceeds of artists' non-recording activities. For example, live concert tours generate excellent publicity for artists and can have a significant impact on the sales of recorded music. Trevel actively encourages its acts to tour and perform live concerts, but does not require any royalties or share of the ticket sales if they do so. Trevel does not take an active role in the promotion of concerts and other live performances, but it does insist that artists refrain from behaving in a manner that might have an adverse effect on the sale of recordings. Trevel usually gives new artists a small financial contribution towards the costs of touring in order to encourage them to do so.

Trevel also has many leading songwriters under contract. Writers' contracts are similar to those of musicians, with songwriters being required to write exclusively for Trevel. Songwriters benefit from being able to write songs for the successful recording artists who are also under contract to Trevel, so any songs that are released are likely to generate significant revenues.

The songwriters receive royalties based on Trevel's revenues from the music. Some songs are recorded and released by several musicians and so a songwriter can continue to receive payments from a piece of work for many years after it was written and first recorded.

Trevel aims to generate revenues from a wide range of recording interests. Most revenues come from existing and well-established artists, both new recordings and back catalogues. Trevel prides itself on developing new acts through its active A&R Department, but the company is not particularly dependent on revenues from recently signed acts.

Trevel's recording interests cover most major categories of music and musical styles. These include pop, rock, R&B, jazz and country.

The global nature of the recording industry means that Trevel generates revenues from around the world. Most of its artists have an international following, although Trevel does have a number of successful acts whose popularity is restricted to their home countries.

Artists and repertoire (A&R)

Trevel has had considerable success in identifying previously unknown acts and helping them to develop successful recording careers. That has been beneficial in earning revenues from those acts and it has helped to promote Trevel as a good company in which to establish a recording career. Trevel invests heavily in A&R activities in order to maintain this reputation.

A&R scouts travel the world, looking for fresh talent that may be performing in clubs or concerts. Sometimes the scouts go to hear a specific act that interests them because of positive reviews on social media and sometimes they go to performances because they happen to be in the area.



A&R also receives large numbers of so-called “demo” recordings from acts who wish to be considered for contracts with Trevel. It is possible to make a reasonably good recording of a musical performance using a digital microphone, a laptop and some software. Many aspiring recording artists rent or buy this equipment, or they speculate by paying a professional recording studio to record a few tracks.

A&R departments generally receive more demos than they can listen to, but Trevel

listens to as many submissions as possible because some of the company’s most successful artists were discovered from demo recordings.

A&R costs include the costs associated with finding new artists and supporting and developing artists who are under contract. They also include the costs of royalties paid to musicians and songwriters.

Trevel generally pays its artists an advance against future royalties when a contract is first signed. That advance is then recouped against subsequent royalty payments. Royalties are paid half-yearly on the basis of the agreed percentage of net proceeds (i.e. revenues received by Trevel, less “recoupable costs”) arising during the half-year.

Marketing and promotion

Trevel invests heavily in marketing and promotion because even the most talented musical act may not prove commercially successful unless it is brought to the attention of the music-buying public.

Trevel’s Marketing and Promotion Department works closely with all acts to help them identify the most successful approach to the creation and release of a new album. That could include listening to potential tracks to identify those that should be included in the album, the selection of the single(s) from the album, working with broadcasters to create a sense of anticipation and producing the all-important videos for television and internet broadcast.

The Marketing and Promotion Department also aims for a cost-effective approach to the marketing spend on any given album. That is important to the artist because marketing costs are generally offset against album revenues before the artist’s percentage is paid. The artist is, therefore, keen to ensure that any marketing costs are justified by additional income and

so they have an incentive to participate in promotion by, for example, appearing on television chat shows to promote new albums or by touring to perform the new songs live.

Public relations

Trevel's Public Relations (PR) team is responsible for managing the reputation of Trevel as a whole, as opposed to its acts. That includes managing press coverage relating to the company by ensuring that positive news is featured prominently while playing down coverage of bad news. The PR team also liaises with external regulators, such as government departments, to ensure that Trevel's interests are addressed in any developments.

