Coevolution of Capabilities and Competition

A Study of the Music Industry

Marc Huygens

COEVOLUTION OF CAPABILITIES AND COMPETITION

A STUDY OF THE MUSIC INDUSTRY

MARC HUYGENS

Coevolution of Capabilities and Competition

A Study of the Music Industry

(De Coevolutie van Ondernemingsvaardigheden en
Concurrentiedynamiek:
Een Onderzoek naar de Muziekindustrie)

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PREFACE

This book is not about competitive advantage. It is about competitive dynamics. In contrast to traditional management research, I did not seek to find those attributes that make some companies achieve superiority over others at a given moment in time. Instead, I aimed to investigate why competitive advantages are eroded over time and how this process impacts the long-term development of industries. Obvious as it may seem, I found that firms within a single industry show considerable proficiency in copying one another. Moreover, it appeared that this element of competitive imitation heavily influences the development of organizational capabilities by the majority of companies in a particular industry. In contrast, few firms seem to possess the creativity that is needed to come up with new capabilities previously unknown to all rivals and so disrupt the existing rules of the competitive game.

Still, regardless of their role as industry leader or laggard, most individual companies do have the intellectual capacity to shape novel capabilities in a unique manner. Whether they manipulate their competitive context or merely adapt to it, firms actively search for capabilities in their environment. As firms do not search in isolation, it is the interactive nature of their relationship that, in the end, determines the industry's competitive dynamics. An initial advantage by one company is inevitably eroded by the actions of its rivals, and this creates opportunities for yet others to create new leads. And so on. Ultimately, the recurrent character of this dynamic shapes the progress of an industry and its path of evolution. It can thus be concluded that firms exert a significant level of control over the well-being and long-term development of the larger industrial system to which they belong.

I alone bear the responsibilities for these and other findings derived from a study of the music industry and presented in this book. I have tried to resolve the strenuous dilemma between management and scholarly styles of writing while maintaining academic standards as to its contents.

It is up to both categories of readers to judge whether I have succeeded in creating such a balance. At the same time, I am confident that the scientific quality of this dissertation has been guaranteed. During the research project, I have had the privilege of working under the creative supervision of Charles Baden-Fuller at the City University Business School in London and Frans van den Bosch at the Rotterdam School of Management/Erasmus University. Other scholars to whom I express my gratitude are Henk Volberda, who did far more than judging these texts, and Raymond van Wijk, who provided valuable comments at different stages.

I was also lucky to benefit from the interest, cooperation and expertise of a number of record company managers in an industry that deserves much more attention from strategy researchers in the future. They are, in order of appearance: Marc Marot at Island Records, Ray Cooper at Virgin Records America, Clive Rich at BMG Entertainment International UK & Ireland, Martin Craig at Warner Music UK, Marcus Turner at Roadrunner International, Mike Heneghan at Independiente, and Jeremy Pearce at V2 Music Group. In addition, I thank Cliff Dane at Media Research Publishing and Stephan Fowler at the IFPI Secretariat in London for providing me with 'hard' data on British music companies and the worldwide record industry respectively. Thanks also to Lex Harding who, as director of The Music Factory, made me realize that the tension between global and local market demands is especially strong in the music business.

Finally, there are a number of people that deserve some special credit. Annemarie Stolkwijk at Erasm took care of a large part of the funding that backed my visits to the UK. I am grateful to Richard D'Aveni at the Amos Tuck School at Dartmouth College for his interest in my project from the moment we met during my stay in London. I am also in debt to friend and colleague Ron Meyer at the Rotterdam School of Management who, despite a hectic schedule at his new consulting firm, could find the time to do a tremendous job on reviewing the manuscript. Further thanks go to Babette Hilhorst at Def. for her work on the cover design. Close to my heart are Hans and Jannie: this book is yours. Before the page turns to the first lines on the relationship between capabilities and competition, I'd like to take my hat off to Anja and bow deeply. She showed that it is indeed the queen who reigns the chessboard of life to protect him who can do only one step at a time.

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CHAPTER 1

Introduction:
Principal Aims of the Research Project

In this thesis the coevolution of capabilities and competition is investigated. This first chapter explains why the concept of coevolution has been selected as the object of research. A rationale is provided for why a study into the coevolution of capabilities and competition could be of value to management science. It explains how a coevolutionary perspective enables a synthesis of the seemingly polar point of views that rival firms are either idiosyncratic or uniform in appearance and behavior. All this is framed in a general research aim and a set of accompanying questions that guide the project's 'operational' issues. It is proposed that two theories of recent interest in the field of strategic management, resource-based theory and Schumpeterian competition theory, can be unified in a coevolutionary style through behavioral theory's notion of 'search.' The project's empirical setting is explored by shortly introducing prevalent features of the music industry, and precedes a discussion of the methodology used in the empirical research. The chapter ends with an outline of the thesis that embodies its general research approach.

RESEARCH CONTEXT

For almost two decades now, management academics and organizational practitioners have been searching for ways to sustain competitive advantage. Porter (1980) taught the strategy field how a firm can create insurmountable barriers to entry to shield off its competitive arena. Scale economies, product differentiation, capital investment and access to distribution channels are the major sources of barriers which keep rivals out. Attractive as such a policy may be for the company in question, Porter's work implies that firms should seek a monopoly position to sustain their

early lead.[1] Irrespective of the economic theorem that such competitive behavior reduces consumer welfare, one could raise doubts as to the conceptual validity of this particular notion of competitive advantage.[2] How can a firm sustain a competitive edge over rivals, if it obstructs even potential rivals to enter its arena? The element of relativity inherent in the concept of competitive advantage thus seems to undermine a Porterian approach to sustainability.

At the start of the nineties, an alternative perspective of how firms can sustain advantages appeared in new research on the so-called 'resource-based view of the firm.' Named after Penrose's (1959) classic treatment of managerial resources, this approach stresses the role of firm-specific resources and capabilities in sustaining a competitive advantage (Barney, 1991; Grant, 1991). Here, firm heterogeneity exists because unique historical conditions shape complex patterns of distinct resources and capabilities. In effect, differences in organizational asset bundles can culminate in one firm having an advantage over others. Moreover, the causal ambiguity inherent in the relationship between the leader's capabilities and its success inhibits rival imitation, which enables the leader to sustain its competitive advantage (Lippman and Rumelt, 1982; Reed and DeFillippi, 1990). According to the resource-based view, such barriers to imitation are the ultimate source of sustainable competitive advantage.

However, this line of thinking has more recently been criticized for its implicit assumption that firms operate in a competitive vacuum (Montgomery, 1995). When a firm's competitive environment alters, the benefits of path dependency may well turn into liabilities which lock a firm into its historical trajectory of development. The new competitive demands lead the company into a competence trap, transforming its core capabilities into core rigidities (Levitt and March, 1988; Leonard-Barton, 1992). In a similar way, the fruits of causal ambiguity can become rotten when the firm wants to sustain its competitive edge. To exploit its advantage, the leading firm needs to make the knowledge sources underlying its capabilities understandable in order to repeat its successful behavior. But

---

[1] It needs to be stressed here that Porter did not recommend more traditional routes to monopoly positions in which vertical integration and horizontal expansion are used to "increase the organization's power in exchange relationships and to reduce uncertainty generated from competition" (Pfeffer and Salancik, 1978: 114).

[2] Although the argument that monopoly power undermines customer satisfaction is well accepted within mainstream economic thinking, Baumol *et al.* (1982) claimed that the mere threat of entrants forces firms in a monopoly position to be as efficient as possible which, according to them, weakens the consumer welfare assumption.

this path to replication facilitates rival imitation (Kogut and Zander, 1992) so that causal ambiguity "cannot be a source of sustainable competitive advantage because it contains the seeds of its own self-destruction" (Collis, 1994: 147).

The incorporation of a competitive process perspective implies that barriers to imitation can do no more than delay the impact of copying by rivals. Indeed, Jacobson (1992) argued that competitive advantages will inevitably be eroded by the effects of competition and are therefore, at best, temporary in nature. This thesis thus follows the advice of Winter (1995), who advocated an approach to strategy in which both organizational capabilities and competitive dynamics shape the transient nature of competitive advantages. While the current study acknowledges firm capabilities as a principal source of competitive advantage, it also recognizes the restraining effects of rivalry on a leading firm's efforts to sustain its competitive edge. Here, competition is perceived as a dynamic process in which rival firms search for new capabilities. It is both organizational and competitive behavior of rivals over time that matter in this process.

The lack of such dynamic properties makes neoclassical treatments of the price system and oligopolistic theories of industrial organization unsuitable for research into the field of strategy (Rumelt, 1984).[3] Competition is therefore treated in this study as a Schumpeterian process of change and development. According to Schumpeter (1934), rivalry is the engine of industrial development, a process which is characterized by the continuous emergence of entrepreneurial firms. These companies search for new ways and methods of competing to make rivals' existing positions obsolete, an act which is called 'creative destruction.' Through this disequilibrating force, the innovator creates an advantage which can only be temporary as the equilibrating force of imitation moves all rivals to adopt the new best practice (Iwai, 1984). Because this process repeats itself, Schumpeterian competition evolves along a 'punctuated equilibrium pattern,' in which creative destructions punctuate incremental periods of convergence.[4]

---

[3] An exception to this seems to be a new stream within industrial organization economics called game theory, which has been claimed to focus on the dynamics of strategic actions and interactions (e.g., Shapiro, 1989; Brandenburger and Nalebuff, 1995). Apart from the argument that game theory's use is limited to a metaphorical level due to the complexity of operating techniques (Saloner, 1991), another drawback to its application in management appears to be its assumption that firms are homogenous in their objectives and capabilities (Barney, 1994).

Empirical research on the competitive implications of technological innovation confirmed the presence of this pattern in a number of industries over time. Abernathy and Clark (1985) observed how, again and again, automobile manufacturers disrupted established industry practice and undermined rivals' existing positions. Tushman and Anderson (1986) presented a similar finding in their longitudinal study of technology-based competition in the minicomputer, cement and airline industries. In the field of strategic management, research into the relationship between capabilities and competition over longer periods of time has been rather limited. Only recently did D'Aveni (1994) offer an interesting point of departure with his theory of 'hypercompetition,' in which competitive advantages are rapidly eroded through fast cycles of creative destruction. Like Schumpeter, he argued that an industry's evolution is determined by the dynamic of competitive interactions among rivals over time.

RESEARCH AIM AND QUESTIONS

Schumpeter (1934) claimed that industrial growth and development is a direct product of the competitive process. It is 'a force from within' because discovery is determined by the things that people in organizations do. Although firms disrupt current methods when they force themselves upon their rivals through innovative behavior, they bring the industry new ideas and practices, triggering its further development. This research project adopts such an endogenous perspective, and assumes it to be ingrained in the relationship between capabilities and competition. This is consistent with Henderson and Mitchell (1997), who called for an enhanced understanding of the endogenous and reciprocal relationships between capabilities and competition. Indeed, they argued that organizational capabilities shape the competitive environment, a process that, in turn, further shapes capabilities. These interactions cross multiple levels of analysis and make capabilities and competition coevolve over time.