Board oversight of A&R, marketing and public relations

Trevel spends heavily on A&R, marketing and PR. The Board insists that it obtains value for money from these activities and so there is an executive director of Marketing and Business Development. That post is presently held by Anna Kari. Her role is to oversee all aspects of the development of artists, the promotion of their recordings and the PR function

In order to permit Anna to discharge her responsibilities, the Board grants her a substantial annual budget that she must allocate to the different activities under her control. She then decides on the priorities for different activities within A&R, marketing and public relations and budgets accordingly. The nature of the business means that there will often be short-lived opportunities that can only be pursued if she reallocates part of her budget during the course of the year.

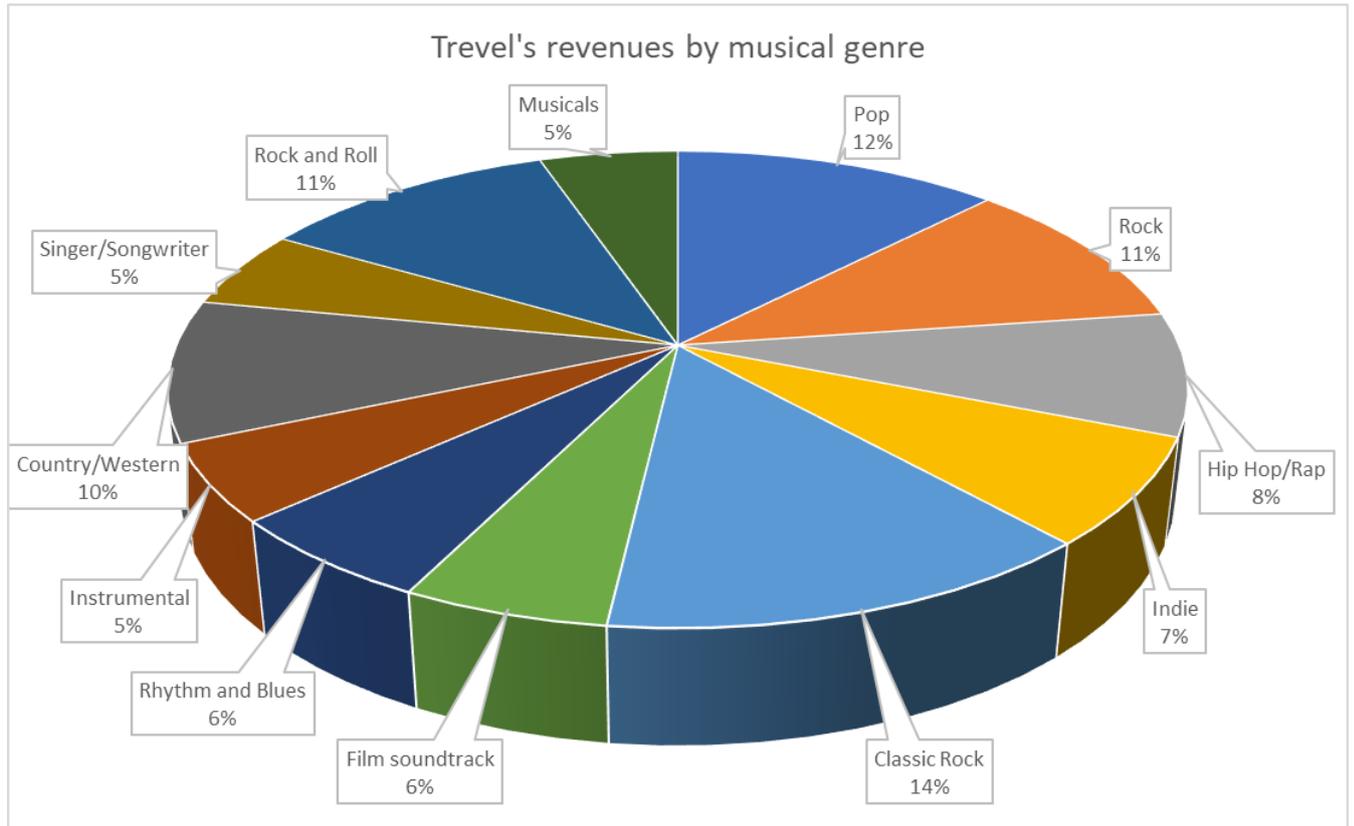
The reallocation of budgets is necessary because the Board does not wish to spend even more on Marketing and Business Development than it does at present. They are however happy for some of the departments under Anna's control to overspend provided there is evidence of an underspend elsewhere.