In other words, the development of capabilities at the firm level is both a cause and an effect of the competitive process at the industry level.

---

[4] This does not mean, however, that competition will actually turn into a state of perfect equilibrium in which competitors are exact replicas. First of all, even marginal differences in thoughts and actions between rivals will guarantee a minimum degree of firm diversity (Nelson, 1991). Secondly, a period of competition in which firms converge to one another through imitation will inevitable be disrupted by the next competitive upheaval. Schumpeter (1934) called this never-ending story the 'perennial gale of creative destruction.'

In his explanation that "coevolutionary effects take place at multiple levels," McKelvey (1997: 360) stressed the need for this compound approach to the dynamics within and between firms. He maintained that reciprocal relationships between firms in a competitive environment are coevolutionary in nature, the essence of which is in line with the above-mentioned idea of coevolution of capabilities and competition. McKelvey continued that such a coevolutionary perspective allows for the mutual inclusion of seemingly contradictory assumptions in social science that organizations are either idiosyncratic or uniform in nature. McKelvey (1997: 356) expressed the latter dilemma as one in which "it seems impossible to simultaneously accept the existence of idiosyncratic organizational events while at the same time pursuing the essential elements of justification logic."

Indeed, whereas more traditional views such as Schumpeterian theory perceive firms to be uniform in their appearance and behavior (as the dynamic of imitation will reduce variety among rival firms), contemporary resource-based theory claims firms to be idiosyncratic in what they have and what they do. It is here where a coevolutionary approach can be most valuable by attempting to integrate apparently discordant theoretical streams. Important as the concept of coevolution may possibly be to management and organization science, empirical research efforts into its drivers and effects have been limited thus far.[5] As one of the few exceptions, Kieser (1989) narrated how medieval guilds were replaced by mercantilist factories as markets and institutions coevolved. Furthermore, Levinthal and Myatt's (1994) study of the mutual fund business confirmed the existence of feedback effects between the firm's ability to sustain market relations and its competitive position.

In response to the considerable lack of knowledge on coevolutionary processes within the field of strategic management, *this PhD study aims to gain insights into the coevolution of capabilities and competition*. If successfully pursued, this ambition will contribute to an enhanced understanding of the concept of coevolution. In addition, it responds to those who argued for a synthesis of firm- and industry-level perspectives in strategy research (Baden-Fuller, 1995; Levinthal, 1995). Furthermore, as coevolution is unavoidably tied to the dimension of time, the project could

[5] Research into technological innovation also pays increasing attention to the concept of coevolution, be it that its focus is on how specific technologies and industries coevolve (e.g., M. McKelvey, 1997; Rosenkopf and Tushman, 1998). As a consequence, this line of work is limited as to its concern for the behavioral component regarding the industry's rival firms.

add to the development of a dynamic theory of strategy as suggested by Porter (1991). In this regard, D'Aveni (1994: 17) argued for a substitution of contemporary static theory by dynamic models of strategy, as "success depends not on how the firm positions itself at a certain point in time, but on how it *acts* over long periods of time." The study's end results can thus also be of interest to firms operating in hypercompetitive contexts.

In line with the research aim, three broad questions are formulated to deal with the actual implementation of this intent:

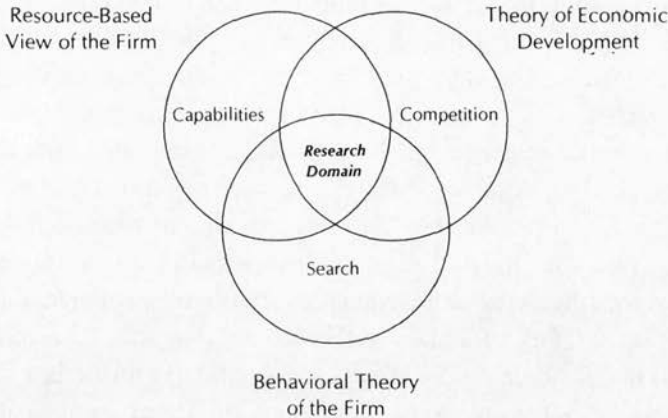
> *How can a coevolutionary approach synthesize contrasting views on firm uniformity and idiosyncrasy?*
>
> *How does coevolution of capabilities and competition unfold at both the firm and industry levels of analysis?*
>
> *How do rival firms search for new capabilities in this particular process of coevolution?*

Obviously, these research questions are related to one another in the sense that they, in reversed order, move from a rather specific to a more general level of understanding. Inevitably, knowledge on how firms explicitly search for capabilities is imperative to a proper appreciation of how the process of coevolution takes place at different levels of analysis. In turn, this wisdom provides the basic input to the synthesis of opposing views on differences and similarities between rival firms. Considering the fact that the concept of coevolution is a relatively unexplored terrain of investigation, the research questions have been defined in rather general terms. That is, no attempt was made to specify causalities between (in)dependent variables because coevolution is concerned with reciprocal and endogenous patterns of interaction (Baum and Singh, 1994).

As mentioned, it is both organizational and competitive behavior that matter in the coevolution of capabilities and competition. A stream of academic literature that pays attention to both types of conduct, and can therefore be of relevance to this study, is the behavioral theory of the firm. Originally developed by Cyert and March (1963), this line of thinking assumes that firms have some degree of control over their market environment, and that they adapt to their habitat through learning processes. Learning takes place after market feedback brings new knowledge into the organization, and is guided by so-called 'standard operating proce-

dures.' These SOPs determine the extent to which the firm is involved in search behavior as response to confronted problems that arise from market feedback. A firm can search for new alternatives in two basic ways: (1) it can search in the neighborhood of current practice, or (2) it can search for radically new alternatives.

Figure 1.1: Theoretical Underpinnings



Nelson and Winter (1982) further developed these concepts in an evolutionary model of innovation and imitation. They translated the SOP notion into the concept of routines as organizational carriers of knowledge and expertise, and introduced the idea that firms are involved in a process of change as they search for new alternatives. The significance of behavioral theory to management science seems to have increased over the past years. For instance, Levinthal and Myatt (1994) examined feedback effects of firms' market activities, while Barnett and Hansen (1996) studied how firms adapt in an ecology of learning organizations. Levinthal and March (1993) discussed the issues concerned with organizational learning, and March (1991) explained search behavior in terms of explorative and exploitative firm activities. The fact that these publications incorporate both firm and industry levels of analysis underlines the potential of search as a concept in moving towards a coevolutionary view of capabilities and competition. Figure 1.1 shows the research project's objective in theoretical terms, and visualizes search's integrative role.

RESEARCH SETTING AND METHOD

The research project's empirical setting for studying coevolution is the music industry (or 'record business'). Here, competition evolves among those companies which direct their capabilities towards the creation and commercialization of music in its different forms. At present, companies in the music industry compete for rights.[6] The industry has traditionally been regarded as consisting of five major record corporations and a host of small independent labels. Together, the majors are responsible for over 85% of worldwide music sales (valued at $40 billion), and this is why many see competition in the industry as oligopolistic.[7] Still, data presented in later chapters show that this has not always been the case, nor that this needs to be so in the future. In recent years, intensifying forms of cooperation between majors and independents stimulated both categories to replicate each other's capabilities, intensifying direct competition. At the same time, ambitious new entrants and digital technology developments may alter the industry's competitive rules in the near future.[8]

The record business is an industry faced with a considerable degree of market uncertainty as, in Denisoff's (1986: 1) words, "the components of popular music are in constant flux." Innovation in music is a fast-paced process, and can be perceived as the interplay between basic market forces. Performing as part of a large oversupply of musicians, creative artists search for ways to distinguish themselves from rival acts, in the process developing new music styles. Whether or not a particular new style or act becomes a success is dependent on a fluid and heterogeneous market demand, where consumers are favorable but fastidious to musical innovation (Denisoff, 1986). This unpredictable and uncontrollable market environment represents the operating context for record companies

---

6 There are three categories of rights: (1) mechanical rights, which entitle composers and the publishing companies to which they are contractually connected to derive income from sheet music and record sales, (2) copyrights, which represent the exclusive right for record companies to be the first to record and distribute composed music on a carrier, and (3) performance rights, which entitle composers and record companies to remunerate fees from publicly performed hearings or broadcastings of their compositions or records.

7. Obviously, the size of the majors' combined share differs from country to country, as shown by 1996 figures for the Top Five music markets (published in the December 1997 issue of *Music Business International*, page ix): (1) USA 80%, (2) Japan 67%, (3) Germany 93%, (4) UK 82%, and (5) France 95%. In the Netherlands (ranked as number 9), the collective major market share was 81%.

8 As an illustration, US research consultancy Jupiter Communications estimated that on-line music sales will grow exponentially from $47m in 1997 to $1640m in 2002 (reported in *Music Business International*, June 1997, p. 9).

(see Exhibit 1.1). In a world where new acts continue to pop up and music exists by the grace of short-lived trends, these firms are the intermediaries between artists and public (Burnett, 1996).

Exhibit 1.1: Record Company Business Processes

Record companies bridge the gap between the creative community and the consumer market. In their attempts to get public attention, record companies continuously renew their artist roster as they compete for repertoire. The ability to discover and commercialize new music talent is as arduous as it is crucial to a record company's existence and success. Innovation in music is not easy to determine let alone measure, and this elusiveness obstructs the company's search for creative acts. At the same time, the velocity with which new music trends emerge and subside makes it hard to trace and evaluate intangible customer preferences. The absence of standard rules or procedures to estimate an artist's creativity as well as its commercial potential up front inhibits a fruitful ongoing new product launch on new music markets. Record companies indeed operate in a risky business: whereas each act requires significant resource investments, an industry average of only ten percent of all new signings is released successfully. Obviously, the uncertainty associated with the quest for new products affects the process through which record companies sign and market new repertoire. To reduce their chances of failure, firms in this industry typically operate along a three-staged process of artist extraction, development and exploitation.

The discovery of promising acts and their incorporation into the organization is the prime responsibility of the company's A&R (artist and repertoire) staff. At a fundamental level, A&R involves every aspect of the relationship between an act and the record company. The process of extracting acts from the cultural environment starts at the talent scout. Not only does the scout listen to the hundreds of demo tapes that are sent to the company by aspiring musicians, but he or she also visits live performances at bars, clubs and theaters. It is crucial for the scout to operate at a 'street level' in the creative community where music originates. Ultimately, the decision whether or not an act presented by the scout is being offered a contract resides at the managing director or the chairman. When the deal has been made, A&R staff supports the newly signed act in a variety of ways. An A&R person assigned to the act exploits a personal network of record producers, engineers and studios in the actual recording of the album. Furthermore, he nurtures relationships with the act's private management and publishing company.

A record company does not necessarily have to be an excellent performer when it has a superb capability in discovering new talent. In the end, artists are judged by market consumers who therefore need to be convinced of the quality of the firm's repertoire. This requires the careful development of artistic careers through the creation of specific images that tie consumers' attention and emotions to a particular act. The artist is uniquely positioned in the music market so that its distinctive value can be communicated to potential buyers. The development of the firm's artists is realized through regularly organized artist meetings. Here, A&R and marketing people join up in a project team where an act's progress in musical orientation and visual image are discussed. Special attention is paid to how the media can best be approached, culminating into a broadly defined campaign program. These temporary projects are coordinated by the head of artist development, whose primary task is to maintain internal

communication and track the effects of specific campaigns in the marketplace. Artist development is the gray area where musical creativity is combined with commercial pragmatism.