Manufacturing

Trevel divested itself of its production facilities for the duplication of physical media in 2006. The company contracts the physical duplication of media, primarily in the form of CDs, to third-party manufacturers. Sales of physical media continue to generate steady income and market research suggests that a small proportion of consumers would be unwilling to buy music as a download or through a streaming service.

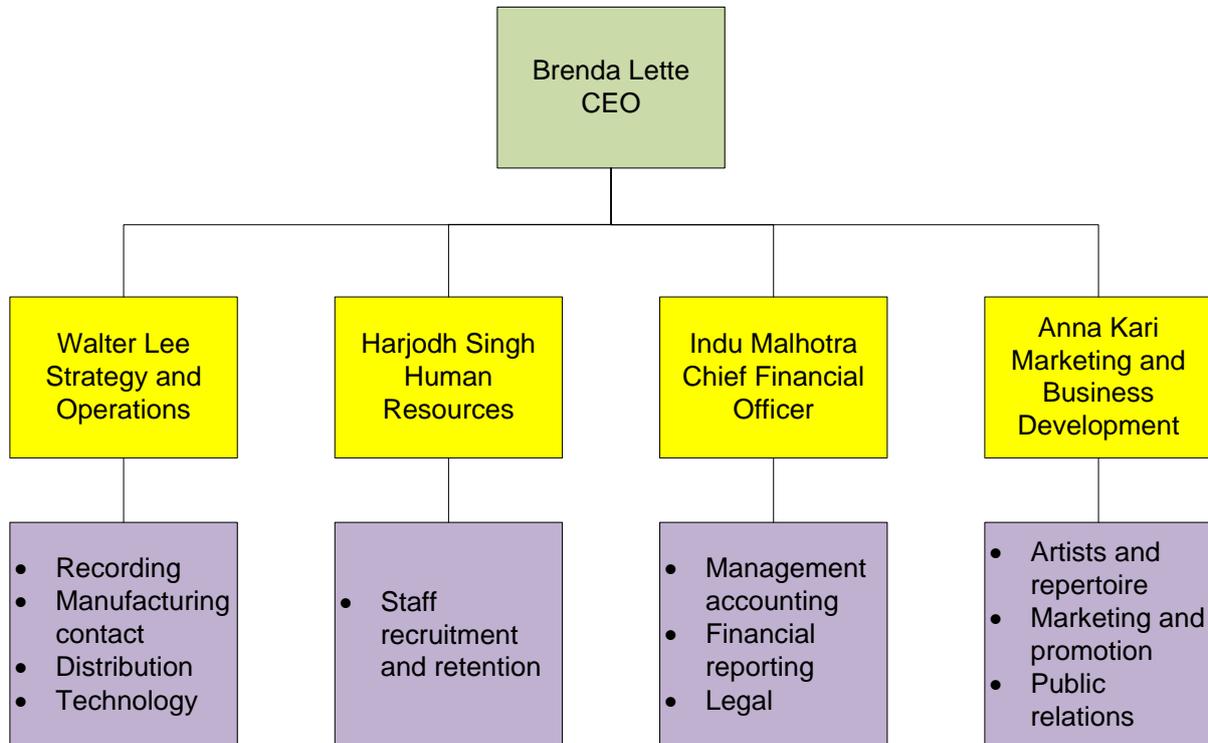
Musical genres

Trevel records a diverse range of music that covers most of the major genres.



Management structure

Executive directors



In addition, the Board has a non-executive Chair and four non-executive directors:

- Gary Farrugia – non-executive chair
- Yui Mazei – non-executive director
- Monika Neff – non-executive director
- Trinh Truong – non-executive director
- John Manley – non-executive director

Costing information

Trevel invests heavily in A&R in order to ensure that it has a steady stream of innovative new music in each of the genres in which it publishes. The cost of getting a new act to the point of releasing an initial album is significant:

	Minimum F\$000	Typical upper limit F\$000
Advance	50	350
Recording	150	500
Video production	50	300
Tour support	50	150
Marketing and promotion	200	700
	500	2,000

Trevel usually treats each new artist as a separate case and budgets each of the costs listed above separately, according to the commercial potential of the act and the need to secure a contract if Trevel is in competition with a rival company. The minimum spend is generally the least that can be spent with any expectation of success.