Promotion and distribution is imperative if the record company wants to recoup the considerable investments made so far. The larger part of the marketing campaign budget is dedicated to promotional activities directed at radio and TV. These are the music industry's main channels of communication through which a firm's repertoire can be brought under the attention of consumers. The oversupply of recorded music makes companies compete for airplay in a crowded and fragmented radio landscape. Specialized promo men therefore present sample copies of tracks or albums to disc jockeys, and try to convince them to broadcast 'this great record.' At the same time, the act's image and identity are communicated through live performances on television shows and video clips on MTV. Promotion and sales staff also maintains relationships with retail chains and record shops, and is backed up by publicity in the press. Manufacturing and distribution make sure that the record as a physical carrier – with the CD as today's primary format – is available on the shelves. During this process of exploitation, protection of the company's relationships and its intellectual property is crucial.

The rationale for studying coevolution between capabilities and competition in the record business is threefold. Ranked second only behind book publishing, it is the oldest software industry with a history that spans more than 100 years, which makes it suitable for the detection of long-term patterns.[9] Furthermore, knowledge is crucial in the performance and survival of record companies, and the idea that capabilities are in essence integrated knowledge components (Grant, 1996) makes this industry adequate for investigation. Finally, the record business is one of the so-called cultural industries which have, until recently, only been of marginal interest to management scholars as objects of empirical research.[10] Relatively little is known today on organizational and competitive dynamics in the music industry to the field of strategic management. The present study can thus not only contribute to theory development, but can also be of value to the academy's empirical knowledge base.

9 The record business is comparable to book publishing (and other industries such as theater arts) in the sense that unique talent is tied to the demands for creative products and services. At another level, the music industry shows similarities with the oil and movie businesses where the industry is structured around five or six major corporations and a vast number of independents. The record industry is also one of the major content providers in a rapidly growing and converging digital network of software and hardware business segments (Yoffie, 1996).

10 Cultural industries are claimed to offer an opportunity to challenge conventional thinking (Call for Papers, 1997), while the film industry has gained some ground as a research site for management studies (DeFillippi and Arthur, 1998; Miller and Shamsie, 1996; Robins, 1993).

By nature, it seems impossible to study coevolution without incorporating the element of time. Research into long-term dynamics of the reciprocal relationships between capabilities and competition therefore requires an explicit process perspective. Van de Ven (1992: 170) offered three working definitions of 'process,' of which "a sequence of events or activities that describes how things change over time" is embraced.[11] Apart from the fact that such an approach gains a deeper understanding of the how and why issues, it is the only one that supports multiple-level research and analysis (Pettigrew, 1992). Moreover, it allows for a 'historical development' perspective based on an investigation of specific events and stages. Such a Chandlerian perspective is crucial in longitudinal studies that consider organizational and competitive behavior of firms over longer periods of time. Longitudinal research has been claimed indispensable to the field of strategic management as it counter-balances the static limitations of cross-sectional analysis (Porter, 1991).

To explore coevolution in the music industry, a 'dual methodology' is employed, which incorporates both the longitudinal and multiple-level research dimensions. The first component consists of a historical study of the record business over the period 1900-1990, where coevolution of capabilities and competition is mainly studied from an industry perspective. In line with Berkhofer (1969), the music industry's evolution is narrated in terms of particular periods; simultaneous data description and analysis is performed to detect patterns and their underlying mechanisms. The second research component is designed as a multiple-case study where cross-case analysis (Yin, 1984) is primarily performed to gain insight into coevolution of capabilities and competition at the firm level of analysis. Individual cases focus on trajectories of organizational evolution during the period 1990-1997, and concern the following record companies: Island Records, Virgin Records, BMG International UK, Warner Music UK, Roadrunner Records, Independiente and V2 Music Group.

Figure 1.2 displays the general research approach that embodies the structure of this book. The research aim and its corresponding questions discussed in the current chapter provide the input for a discussion of the triangle of theories shown in Figure 1.1. Whereas Chapter 2 explores firm idiosyncrasy as suggested by resource-based thinking, Chapter 3 takes an in-depth look at Schumpeter's theory of competition regarding uniformity

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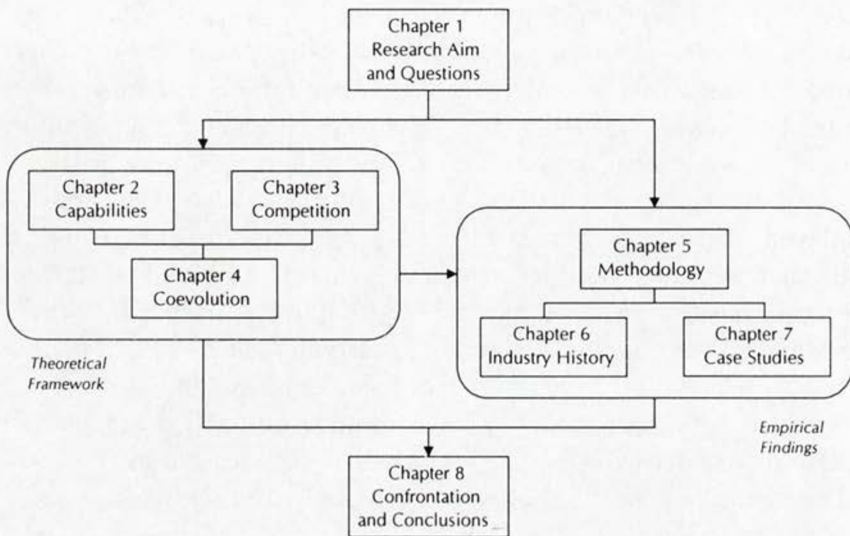
[11] The other two definitions are: (1) a logic that explains a causal relationship between independent and dependent variables in a variance theory, and (2) a category of concepts or fixed variables that are operationalized as constructs.

among firms. The following chapter integrates these seemingly contradictory theories by drawing upon the search concept, in the process generating a number of theorized propositions and an integrative framework of coevolution. Here, a pure theoretical answer is given to the research questions as stated above, based on a synthesis of existing knowledge on capabilities, competition and search behavior. Together, these three theoretical chapters constitute the first basic section of this thesis.

Figure 1.2: Structure of the Study



As a prelude to the empirical part of the study, Chapter 5 discusses the specific empirical research methods employed, primarily in terms of data collection, analysis and validity. Chapters 6 and 7 move on to an inquiry into coevolutionary processes of a dynamic nature as encountered in the music business. The first of these chapters focuses on coevolution of capabilities and competition from an industry-level perspective in terms of socalled 'competitive regimes.' In contrast, the second does so from the firm-level point of view in terms of distinct organizational change processes. The final chapter assesses the validity of the framework through a confrontation of the empirical findings with the theoretical propositions. Essentially, it addresses the research questions again, incorporating additional knowledge derived from the empirical setting. Guided by the initial research aim, the project's major conclusions are presented, after which some future research trajectories are suggested.

CHAPTER 2

Theory on Capabilities:
The Contributing Value of Resource-Based Views

This chapter explains why, according to resource-based thinking, firms are essentially idiosyncratic in their appearance and behavior. This view assumes that heterogeneity in organizational assets among firms leads to differences in the capabilities they have. This is why some firms are able to create superior capabilities and, as a consequence, generate a competitive advantage over others. Moreover, the resource-based view of the firm argues that such advantages can be sustained through barriers to imitation. As firms have their own histories, capabilities are unique in that they are built over time through path-dependent processes, and can therefore not easily be copied by others. Also, the nature of the relationship between the firm's capabilities and its advantage can be ambiguous, as the interdependencies between the various components or parts out of which a specific capability has been created may be unobservable and complex. As resource-based thinking is focused on the firm level, it appears to be appropriate for integration into a coevolutionary approach. Starting with the concept of sustainable competitive advantage, this chapter thus explores the essence of resource-based thinking.

SUSTAINABLE COMPETITIVE ADVANTAGE

It will probably always be arbitrary when the term sustainable competitive advantage was coined in public, and by whom. The reason is that its origins come from different corners of the scientific world: sustainability has its roots in the rich field of industrial organization, while competitive advantage came to life during the institutionalization of the discipline of business policy. It was none other than Porter (1980) who knitted both ideas together in his impressive inquiry into the nature of competitive

strategy. Although he did not use the term explicitly, there can be no doubt that the following words enabled a host of others to explore it: "The strength of the competitive forces in an industry determines the degree to which this inflow of investment [through new entry or through additional investment by existing competitors] occurs and drives the return to the free market level, and thus the ability of firms to sustain above-average returns" (Porter, 1980: 5-6).

Early Views on Sustainability

Strategy and strategic management became common language in many corporations during the late fifties and early sixties when professional schools of management in the United States redirected their business policy course.[1] The leading texts were those from Selznick (1957), Chandler (1962), Ansoff (1965) and Andrews (1971). The central idea common to all was the executive's task to design a strategy that, in a Darwinian manner, matched environmental opportunities with the firm's competences in pursuit of a competitive advantage. The idea of sustainability, however, was a key concept in the field of industrial organization, the name of which had been introduced by Marshall (1890) more than a century ago. Research really started off in the 1930s, and took a flight in the late fifties with the works of Bain (1956) and Mason (1957) on concentration and entry barriers, performed in the context of the so-called SCP (structure-conduct-performance) paradigm.

The industrial organization tradition had originally examined monopolistic and oligopolistic practices in the context of consumer welfare, and the field's principal aim was to provide a knowledge platform for the US government. Washington needed unprejudiced intelligence in its task to select the most suitable antitrust and regulatory policies, and company studies performed by industrial organization advocates came to be a primary input to its policies. These inquiries made it clear that, depending upon the more structural characteristics of the industry, persistent above-normal returns were possible, an idea contrary to traditional economic thoughts on price, demand and supply. This notion of sustainability referred to the enduring structure of the industry, in which the firm (on its

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[1] In his exploration into the history of management thinking, Van den Bosch (1993) argued how early work by Taylor (1911) and Fayol (1916) stressed generic management principles but disregarded environmental conditions. As a result, courses in business policy focused on general instead of strategic management until the 1950s.

own or in collusion with a few others) could gain long-lasting profits. But during the late seventies, new research efforts took a more prescriptive route in the industrial organization field (e.g., Caves and Porter, 1977).

Porter (1980) argued that the essence of a firm's competitive strategy is to create a position in the industry which is defendable against five competitive forces: threat of new entrants, threat of substitute products or services, bargaining power of suppliers, bargaining power of buyers, and rivalry among existing firms. In other words, a firm can only sustain its above-average performance by shielding off competitors and in this way being the sole master in a particular competitive arena. Key to such a strategy is the erection of entry barriers such as economies of scale, capital requirements, and access to distribution channels in order to deter rival firms. However, Teece (1984: 94) argued that such a focus on "how to increase profits (and, if necessary, reduce consumer welfare) by containing or restricting competition" stands in sharp contrast with industrial organization's intentions to discover ways to "increase consumer welfare by enhancing competition." Pushing the essence of these words even further, Cooper (1995) noticed that Porter's original notion of competitive strategy results in firm behavior that *avoids* competition, and in its pure form creates zones of no competition.[2]

Porter (1980) had indeed avoided the term sustainable competitive advantage, presumably because his own conceptual exposition obstructed him to do so. When a firm succeeds in creating what is essentially a monopoly position, it has no rivals to compete with, and the sustained returns to such a firm can therefore never be related to the concept of competitive advantage. Without competitors, a firm can have no advantage at all; it is the relative and relational property of the word itself that inhibits its application to those circumstances in which there is no other entity to relate it to. The simplicity of this logic explains Porter's negligible attention to the concept of distinctive competence, despite its crucial role within early business policy thinking. For without competition, there will be a scarcity of pressures on the firm's ability to create unique capabilities (Barnett, Greve and Park, 1994). It would take Porter another five years to come up with a solution to the absence of capabilities in his ideas on competitive strategy.

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[2] More recently however, Porter's (1990) view of competition has changed into a more assertive one where competitive pressures force rival firms to be involved in innovative behavior; in the end, such entrepreneurial conduct will benefit companies' competitive vitality.

Contemporary Views on Sustainability

In the meantime, the discipline of industrial organization had generated two offsprings that both focused on the role of firm efficiency as obstructing monopoly positions, be it from different perspectives. On the one hand, the 'contestability' school, developed by Baumol, Panzar and Willig (1982), sees the threat of potential entrants as sufficient in forcing incumbents to take the most efficient route to the market. What matters here is an absence of entry barriers – to which governmental policies should be directed in order to protect social welfare – and the possibility for all competitors to use the same productive techniques. The 'Chicago' school, on the other hand, does recognize differences in firm resources, but any gains to be derived from this heterogeneity are short-lived. Stimulated by the early work of Knight (1921) and flourished under the leadership of Stigler (1955), this view argues how firms pursue efficiency by means of economies of scale in production and distribution.

Although both schools at the time explicitly excluded the possibility for firms to enjoy long-lasting above-average returns, the emphasis on firm behavior in the causal relationship between conduct and performance changed things dramatically. This new development not only changed the course of thinking within the industrial organization discipline, but also left its mark on the field of strategic management. Porter (1985) introduced the firm's value chain as the primary source of competitive advantage and, at last, explained how sustainability could be achieved. Firms were to create systems of interlaced activities tailored to their positioning strategy, resulting in proprietary learning, economies of scale, knowledge linkages within the corporation, technology patents, and channel loyalty. These elements form the protective barriers to imitation that safeguard the firm's competitive advantage – grounded in the unique constellation of its value chain – from erosion by rivals.

Although the concept of sustainable competitive advantage had already been used before Porter's work on competitive advantage, its popularity in management publications and corporate offices now exploded in an unprecedented form.[3] In his article *Sustainable Advantage*, Ghemawat (1986) discussed the types of advantage firms need to avoid imitation by rivals: size in the target market in terms of scale and scope economies and experience effects, superior access to customer markets as well as to resources such as know-how and other inputs, and the ability to

3 See, for instance, Buaron (1981).

influence public policy and restrict competitors' moves. The strategy field had evolved in its beliefs concerning the essential meaning and primary determinant of sustainable competitive advantage. Whereas the concept of SCA originally referred to abnormal returns over a certain period of calendar time due to the monopolistic structure of the industry, it now came to be tied to firm behavior and subjugated to imitation by rivals.

The idea that the sources of sustainability could well be situated within the firm as a direct result of its own activities instead of nestled in the external conditions of its habitat, acquired form and substance with Barney's (1986) discussion on 'strategic factor markets.' He argued that performance variations between firms are the outcome of differences in efficiency with which they implement their strategies: "Firms can only obtain greater than normal returns from implementing their product market strategies when the cost of resources to implement those strategies is significantly less than their economic value" (1986: 1232). Different expectations and plain old luck determine the ability of firms to create or exploit such competitive imperfections in strategic factor markets. In response, Dierickx and Cool (1989) amplified Barney's arguments on how to create a competitive advantage into the more specific question of what determines the sustainability of competitive advantage.

A Definition of SCA

According to these authors, the most crucial organizational assets are those that have been accumulated within the firm, and for which no open market exists on which they can be traded freely. Such firm-specific resources can only be a source of sustainable competitive advantage if they meet the test of replication: the firm's competitors have to be thwarted in their attempts to imitate or substitute these assets. From this moment on, strategy thinkers adopted Grant's (1991: 123) argument that the speed of erosion of competitive advantage through imitation by competitors "depends critically upon the characteristics of the resources and capabilities." The field's new ideology made academics turn their backs towards traditional industry analysis. Firm strategy was no longer an issue of obtaining monopoly profits through restriction of competition; what mattered now was efficiency in exploitation of resource advantages, a view clearly inspired by the newly advanced contestability and Chicago streams of thought in industrial organization.

Although management scholars used to see *the period of calendar time* as the mandatory determinant of sustainability,[4] contemporary strategy thinking has substituted this factor by *the possibility of competitive duplication*. Indeed, this study conforms itself to this second notion of sustainable competitive advantage, and adopts the definition suggested by Barney (1991: 102): "A firm is said to have a sustained competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors *and* when these other firms are unable to duplicate the benefits of this strategy." Likewise, a created competitive advantage is sustainable "only if it continues to exist after efforts to duplicate that advantage have ceased." Although the conceptual tenor of sustainability should now be clear, a closer look at what has been called the 'resource-based view of the firm' is necessary to incorporate the value of firm resources and capabilities into its meaning.

RESOURCE-BASED VIEWS OF THE FIRM

Strategic management's current passion for resources and capabilities in its search for the sources of sustainability has not only evolved out of avant-garde approaches to IO, but has also descended from management research into corporate strategy (see Figure 2.1). In his original investigation of the relationship between diversification strategy and economic performance, Rumelt (1982) expanded the concept of synergy to the broader one of relatedness between various units within the multi-business firm. In doing this, he proposed that sharing particular core factors within the corporation induced relatedness among its business units: "[...] particular attention was paid to the absence or existence of shared facilities, common selling groups, and other tangible evidence of attempts to exploit common factors of production" (1982: 360). In time, other researchers, which conducted quite a number of sequel studies in which alternative methodologies were employed, confirmed his results.[5]

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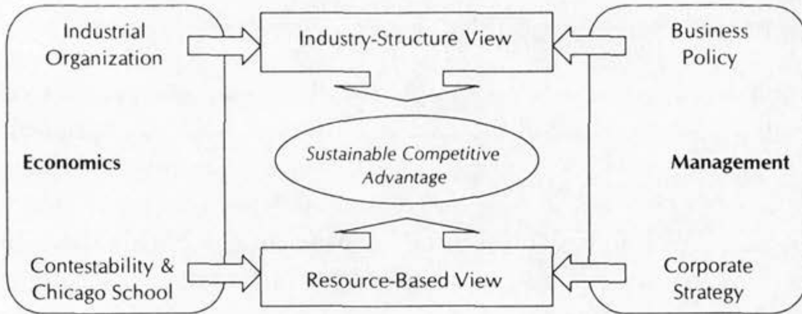
[4] Jacobson (1988), for example, tied a sustainable competitive advantage to the ability of firms to earn abnormal returns for a substantial number of years, whereas Kay (1993: 166) claimed that the best measure of the sustainability of competitive advantage is "the extent to which a firm continues to enjoy above-average profitability year after year."

[5] See, for example, Bettis (1981), Montgomery (1982), Palepu (1985), and Lubatkin and Rogers (1989).

Figure 2.1: Origins of the SCA Concept



The role of organizational assets within this line of research gradually shifted in character from being a determinant of relatedness to an explanatory variable of performance at the industry level.[6] Schmalensee (1985) claimed that more than 80 percent of the variance in business unit profitability was not related to industry effects, while Jacobson (1988) could only observe a remote influence of market forces on the persistence of above-normal returns to firms. Wernerfelt and Montgomery (1986) argued that traditional ideas on industry attractiveness should be given second thoughts considering the evidence that sources of efficiency differences can be located at the firm level. In yet another test, Hansen and Wernerfelt (1989) stated that building an organizational context is twice as important as the firm's selection of growth industries. Finally, Rumelt (1991) found that differences in returns are explained six times more by business-unit effects than those of industry.

At an even earlier stage, others had noted the significance of firm resources and capabilities to survival and success. Within the discipline of population dynamics, Astley (1985) had claimed that capabilities define the genetic make-up of firms. In the field of technological innovation, Abernathy and Clark (1985: 5) saw the ensemble of tangible resources, human skills, relationships and tacit knowledge as "competitive ingredients from which the firm builds the product features that appeal to the marketplace." But in the world of strategy, things really started off when Prahalad and Hamel (1990) published an article on corporate strategy that rocked managerial thinking. These authors championed the idea that cor-

[6] In this study, 'organizational assets' encompasses both resources and capabilities.

porate-wide technologies and production skills, embodied in so-called 'core competences,' are the real sources of advantage.[7]

Firm Behavior and Capabilities

So although its incubation time took a while, a newborn perspective on strategy came into being at the start of this decade. It was christened the resource-based view of the firm, after the title of an article written by Wernerfelt (1984). He, in turn, had picked up Penrose's (1959) theory of corporate growth in which the firm's expansion is primarily determined by the availability of firm-specific management resources. According to contemporary proponents of the resource-based view, there are at least two reasons why firms should build their strategy upon an infrastructure of resources and capabilities instead of relying upon an analysis of their external environment. First, the various frameworks and conceptual models firms use as tools for external analysis are public property, so the expected variance in firms' outlook on their environment will be very low (Barney, 1991). Second, whereas the firm is assumed to have little or no control on the pace of external change, it is far more sensible to trust the stability of the firm's own organizational assets, as their development can be controlled to a much higher degree (Grant, 1991).

If the environment is supposed to have the same features to all rivals, then there is no choice but to accept the idea that firms have to be different.[8] If this would not be the case, any form of competitive advantage is simply not possible; if firms are all alike, and the setting in which they compete is the same to all, then any advantage created by one will be immediately eroded by the others. This is exactly the orthodox approach to economics that has been criticized by less rationalistic academics such as Penrose (1959). Thus, not only because we intuitively know that no one organization is the same as any other, but also because there is plenty of evidence that there are indeed companies that perform (much) better than their rivals and seem to have a competitive advantage, the resource-based view has adopted the assumption of firm heterogeneity. A variety of rea-

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[7] Until further notice, the words competences and capabilities will be used interchangeably, although there seem to be conceptual differences in that Prahalad and Hamel's concept of core competences is mainly related to a firm's technology base.

[8] Of course, firms can appear to be similar in their competitive behavior. The next chapter discusses how rival firms aim to copy each other's capabilities and in this sense try to be alike. The point made here, however, is that firms differ with respect to the resources and capabilities that lie deep down in the organization.

sons explain for the natural differences between companies operating in the same business area.