The advance is an initial payment that is paid against future royalties. It is industry practice to pay an advance because artists need to support themselves while working on a potentially full-time basis on the initial recording and promotion of their first album. Trevel treats advances as a cost, even though they are recoverable against future royalty payments. Advances can take two years or more to recover, assuming that the artists release one moderately successful album per year. Some advances have to be written off when artists fail to achieve anticipated revenues.

Recording costs are the variable costs associated with recording an album at Trevel's studios. These include fees paid to the producers, who "direct" the performance and approve the resulting recordings. There are also technical staff who operate the equipment and session musicians who play instruments. These staff are generally freelance because it is more flexible to bring in specialists in different styles of music.

Video production is crucial for the initial marketing of any new artist. Potential listeners expect to be able to watch at least one video when they look at the artist's website or search social media. Extracts from the video may also feature in television and cinema advertising.

Trevel subsidises the touring activities of new acts in an effort to boost publicity. The artist may be unable to afford to tour unless Trevel covers at least some of the costs. The subsidy might also enable the artist to enhance the quality of live performances by making it possible to hire additional backing musicians. Tours generate publicity and increase the visibility and credibility of artists.

Marketing and promotion is typically the greatest outlay. Record companies must spend heavily on appropriate online and traditional platforms to ensure that the artist's first album is anticipated.

With established acts, the costs of second and subsequent albums are often dictated by the popularity of previous releases. If an artist has already proven to be commercially successful, then it may be necessary to pay a larger advance or to agree to spend more on recording in order to demonstrate a commitment to ongoing collaboration. For example, Trevel spent

F\$980,000 on recording Daisy Wander’s most recent album and she negotiated an advance of F\$1.5 million. The recording costs were high because she had insisted on an orchestra to provide backing music on most of her tracks and that complicated the technical work in the recording studio.

Once an album has been recorded, Trevel must decide on how it should be released and promoted. If the album is to be sold as a CD or a digital download then the costs and revenues average:

	CD	Digital download
	F\$	F\$
Selling price to consumer	10.00	10.00
Retailer’s profit margin	(3.47)	(3.47)
Payment to manufacturer	(1.36)	
Inventory and delivery costs	(0.80)	
Surplus to Trevel	4.37	6.53

Trevel generally charges streaming companies F\$0.0055 per play for music tracks, although that royalty is open to negotiation, depending on the size of the streaming company’s list of subscribers.

The surplus from sales and streaming is shared with the artist, in accordance with the terms of the artist’s contract.

Extracts from Trevel's annual report

Trevel Group		
Consolidated statement of profit or loss		
For the year ended 31 December		
	2019	2018
	F\$ million	F\$ million
Revenue	3,124.7	3,249.7
Cost of revenues	(1,462.2)	(1,491.4)
Gross profit	1,662.5	1,758.3
Administrative expenses	(573.4)	(561.9)
Selling and marketing expenses	(448.9)	(466.9)
Distribution expenses	(64.3)	(61.1)
Operating profit	575.9	668.4
Finance costs	(190.0)	(190.0)
Profit before tax	385.9	478.4
Tax	(104.2)	(138.7)
Profit for year	281.7	339.7

Trevel Group		
Consolidated statement of financial position		
As at 31 December		
	2019	2018
	F\$ million	F\$ million
Non-current assets		
Property, plant and equipment	326.3	315.7
Goodwill	1,665.0	1,665.0
Intangible assets	1,447.4	1,312.3
	3,438.7	3,293.0
Current assets		
Inventories	32.1	29.8
Royalty advances	137.6	132.4
Trade receivables	489.2	466.7
Bank	374.3	362.4
	1,033.2	991.3
Total assets	4,471.9	4,284.3
Equity		
Share capital and share premium	600.0	600.0
Foreign currency reserve	309.6	317.9
Retained earnings	1,448.7	1,261.9
	2,358.3	2,179.8
Non-current liabilities		
Borrowings	1,200.0	1,200.0
Deferred tax	177.3	186.4
	1,377.3	1,386.4
Current liabilities		
Accrued royalties	415.8	408.7
Trade payables	217.6	203.1
Tax	102.9	106.3
	736.3	718.1
	4,471.9	4,284.3

Trevel Group				
Consolidated statement of changes in equity				
	Share capital and premium	Foreign currency reserve	Retained earnings	Total
	F\$ million	F\$ million	F\$ million	F\$ million
Balance at 31 December 2018	600.0	317.9	1,261.9	2,179.8
Exchange losses for year		(8.3)		(8.3)
Profit for the year			281.7	281.7
Dividends			(94.9)	(94.9)
Balance at 31 December 2019	600.0	309.6	1,448.7	2,358.3

Notes

Accounting policy

“Intangible assets” comprise the value of back catalogues of subsidiary companies that are acquired by Trevel. They are valued at their estimated fair value and are then amortised over ten years from the date of acquisition.