Because the behavior of an organization is reducible to the behavior of its individual members (Nelson and Winter, 1982), all organizations must be unique to some degree as no individual is the same as any other. This is the crux of the heterogeneity assumption, out of which all other reasons cited below seem to arise: if individuals eventually form the organization's behavior, and this behavior can be mirrored by the practices and business processes in which the firm's capabilities are rooted (Stalk, Evans and Shulman, 1992), then firms can and indeed do have different competences on the basis of which they can create and exploit competitive advantages. This is not to say that firms will breed distinctive competences and, in effect, a competitive edge of their own accord as soon as they employ human labor. It is merely argued that, in the end, unavoidable uniqueness of each firm's personnel makes the company what it is: a distinct entity that is distinguishable from others through its behavior.

The idea that an organization's behavior is deducible from the conduct of its members has inescapable implications for the firm as a whole. Eventually, the sum of the unique courses of thought and action by its working members over time results in the creation and development of systems, procedures, activities, processes, values and even politics that are exclusively tailored to the firm itself. Furthermore, because companies are dissimilar in most of these features, they also have different ideas about the nature of the business environment in which they operate and, as a consequence, also vary in their expectations about the future value of a particular strategy (Barney, 1986). Such diversity in 'trade foresight' among firms is reflected in the heterogeneity firms display in their reservoirs of resources and capabilities. Over time, companies make their own decisions as to which organizational assets to acquire or develop, based on distinct perceptions of the future.

Firm Heterogeneity and Knowledge

This brings us to the essence of the resource-based argument: firm heterogeneity in terms of variety in resources and capabilities may increase the imbalance between competitors' exclusive repertory of assets and their specific market strategy (Dierickx and Cool, 1989). It is this disparity that may result in significant performance differences, i.e. competitive advantages, according to one of its main proponents: "in order for there to be a first-mover advantage, firms in an industry must be heterogeneous in

terms of the resources they control" (Barney, 1991: 104). It is important to note here that, as Rumelt (1984) argued in his discussion on entrepreneurial strategy, firm heterogeneity is indeed an outcome rather than a given. Denoting the significance of innovative firm behavior, Rumelt stressed that "without resource heterogeneity [...] there is little incentive for investing in the risky exploration of new methods and the search for new value" (1984: 561). Thus, it is the firm's behavior that, in the end, makes it different from others.

In addition, Levinthal (1995) argued that this idea is not restricted to firm behavior of an exploratory nature, but also applies to exploitative product-market activities through which these organizational capabilities emerge. In general, variety among companies reflects their heterogeneity at a much earlier point in time, and even minor differences at firms' starting points can, over wider spans of time, lead to large-scale inequalities due to their path-dependent nature. A further incorporation of the element of time into the resource-based view has been suggested by proponents of the so-called 'dynamic capabilities view of the firm.' Teece, Pisano and Shuen (1997) proposed that dynamic capabilities represent the firm's latent abilities to renew, augment, and adapt its core competences over time. Such meta-capabilities affect both the rate and the direction of the evolution of a firm's organizational assets.

This dynamic view of the firm as a constellation of resources and capabilities has been closely coupled to the firm's basic mental mindframes, or in more mundane language, its fundamental beliefs about the organization's internal and business environment. In this respect, Lei, Hitt and Bettis (1996: 559) argued that "dynamic routines refer to the organization's cognitive maps and particular approach to framing" that are essential to the firm's problem-solving requirements to new market approaches. In a follow-up article on their notion of 'dominant logic,' an organizational genetic factor that represents beliefs, ideas and heuristic principles concerning the firm's business, Bettis and Prahalad (1995: 8) claimed that an organization's intelligence is its ability to learn over time, and "what an organization is able to learn can be transformed into organizational knowledge." More and more, strategy scholars are convinced that the most valuable resource for a firm's competitive advantage is knowledge.

Leonard-Barton (1992) was probably the first to embrace these thoughts under the label of the 'knowledge-based view of the firm.' She defined a core capability as a four-dimensional knowledge set underlying a firm's competitive advantage, reflecting accumulated firm behavior over

time. Employee skills and physical technical systems are both knowledge reservoirs, while managerial systems and company values can be thought of as knowledge-channeling mechanisms. Conner and Prahalad (1996) have called a knowledge-based perspective the essence of the resource-based view, while Grant (1996: 375) only recently stated that "knowledge has emerged as the most strategically-significant resource of the firm." In doing this, he claimed that the essence of an organization's capability is the complex integration of the firm's stock of specialist knowledge with the objective to repeatedly perform a productive task. The value created in such a firm-specific process will, in the end, be crucial to a firm's competitiveness.

Barriers to Imitation

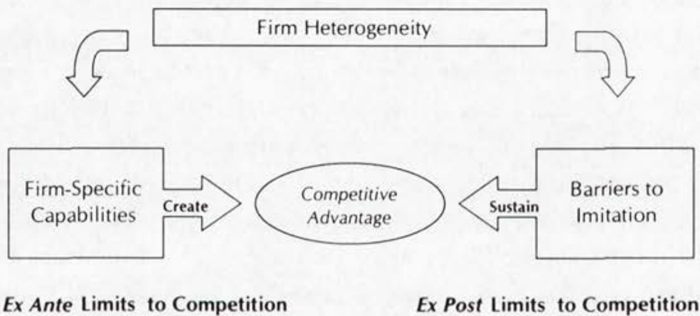
Organizations are different in their repertories of organizational assets such as people, capabilities and knowledge, and this heterogeneity enables firms to gain a competitive advantage over their rivals. But having a competitive edge is something entirely different than keeping it alive. Competitors who notice their respective disadvantages are highly motivated to destroy such detriment in order to regain what they have lost, to also gain extraordinary returns, or to simply keep up in the competitive race. It is a reality that leading firms are confronted with: at the very moment a firm earns superior returns through the creation of a competitive advantage, it also stimulates others to imitate its actions and exterminate its privileged position. Thus, in order to sustain a competitive advantage, firms should be able to protect the resources that underlie this edge from appropriation by rivals.

Peteraf (1993) argued that, apart from *ex ante* limits to competition for valuable organizational assets, which stem from firm heterogeneity and in the end enable the emergence of a competitive advantage, there should also be certain *ex post* limits to preserve that advantage. In his respect, Rumelt (1984) introduced the term isolating mechanisms: firm-specific assets that act as devices to sustain first-mover advantages and the returns derived from them. Today, strategy academics refer to the more down-to-earth concept of barriers to imitation that make it difficult for rivals to imitate or even substitute for strategically valuable resources and capabilities over substantial periods of time (Mahoney and Pandian, 1992). Effective barriers to imitation should create delays in competitors' detection of the firm's supranormal returns, frustrate their ability to properly diagnose the exact configuration of the organizational sources that

bestow the competitive advantage, and obstruct rivals' acquisition of these assets.

The challenge for a firm and its management is thus to erect a set of powerful barriers to imitation that reduce or even eliminate existing and potential competitors' ability or desire to imitate its specific sources of competitive advantage (Amit and Schoemaker, 1993). Apart from the obvious necessity to continuously develop assets over time, another requirement to be met in this respect is texture complexity: complexity in system configurations of organizational resources and capabilities will confound rivals' ability to analyze the sources of success (Black and Boal, 1994). The problem, however, is that the least imitable assets are those that have gradually evolved over time instead of deliberately designed by plan. In the words of Barnett, Greve and Park (1994: 12): "what resists being designed by strategists also resists being imitated by them." Firms can also protect their most valuable knowledge by reducing its observability to the outside world and by preventing its expropriation (Liebeskind, 1996).

Figure 2.2: The Logic of Resource-Based Views



The notion of barriers to imitation is crucial to the resource-based views of the firm in its search for sustainability, for without the existence of these barriers it is simply not possible for companies to preserve a competitive advantage.[9] The pivotal role of these obstacles lies in their capacity to obstruct the perfect mobility of organizational assets among firms. Orthodox economic thinking, as well as traditional IO models, as-

[9] For matters of convenience, the resource-based view, dynamic capabilities view and knowledge-based view are from here on collectively referred to as resource-based viewS of the firm.

sumed that firms within a sector of industry are identical in the sense that they can command the same resources and production methods. Whereas this point of view holds that any differences between firms evaporate immediately because organizational assets can be transferred almost perfectly and without any problem whatsoever, resource-based views adhere to the opposite perspective of imperfect mobility (Conner, 1991). So by protecting the idiosyncratic nature of the successful firm, barriers to imitation sustain its competitive advantage as they maintain firm heterogeneity (see Figure 2.2).

IMPEDIMENTS TO SUSTAINABILITY

The sound reasoning with which resource-based views discuss the strategic value of barriers to imitation makes them very attractive to those who wish to understand the sources of sustainability. But despite reported success stories of companies such as Canon (Prahalad and Hamel, 1990) and IBM (Peters and Waterman, 1982), a growing body of theoretical contributions challenge that even prestigious and resourceful firms are able to sustain competitive advantages. Jacobson (1992) reasoned that abnormal returns to superior information can only be temporary because, eventually, knowledge is dispersed through market forces. In a similar vein, D'Aveni (1994) maintained that many industries have experienced a shift to 'hypercompetition,' where advantages are rapidly created and eroded. If this is true, the validity of resource-based arguments on sustainability seems to be in doubt. A closer look at the notions of causal ambiguity and path dependency, crucial to resource-based reasoning, reveals a possible reason for this basic flaw.

Diffusion of Property and Knowledge

The rapid erosion of patents and trade secrets through competition is not an exclusive phenomenon of current times. Marshall (1890) observed how the diffusion of practical and scientific knowledge by trade journals aided rivals in their attempts to invade the competitive territory of successful firms. And this is just one of a variety of mechanisms that enable diffusion of the outcomes of innovative firm behavior over a population of competitors. For instance, valuable information can become public property when gathered by trade associations or more independent institutions such as industry observers, business analysts and brokers. Furthermore,

research publications, informal lines of communication among colleagues employed by rival firms, and even forms of industrial espionage can be crucial in this respect. Finally, diffusion of ideas occurs via alternative routes like workforce mobility among firms, industry-wide suppliers or customers, and reverse engineering (Lieberman and Montgomery, 1988).

Resource-based views acknowledge this and, more than that, embrace it in the argument that the real sources of sustainability often do not rest in such *having* resources, but instead lie in the firm's *doing* capabilities (Hall, 1993). Those skills and competences that have an integrative, coordinative or creative quality are critical to the preservation of competitive advantage, simply because they can not as easily be imitated as the firm's other assets. The character of doing capabilities is to a very large degree dependent upon the underlying knowledge patterns residing within the firm's organization. Indeed, "there is a close connection between the type of knowledge possessed by the personnel of the firm and the services obtainable from its material resources" (Penrose, 1959: 76). The more unique and idiosyncratic a company's knowledge is in content and form, the more problematic imitation will be for its competitors. It will therefore often be much easier to copy the property-based resources generated by such knowledge-based resources than to replicate the latter (Miller and Shamsie, 1996).

Resource-based views further reason how the notions of 'causal ambiguity' and 'path dependency' transform knowledge-based assets into barriers to imitation and thus condition the sustainability of competitive advantage. Although at first sight the logic of this reasoning is appealing, both conditions have a 'flip side' as they facilitate and obstruct the continuation of a competitive advantage. These negative forces, rooted in the barriers themselves, impede rival imitation, but at the same time obstruct the firm's ability to further exploit and continue its newly developed competitive advantage. This chapter ends with a discussion of how barriers to imitation can thus become barriers to sustainability. In this respect, it uncovers a fundamental limitation of resource-based reasoning on the role of firm capabilities in sustaining a competitive advantage.

To avoid confusion, the terms imitation and substitution will not be treated as separate categories here. Ghemawat (1991: 91) explained that "the conceptual distinction between imitation and substitution as threats to scarcity value is that the former increases the supply of sticky factors while the latter effectively depresses the demand for them [...] this conceptual distinction is often less clear-cut in practice." The reason is that

pure forms of imitation virtually never occur. Marshall (1890: 517-518) noted that "even in the same place and the same trade no two persons pursuing the same aims will adopt exactly the same routes." On principle, this means that each imitative trial is, in essence, a ceremony of substitution. Accordingly, Nelson and Winter (1982: 123) stressed that "the imitator is not directly concerned with creating a good likeness, but with achieving economic success – preferably, an economic success at least equal to that of the original. Differences of detail that are economically of no great consequence are perfectly acceptable."

The Liability of Causal Ambiguity

The first keystone upon which resource-based views have constructed the argument of sustainable barriers to imitation is Lippman and Rumelt's (1982) concept of 'causal ambiguity.' In other words, the uncertainty involved in analyzing the exact nature of the successful firm's knowledge bundle often makes it extremely ambiguous for rivals to determine which organizational assets are really critical to that firm's competitive advantage. Lipmann and Rumelt (1982: 420) argued that "it may never be possible to produce a finite unambiguous list of the factors of production responsible for the success of such firms," and in this sense "ambiguity as to what factors are responsible for superior (or inferior) performance acts as a powerful block on both imitation and factor mobility". If competitors do not know what to copy, imitation becomes next to impossible, and this reduces the negative effects of imitation upon the sustainability of the leading company's competitive advantage.

The degree of ambiguity, and thus its inherent power as a barrier to imitation, is an outcome of the characteristics of the leading firm's individual resources and capabilities as well as the way in which they are linked to each other. In this respect, the strategic quality of these assets is dependent upon their observability, complexity and interdependency (Winter, 1987). When the particular competences of a firm are hidden from the direct eye, rivals will find it difficult to identify them. When a firm's strategic asset bundle is highly complicated and sophisticated in nature because of an elaborated development process, competitors will have a hard time re-manufacturing them. When a firm's core capabilities result from a number of interactive systems of inextricably intertwined organizational assets, imitators will be faced with significant difficulties on both matters of specification and duplication. Together, these attributes

create formidable barriers to imitation that enable the superior firm to fight off rivals. [10]

Proponents of resource-based views often like to refer to causal ambiguity as favorable towards the protection of the innovator's sources of competitive advantage. But it seems rather inconsistent that resource-based views pay exclusive attention to the glittery part of the argument, while neglecting its gloomy aspects. It should not be forgotten that the firm's distinctive resources and capabilities in the end stem from the collective and cooperative behavior of its members. And in its difficult task of dealing with these social phenomena, management faces the same problem politicians are also confronted with in a much wider context: social behavior can not be systematically structured, managed and influenced as pleased, and well-intentioned policies always have (unsuspected) negative side-effects. And so it is for corporations: the weaknesses that confront commercial entities are very often a consequence of the strengths of their strategies.

In a similar vein, the effects of causal ambiguity can be an advantage and a liability to the firm. For ambiguity to be a barrier to imitation, both the leading firm and its rivals must be faced with the same level of uncertainty surrounding the respective assets and their linkage to competitive advantage (Barney, 1991). If the successful firm's managers do have an understanding of the various causalities, competitors will be able to break down the barriers by using one or more of the above-mentioned diffusion mechanisms and thus inhibit sustainability (the successful firm's managers can be offered a better contract by rivals, for example). So in order for its advantage to be sustainable, the first-mover firm itself should not be faced with a lower degree of ambiguity than its rivals. But if this is true, then the leading firm, lacking a comprehensive understanding of its sources of advantage, will not be able to continue its competitive success: the company is, just like its rivals, unable to replicate that what created the advantage in the first place (Teece, 1984).

This last point has also been advanced by Reed and DeFillippi (1990: 90-91), claiming that "ambiguity may be so great that not even managers within the firm understand the relationship between actions and outcomes." Moreover, "where ambiguity is so great that managers do not understand intrafirm causal relationships, or factor immobility exists, it may be impossible to utilize competences for advantage." Rumelt (1987:

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[10] In this sense, Porter's (1996) recent work on activity systems claims interdependencies between individual firm activities to be key to a company's strategic capabilities.

144) also reasoned that in cases of significant causal ambiguity, "successful entrepreneurs are no more likely to repeat their success than *de novo* entrants." Further exploitation of the leading firm's competitive edge demands a reduction of the level of ambiguity, which, in turn, entails declining degrees of inobservability, complexity and interdependency. Winter (1987) noted that for competences to be expanded and exploited, they should be articulable, observable and simple. But this enables successful imitative efforts by rivals, which again forestalls sustainability.

As noted, contemporary resource-based thinking is placing its bets on knowledge as the paramount component of barriers to imitation and sustainable competitive advantage. The idea is that the idiosyncratic nature of the firm's knowledge base raises the degree of causal ambiguity and thereby precludes rival attacks. Knowledge is thus claimed to be the most strategically relevant resource in the corporation's portfolio of assets. For instance, Liebeskind (1996) argued that organizational knowledge can be kept proprietary through internalization of knowledge transactions within the firm and disaggregation of organizational tasks. However, such policies may very well lead to considerable transaction costs and failures to communicate within the firm. According to Grant (1996), the pivotal role of knowledge is its integrative ability to economize on communication, but to achieve such efficiency, the level of common or routine knowledge has to be high. This will inevitably increase rivals' chances of successful replication efforts.

In the same vein, Baden-Fuller and Pitt (1996) claimed that new ideas can be most effectively exploited if they become the property of all organizational members. Communication within the company is a necessity to realize such an ambitious goal, but again imitation by rivals will be simplified as entrepreneurial knowledge becomes widespread throughout the leading firm. It seems that even knowledge can not escape the essence of dual reasoning. It is primarily the tacit component of knowledge assets that prevents their articulation, thereby increasing the complexity and inobservability of the firm's internal success factors. In this situation, both the leading company and its rivals are faced with difficulties in replication and high barriers to imitation. Indeed, Spender and Grant (1996: 8) stressed that "the dilemma for management is that, for the same reasons that competitors cannot replicate the firm's knowledge, the firm itself may not understand it well enough to exploit it effectively."

This dilemma has also been discussed by Kogut and Zander (1992), claiming that replication of knowledge within the firm and its imitation by

other companies are 'blades of the same scissors.' The firm's desire to grow and to enhance efficiency by further exploitation of its advantage calls for codification and simplification of the underlying knowledge, which also provokes copying behavior by rivals. A catch-22 situation arises: the level of causal ambiguity surrounding the successful firm's asset base should be high to avoid imitation by its competitors and, at the same time, should be low to enable exploitation by the company itself. Whatever choice it makes within such a setting, the firm will never be able to gain a sustainable competitive advantage, simply because the alternatives are mutually exclusive. In one of the few querulous writings on resource-based theory, Collis (1994: 147) indeed noted that "causal ambiguity ultimately cannot be a source of sustainable competitive advantage because it contains the seeds of its own self-destruction."

The Liability of Path Dependency

The second keystone on which resource-based theories have built their premise that barriers to imitation can lead to sustainable advantages is known as 'path dependency.' In their eyes, firm heterogeneity is time-dependent: throughout the years, firms create different resource bundles as a result of gradually growing differences in management styles, cultural values, processes and procedures. Over time, individual firms develop unique routines to repeatedly perform organizational tasks, and these routines can eventually turn out to be (at the basis of) the company's distinctive competences. Such strategic resources and capabilities are "the cumulative result of adhering to a set of consistent policies over a period of time" (Dierickx and Cool, 1989: 1506). When this leads to a competitive advantage, the successful firm will be able to sustain that edge in two ways: (1) rivals can not copy them precisely because it took the leading company a long time to develop them in a unique way, and (2) by the time rivals have succeeded in imitating the target capabilities, the pioneer has used its lead to move on and further develop its distinctive competences (Teece, Pisano and Shuen, 1997).

But instead of viewing routines as evolving into core capabilities that sustain a competitive advantage, Nelson and Winter (1982) defined their concept of routines in an entirely different way: "It may refer to a repetitive pattern of activity in an entire organization, to an individual skill, or, as an adjective, to the smooth uneventful effectiveness of such an organizational or individual performance" (1982: 97). Hannan and Freeman (1984: 154) saw the creation of highly standardized routines as cardinal in

firms' search for reliability and accountability, but also stressed that "the very factors that make a system reproducible make it resistant to change." So considering routines as possible roots of a company's strategic assets is only one side of the coin; the development of routines also involves the creation of organizational procedures and systems through which the principles and heuristics tied to the firm's activities become effective. Both organizational thinking and doing evolve into monotonous rituals.

In their writing on organizational evolution, Tushman and Romanelli (1985) noted that the institutionalization of routines goes hand in hand with the evolution of commitment, and adopted the Weickian idea that 'habit becomes a substitute for thought.' Ghemawat (1991), in his publication on commitment, argued how firms' investment in distinct assets are usually tailored to specific strategies. Such a fit causes firms to be locked into their original intentions, as accumulated stocks of strategic factors over time restrain companies in their decisions to disinvest or act upon new opportunities. In other words, firms are persistent in their course of action over time and thus resistant to change. Boeker (1989) claimed that past organizational strategies have a bearing on the present. The firm's commitment to particular courses of action in terms of asset bundles, and patterns of activity that have become routinized as distinctive competences are major barriers to renewal, and so is the distribution of power within the firm.

This last point has also been noted by Levinthal and March (1993), who argued that political power within the organization often rests with managers responsible for past success, even when the firm is not successful anymore. Such individuals are often reluctant to abandon the way in which they perceive the features of the company and its business environment. Rigidities arise when such mental models are incompatible with today's realities, and tend to worsen if power positions remain the same. Thus, the role of learning becomes an indispensable component in explaining the impact of path dependency, especially when one recognizes that "the routinization of activity in an organization constitutes the most important form of storage of the organization's specific operational knowledge" (Nelson and Winter, 1982: 99). Unavoidably, routines retard the learning ability of especially successful firms by reducing their capacity to cope with contextual transitions.