Cost of revenues		
	2019	2018
	F\$ million	F\$ million
Artists and repertoire costs	915.3	914.6
Production costs	482.7	501.9
Licensing costs	64.2	74.9
	1,462.2	1,491.4

Extract from Spandor's annual report

Spandor is Trevel's closest rival. It is a recording company, based in Fortuna, with a very similar business model to Trevel's. The two companies often compete to sign up the same artists to recording contracts.

Spandor Group		
Consolidated statement of profit or loss		
For the year ended 31 December		
	2019	2018
	F\$ million	F\$ million
Revenue	2,874.7	2,702.2
Cost of revenues	(1,301.4)	(1,236.3)
Gross profit	1,573.3	1,465.9
Administrative expenses	(550.5)	(523.0)
Selling and marketing expenses	(417.5)	(396.6)
Distribution expenses	(61.7)	(57.4)
Operating profit	543.6	488.9
Finance costs	(160.0)	(160.0)
Profit before tax	383.6	328.9
Tax	(107.4)	(92.1)
Profit for year	276.2	236.8

Spandor Group		
Consolidated statement of financial position		
As at 31 December		
	2019	2018
	F\$ million	F\$ million
Non-current assets		
Property, plant and equipment	121.2	108.8
Goodwill	1,450.0	1,450.0
Intangible assets	1,331.6	1,220.4
	2,902.8	2,779.2
Current assets		
Inventories	29.5	28.0
Royalty advances	132.1	124.5
Trade receivables	474.5	434.0
Bank	344.4	329.8
	980.5	916.3
Total assets	3,883.3	3,695.5
Equity		
Share capital and share premium	500.0	500.0
Foreign currency reserve	211.7	216.8
Retained earnings	1,371.1	1,188.9
	2,082.8	1,905.7
Non-current liabilities		
Borrowings	950.0	950.0
Deferred tax	164.3	171.1
	1,114.3	1,121.1
Current liabilities		
Accrued royalties	382.5	384.2
Trade payables	202.4	184.8
Tax	101.3	99.7
	686.2	668.7
	3,883.3	3,695.5

Spandor Group				
Consolidated statement of changes in equity				
	Share capital and premium	Foreign currency reserve	Retained earnings	Total
	F\$ million	F\$ million	F\$ million	F\$ million
Balance at 31 December 2018	500.0	216.8	1,188.9	1,905.7
Exchange losses for year		(5.1)		(5.1)
Profit for the year			276.2	276.2
Dividends			(94.0)	(94.0)
Balance at 31 December 2019	500.0	211.7	1,371.1	2,082.8

News reports

Fortuna Daily News

Summer Sandals still tapping their toes

When Dwyre Colt wrote and recorded the song “Summer Sandals” in 1997 he had no idea



that his life would change forever. His song has become a popular summer theme that has been played endlessly on radio and television at the start of every summer vacation period since and it is frequently used as the soundtrack for television advertisements for summer holidays and associated products.

Dwyre admits that he never imagined that the song would be so popular. “I had a cheerful tune in my head and I decided to write it down before I forgot it. It was a

lovely sunny day and that inspired me to write about putting on my sandals and heading for the beach. I was slightly surprised that Trevel wanted to release the song as a single and shocked when it went into the charts at number 1, staying there for four weeks.”

It is estimated that Dwyre continues to earn at least F\$500,000 every year in royalties from the song and from making personal appearances at open-air summer music festivals.

A music industry lawyer told the Fortuna Daily News that copyright law in Fortuna protects rights for 75 years from the creation of a work, or until 50 years after the creator’s death. Dwyre Colt (or his estate) can look forward to receiving royalties until the year 2072, provided broadcasters continue to play the song.

Fortuna Business Daily

Music industry continues to rely on live music



Despite recent recoveries, the global market for recorded music has been declining over the past 20 years. The market for live music performances is worth an estimated total of F\$27 billion, compared to F\$21 billion for recorded music.