The idea that the development of new knowledge is sacrificed by the firm's devotion to current knowledge has given rise to the notion that organizations are bound to fall in so-called 'competence traps' (Levitt and

March, 1988). In this situation, firms respond to novel developments by using the routinized competences that once were the foundation of success, but today are completely out of sync. Such firm behavior will not only inevitably lead to the end of its competitive advantage, but will also have a continued negative impact on its future performance for as long as the company holds on to past beliefs. This explains the fact that many firms that have been industry leaders in the past have been knocked off their pedestals by rivals who were able to create the new resources and capabilities required for competing under new circumstances (Rumelt, 1984). The inertia with which successful firms react to the changing world inhibits their capacity to assume the offensive and to embrace organizational renewal.

Path dependency may be the source of a company's competitive advantage, but it is also a force that will destroy such an advantage and thus prevent its sustainability. Routinization, commitment and learning form the backbone of competitive advantage, but will unavoidably also break its neck. The inertia that in the end arises out of these determinants of path dependency restrains the company's potential capacity to further explore new capabilities and possibilities. And such innovative behavior is an absolute necessity if the firm aims to utilize its competitive edge and keep rivals at a distance. Lei, Hitt and Bettis (1996: 565) proposed that, next to its more positive effects, path dependency can lead to "produce inflexibility, eliminating the dynamic quality of core competences, and thus loss of competitive advantage." Nelson and Winter (1982: 135) insisted that we "should come to grips with the fact that highly flexible adaptation to change is not likely to characterize the behavior of individual firms."

It appears that both causal ambiguity and path dependency have a dual nature: they act as barriers to imitation for competitors and, at the same time, act as barriers to sustainability for the pioneering firm itself. Both barriers have a limited number of determinants that define their respective intensity. Causal ambiguity is measured in the character of the firm's capability bundle in terms of observability, complexity and interdependency, while path dependency is measured in the level of inertia in terms of routines, commitment and learning. Although the barriers of causal ambiguity and path dependency are similar in their effects on sustainability, one should not forget that there is an important conceptual difference: whereas causal ambiguity restrains sustainability by limiting the first-mover firm's current choice set, path dependency acts as a constraint on sustainability by limiting its future choice set.

SUMMARY

At first sight, resource-based views seem to offer an adequate line of reasoning for our original purpose: to integrate theories that emphasize firm idiosyncrasy or uniformity, so that coevolution can be studied from both the firm and the industry-level perspective. Not only does resource-based thinking focus on the bearing of capabilities to competitive advantage (in contrast to the Porterian industry-structure or 'positioning' school), but it also sees the firm as principal unit of analysis. Moreover, firms are considered to be idiosyncratic because of the heterogeneity that marks their bundles of resources and capabilities (as Table 2.1 summarizes). In this sense, this chapter thus addressed the first two research questions posed in Chapter 1. Altogether, its explicit perspective on firms as distinct collections of capabilities makes resource-based logic highly appropriate as a first theoretical building block that supports an integrative framework on coevolution.

Table 2.1: Resource-Based Thinking Summarized

Key Arguments and Core Concepts	Roots and Conceptual Studies
Competitive advantage originates from *firm heterogeneity* in resources and capabilities	Penrose (1959), Nelson and Winter (1982), Teece (1984), Barney (1991), Peteraf (1993)
Competitive advantage can be *sustained* through barriers to imitation as	
• path dependency makes heterogeneous firms more *idiosyncratic* in their capabilities	Lippman and Rumelt (1982), Rumelt (1984), Winter (1987), Reed and DeFillippi (1990)
• causal ambiguity exists in the determinants of the *firm*'s superior performance	Dierickx and Cool (1989), Ghemawat (1991), Teece, Pisano and Shuen (1997)

Still, the resource-based theory's virtue of idiosyncrasy may easily become a detriment when it is not recognized that firms also display behavior that increases their uniformity. When rival firms, all made up of distinct organizational assets, aim to copy each other's capabilities, they become increasingly similar as to their competitive behavior as well as to

their capabilities. This explains for the paradoxical character of causal ambiguity and path dependency as barriers to both imitation and sustainability. If one overstates the uniqueness of firms and, as a result, undervalues the idea that firms try to be the same at a competitive level, both causal ambiguity and path dependency can indeed be perceived as barriers to imitation. But if one recognizes the idea that rival firms in a competitive arena or industry often tend to move towards each other over time, both phenomena may well turn into barriers to sustainability.

Table 2.2: Main Empirical Works on Resource-Based Thinking

Empirical Study	Research Focus	Research Method
Collis (1991)	Value of capabilities to competitive strategy	Case study of 3 firms in the bearings industry
Hamel (1991)	Internalization of skills through partnerships	Multiple-case study of 9 international alliances
Leonard-Barton (1992)	Role of capabilities in product and process development	Twenty case studies of projects in 5 firms
Hall (1993)	Value of intangible assets to competitive advantage	Multiple-case study of 6 firms
Henderson & Cockburn (1994)	Measurement of R&D competence	Econometric model of 10 firms in the pharmaceutical industry
McGrath *et al.* (1995)	Relation between new initiatives and capabilities	Regression analysis of 40 firms
Miller & Shamsie (1996)	Property- versus knowledge-based resources	Statistical analysis of film industry over 30 years

The implicit neglect of the possibility that firms do display a certain degree of uniformity by contemporary resource-based thinking not only characterizes most of its conceptual work.[11] Table 2.2 recapitulates the major empirical contributions made in the name of the resource-based

[11] To be precise, here the term 'contemporary' refers to the writings that have been published under the formal heading of the resource-based view of the firm since the late eighties.

perspective. Apart from that there appears to be a shortage of empirical work in this research area, it is striking that only one of these contributions (the Henderson and Cockburn (1994) study) recognizes the significance of rivalry (although it measures firm heterogeneity instead of actual imitation efforts). The other studies primarily report the process through which capabilities are built, and focus on the properties and characteristics that distinguish one type of capability from another. However, they do not pay explicit attention to competitive pressures, that is, the competitive context in which capabilities matter.

Clearly, resource-based theory lacks a view of how uniformity in firm behavior can come about. The most obvious situation in which firms move towards each other seems to be the process of competition. Ultimately, rival firms in an industry have to manage system dynamics of innovation and imitation if they attempt to create or overcome a competitive advantage. This is the subject of discussion in the next chapter.

CHAPTER 3

Theory on Competition:
The Contributing Value of Schumpeterian Views

This third chapter explains why, according to Schumpeterian logic, rival firms tend to become increasingly uniform in their posture and behavior as the competitive process unfolds. When a particular pioneering firm introduces a new set of competitive rules to the industry, it creates a competitive advantage based on some new capabilities. Noticing the success of the innovating firm, lagging rivals will inevitably be forced to copy the leading firm's configuration of capabilities. Assuming that intelligence is equally spread over a population of competitors, the other firms will succeed in their imitative behavior. Whereas resource-based thinking argues that firm idiosyncrasy increases over time as a result of path dependent processes, this line of reasoning concludes that rivals move towards each other as time goes by. Still, Schumpeter (1934) assumed that there will always be new innovators that disrupt established practice in the industry. In other words, the industry's evolution is triggered by the endogenous force of competition, that is, a 'force from within.' This implies that any competitive advantage is transient in nature, an idea that provides the starting point of an exploration into Schumpeterian competition.

TEMPORARY COMPETITIVE ADVANTAGE

Strategy scholars have since long searched for the sources of sustainable competitive advantage, but it seems that there are still no clear-cut explanations for what should or could determine the sustainability of a firm's competitive edge. It has been shown in the previous chapter that pioneering firms are unlikely to prevent rivals from copying their organizational assets that sustain its first-mover's advantage. Like the traditional industry analysis perspective, resource-based views seem to run into problems

when trying to theorize how firms can create a sustainable competitive advantage. Although the added value of resource-based views to the field of strategy has been substantial, it could well be that strategic management's goal to unravel the phenomenon of sustainability has always been a bit too ambitious. The main reason for strategy's Holy Grail syndrome can be found in its traditional neglect of the dynamics underlying the competitive process.

Optimistic Views on Advantage

According to Porter (1991), the added value of resource-based views will primarily lie in the explanations they offer for corporate strategy issues. Although some say that success in diversification moves as based upon a limited number of core capabilities can only be explained in retrospect (Carroll *et al.*, 1996), there is indeed an implicit focus on corporate diversification in much of the work done in this direction (Mahoney and Pandian, 1992; Peteraf, 1993; Teece, Pisano and Shuen, 1997). And this is no wonder if one remembers from the previous chapter that resource-based thinking was partly stimulated by research findings on the relationship between diversification strategy and economic performance. It should also not be forgotten that Prahalad and Hamel's article on core competences is essentially an exposition on corporate strategy. They argued that core competences should "constitute the focus for strategy at the corporate level" (1990: 91), and should be seen as "the glue that binds existing businesses" because they embody "the engine for new business development" (1990: 82).

Apart from being a crown jewel of the corporation (Collis and Montgomery, 1995), the notion of competence also renewed interest into the nature of organizational behavior that characterizes the firm's development of resources and capabilities. For it is precisely this behavior that, further down the line of causality, enables firms to take and hold position on the chosen product market, and may lead them to a competitive advantage. However, the growing number of resource-based proponents seems to have been carried away by enthusiasm, and the strategy field's well-established sense of optimism led to an effort to incorporate the notion of sustainability in its analyses. Montgomery (1995) observed how this rather exaggerated reaction resulted in a gap between strategic management's ideals and what can be seen in reality. She also noted that this discrepancy between romantic goals and observed facts is a point "where the resource-based literature falls dangerously short" (1995: 257).

The theoretical arguments which culminated into the original resource-based framework were supposed to suggest "the kinds of empirical questions that need to be addressed in order to understand whether or not a particular firm resource is a source of sustained competitive advantage" (Barney, 1991: 115). But a more fundamental question seems to be whether the framework itself has to be empirically tested before using it as a tool in the analysis of strategy and competitive advantage. As shown, resource-based thinking experiences a shortage of staunch empirical research efforts. The reason, according to Doz (1994: 2), is that "research on core competences has so far been driven by theory building and theory refutation." More openness towards more 'pessimistic' views on competition and firm advantages, such as those advocated by evolutionary economists and, to a lesser degree, scholars in the field of population dynamics, could therefore be of a contributing value to resource-based thinking.

Realistic Views on Advantage

These social-economic schools of thought pay significantly more attention to the role and nature of competition over time. Whereas traditional resource-based thinking perceives competition essentially as a one-way process, these disciplines incorporate an evolutionary perspective that accentuates the quality of competitive interaction at the industry level. As argued, resource-based perspectives stress the significance of causal ambiguity and path dependency in what is considered to be the firm's main task: the erection of barriers to imitation to shield off rivals. But such thinking does not consider the impact of competitors that display a continuous tendency to imitate those who lead the pack of rivals.[1] As soon as the innovating firm wants to exploit its newly-created advantage, or aims to further develop its advantage, the necessary decrease in path dependency and causal ambiguity causes a shift in the balance of competition in favor of rivals on the lookout and ready to duplicate the firm's success.