There is a mutually supportive relationship between live and recorded music, with most major recording artists performing live concert tours in order to generate income and also to promote their latest recordings.

Major musical acts often find it necessary to stage their concerts outdoors within a park, sport stadium or similar venue because indoor halls are too small to accommodate a large enough audience.

Fortuna Daily News

Benny Ralkette declared bankrupt

The Ralkettes were one of the most successful pop groups in the 1990s. The group has not recorded anything since 2005, but their music lives on in their record label's back



catalogue. Their hit singles remain on many fans' playlists and they frequently feature on movie soundtracks.

Sadly, most of the band seem to have fallen victim to their own success. Dannah Styles and Raji Gupta left the music industry in 2008. Dannah now owns a small hotel and Raji is a taxi driver. Benny Ralkette (real name Benedict Walker) was the group's lead singer and the spokesperson for the band. He

has struggled to create a new career in music management. His

struggles came to an end when he finally closed down his business and filed for bankruptcy.

When interviewed, Benny admitted that the income from the band's back catalogue was quite disappointing. "Remember that there are four of us, so the odd royalty from a television advert doesn't go far. The only group member still making money from The Ralkettes is Symphony Waites, our former drummer. She wrote all the songs, so she makes a fortune from her writer's royalties and also from any re-releases by other bands who cover our music."

Ms Waites declined to be interviewed, but it is understood that she earned F\$300,000 from her song Sudden Crush when it was recorded last year by Doranna West and used as the theme tune to the major movie Spychancer. Sudden Crush was a number 1 recording for The Ralkettes when it was first released in 1997.

Fortuna Business Daily

Younger generation driving demand for vinyl

Sales of vinyl records continue to grow, despite the fact that the format had almost completely died out thanks to the rise in CDs, followed by the dramatic growth in downloads and streaming. Some audio enthusiasts claim that vinyl offers superior sound quality to any other format, although there have been blind trials that suggest that these “experts” cannot distinguish vinyl from digital.



More than 4.8 million vinyl records were sold in Fortuna in 2019, an increase of 42% over the previous year. This is in sharp contrast to 2009, when only 200,000 vinyl records were sold. Perhaps surprisingly, most of 2019's purchases were by 25-35-year-olds, most of whom would struggle to remember when vinyl was originally a mainstream format for music purchases. Market research suggests that they enjoy the sensation of handling vinyl records. They also appreciate the artwork and text printed on a 12" vinyl record sleeve. Indeed, some collectors choose not to play their vinyl records.

The process of manufacturing vinyl records is complicated:

- Sound engineers have to process the original audio tapes or high-quality digital files to render them suitable for recording to vinyl. Then a master copy can be cut using a special cutting lathe. Vinyl records have two sides, so two master discs must be created.
- The master copies must be sprayed with silver, before being plated with nickel to create a pair of stampers that can be used to press the music onto the vinyl records.
- Pellets of vinyl are heated and formed into “pucks” that are flattened under high pressure between the stampers, leaving an impression of the music embedded in the resulting disc. The edges of the disc are trimmed, a paper label is applied to the centre of each side and the vinyl record itself is inserted into a paper inner sleeve. Finally, the vinyl records are then left flat to cool. This whole sequence is conducted mechanically by specialised machinery.
- The cardboard outer sleeve that protects the record is printed, cut, folded and glued mechanically.
- Finally, machinery inserts the paper inner sleeves containing the vinyl records into their cardboard sleeves. The sleeves are shrink wrapped and packaged for storage or despatch.

Fortuna Daily News

Samples mean big business

Recording artists have learned to pay close attention to new musical releases thanks to a



resurgence in the use of audio samples. These are basically brief snatches of music that are taken from another recording and incorporated into the mix for a new piece of music. For example, Butter'n'Cheese's latest single Both Together has a recurring haunting vocal extract from Matty Brand's 1993 album track Cheerful Day.

The trend to incorporate samples into new recordings can be expensive because of copyright. It is rumoured that Matty Brand has

made more from the royalty payment on the samples used by Butter'n'Cheese that she earned from the original album itself.

There have been cases of musical careers receiving a boost thanks to publicity from association with a major artist. Conor Twinns re-released his 2012 album Gothic Jingles after The Durridders used samples from it in their 2018 Molten Milk album. The re-release was such a success that it led to Spandor offering Conor Twinns a two-album recording contract.