Figure 3.1 shows that there is an alternative route to determining the effects of barriers in the competitive process: it starts at the side of rivals, ends at the other side of the scales where the focus is on the leading firm,

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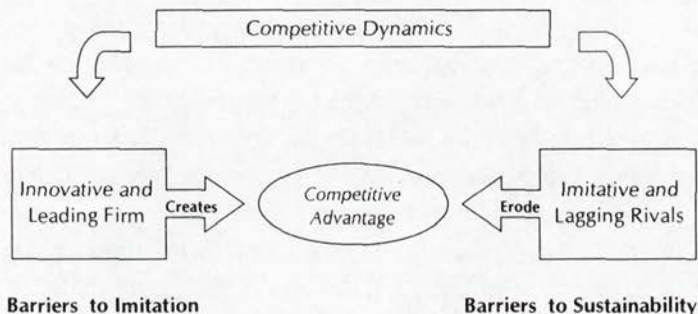
[1] In this sense, innovation is not restricted to something technological. Instead, this thesis incorporates a view of innovation as the creation and development of new capabilities through which firms can maintain or improve their competitive position in the industry by competing differently.

and involves both barriers to sustainability and barriers to imitation. Such reasoning permits the composition of a somewhat tangible image of competition's interactive nature, in which the related routes of competitive causality are united by the dual character of the barriers. As these barriers undermine the existence of sustainable advantages, the figure enables an exploration into the *temporary* nature of competitive advantage. That is, any advantage will eventually be eroded by the actions of both the leading firm and its competitors. In other words, "it is no longer a question of whether the current competitive advantage will be eroded but rather a question of when" MacMillan (1988: 111). This statement calls for an exploration into the body of knowledge on temporary advantages.

Figure 3.1: Why Advantages Are Temporary



The difficulties confronted with when championing the doctrine of sustainable competitive advantage do not imply that the strategy field should restrain itself from inquiries into medium-term benefits of innovative strategies. In a recent publication, Winter (1995: 159) mentioned that "the emphasis the strategy literature gives to sustainable advantage may have the unintended consequence of diverting attention from the effective pursuit of transient rents." His opinion conforms to that of Jacobson (1992), who argued that the successful firm's competitive advantage will inevitably be eroded by imitating rivals, and that in this process barriers to imitation can do no more than delay the impact of imitation. Consistent with the above-mentioned arguments, such a view implies that competitive advantages are at best temporary. In his discussion on 'hypercompetition,' D'Aveni (1994) noted that barriers to imitation frequently miss the strength management thinkers commonly assume.

The period over which a successful innovator generates above-average returns is not only dependent upon the height of the barriers to imitation, but is also subject to the intensity of competition that defines the strength of the barriers to sustainability. In more down-to-earth language, both the abilities of the leading firm and those of its rivals determine the innovator's returns to its competitive advantage. It is rather naïve to simply assume that companies operate in a competitive vacuum, yet this is exactly what resource-based thinking seems to do (Montgomery, 1995). The inconsistency in its reasoning is unquestionable if one considers the essence of such an assumption: on the one hand, a specific firm is perceived to be highly intelligent in comparison to the lower life forms represented by its rivals. On the other hand, this unequal distribution of intelligence is not corrected for: competitors are presumed to be passive players who act as ornaments to decorate the set for the leading role's glory.

The most obvious weakness of this premise is the incongruous way in which agility and obedience as opposite forms of firm behavior have been allocated to leader and laggards. Apart from these contrasting expectations on competitive behavior, a far less visible flaw lurks in the implicit presumption that firm heterogeneity can be stated in terms of intellectual capacity. However, differences in organizational assets, even knowledge, can not simply be restated in terms of variety in intelligence. Instead, a more sound assumption would be that rivals at least actively try to imitate the success of the leader. When competitors experience a decrease in returns or even a loss, while at the same time spotting enhanced profits at the innovator, they will be stimulated to commit themselves to imitation (Nelson and Winter, 1982). It won't take many years before some or most of them launch a counterattack using an equal (or even better) package of organizational assets.

In this process, barriers to imitation temporarily delay rivals' ability to imitate, and this explains why "competition does not instantaneously and costlessly drive rents (if they were to arise) to zero" (Schoemaker, 1990: 1183). Moreover, in addition to the rebuttal of this well-known assumption among orthodox economists, the two-way process of rivalry presents another outcome that deserves attention here. If the first-mover firm's alternative route to success turns out to increase profits and life chances, the innovation will almost certainly be dispersed throughout the herd of lagging competitors (Hannan and Freeman, 1984). However, the inevitable reduction in firm heterogeneity does not transform rival firms

into perfect replicas because they never will be identical on all significant attributes (McKelvey and Aldrich, 1983). The reason for this is that none of the methods by which organizational assets diffuse among companies are, to use Nelson and Winter's (1982: 65) words, "so cheap and effective as to make it plausible to assume that anything known to one firm is known to all."

PROCESS-BASED VIEWS OF COMPETITION

So although firm heterogeneity will always be maintained at a certain substratum, the responsive behavior of rivals to entrepreneurial actions of the innovating firm tends to eliminate variety among competitors in their sources of success or survival. From the moment a firm flourishes from a new approach to the business, others will inevitably try to copy its sources of success. If their attempts are fruitful, even more imitators will follow, attracted by the observation that it is possible for others than the original innovator to make a fortune on the basis of new capabilities. The speed with which the new rivals start to compete on these novel competences accumulates over time as the ease and possibility of reproduction increases. Finally, the innovating recipe becomes familiar to the total pack of rivals, and what remains of the diversity among firms will no longer lie at the level of competitive advantage: in their industry, rival firms will show a tendency towards uniformity. This idea of competition was first preached by Schumpeter (1934) in his theory of economic development.

The Interactive Nature of the Innovation-Imitation Process

According to Schumpeter, it is impossible for firms to have a sustainable competitive advantage because – consistent with the discussion on the dual nature of barriers – all strategies and capabilities can be duplicated in the end. The first mover's competitive advantage is therefore destined to be destroyed by followers, reflecting its temporary nature. But why do firms develop new organizational assets to achieve a leadership position in their business if such behavior will be copied anyway? Why do innovators create new resources and capabilities if the resulting competitive edge will only be temporarily enjoyable? Schumpeter's answer is that, just like the envious platoon of laggards is stimulated in its behavior to imitate the leader, pioneers are challenged to create followers out of their rivals. Competition becomes a highly interactive process in which both

the innovator and the imitators in a particular industry are motivated to act in response to each other's presence and performance.

There are a number of elements that motivate a company in its efforts to be the first one that brings a new, problem-solving idea to the market. Apart from the joy of creating something different, there are more platonic incentives such as the will to erect a new business empire or the thrill of power and independence. But the principal element is the firm's drive to compete, and to dominate all other contestants while at the same time being admired by them. According to Schumpeter (1934: 93), entrepreneurs are characterized by "the will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself." He further noted that financial prosperity is of secondary concern as it is not a source, but an appreciated outcome of the innovator's success. Although monetary gains are essential to the further growth of the firm, both issues do not constitute the primary objective of its search for new ways to compete.

In the same vein, Stopford and Baden-Fuller (1994) stressed the importance of companies having ambitious aspirations beyond their current competitive capacities as a prerequisite to achieving industry leadership. Whereas the innovator possesses some sort of voluntary drive to suppress its rivals by competing victoriously, the latter often have no choice but to confront the leader and adopt its sources of success. Some of them will notice the pioneer's increase in returns in sharp contrast to their own stagnant profits, and decide that imitation will be the most suitable route to enhanced performance. These will be the ones that are quick to react and seize the opportunity to steal a ride and profit from the leader's innovative ideas. Others, struggling with the rigidities of their own past, only notice the seriousness of a performance decline when it is almost too late. Such firms are normally forced to copy the successful firm(s) just to survive.

The interconnected motivation to compete against those who are superior or inferior can also be extracted from Nelson and Winter's (1982: 266) expression that "there is both a carrot and a stick to motivate firms to introduce better production methods." It is obvious that without the presence of a first-mover firm, there will be no imitators. At the same time, one should bear in mind that there will be no innovator without the existence of (potential) followers. It is the inevitable interaction between leader and followers that touches the essence of the competitive process. In this process, the role of new resources and capabilities is inherently paradoxical. If companies do not create new capabilities, they will not be

able to survive (like the leading firm, imitators are essentially involved in creating something new). However, when firms do create new capabilities, they will not be able to achieve a sustainable competitive advantage (which obviously applies to both leader and followers).

This was also recognized by Schumpeter (1934: 89) in his observation that an entrepreneurial company "leads in the sense that he draws other producers in his branch after him. But as they are his competitors, who first reduce and then annihilate his profit, this is, as it were, leadership against one's own will." In line with this paradox, it is assumed in this thesis that the process of creating and developing new capabilities is *both a cause and an effect* of the competitive process. Capabilities evolve out of the competitive conduct among rivaling firms, and "organizations coevolve through these reciprocal interactions, developing strategic capabilities whether or not by the design of strategic managers" (Barnett and Hansen, 1996: 142). Companies, in their united roles of innovator and imitator, introduce and adopt new capabilities as they are involved in a competitive process. Thus, when a new competitive recipe has proven successful, competitive dynamics make sure that uniformity among rival firms in an industry will increase.

The Temporal Nature of the Innovation-Imitation Process

Competition is a process in which the dynamic of innovation and imitation among rivals shapes its outcome. This implies that competitiveness is a property of collections of companies, and that strategy should best be understood in a competitive context. Traditional resource-based views, in contrast, have so far almost exclusively focused their inquiries on organizing mechanisms and forces underlying the process of asset development that can be found within the firm (Teece, Pisano and Shuen, 1997). Such a unilateral approach thus tends to discount the impact of rivalry upon the process of capability creation and development, subordinating competition to a property of markets (Barnett and Hansen, 1996). But competitive advantage can only be created if one understands the character of competition in an industry (Grant, 1995). Levinthal (1995) therefore stressed that research in resource-based views must link firm-level analyses with industry-level competition in order to add further value.

Henderson and Cockburn (1994: 63) also remarked that "studies of the evolution of capability at individual firms have greatly enriched our understanding of the nature of particular competences ... but by and large these insights have not been incorporated into studies of aggregate firm

behavior or systematic studies of competition." Such criticism is probably rooted in the fact that most of the popular studies into resources and capabilities have been published as success stories of individual firms. Prestigious corporations' core competences were analyzed over time, while firm performance was measured in terms of successful diversification efforts.[2] The competitive process came to be neglected, although these investigations did indicate the relevance of time-based research into firms and their industries. Still, Montgomery (1995) argued that proponents of resource-based views incorporate a too narrow window of time and, as a consequence, fail to address the dynamics of competition.

As the process of competition is characterized by reciprocal firm behavior that results in both the creation and diffusion of new and successful routes to competitive advantage, the logical sequel move indeed seems to be the incorporation of time. The reason is that we simply can not assume that interactions between rivals no longer continue once the total population of firms competes on the same rules of success. It is the unremitting zeal of firm motivation that continually drives the interactive process of imitation and innovation and makes it start over and over again, not waiting for the eventual state of perfect competition. This dynamic view of interactive competition is also known as the process of 'creative destruction,' originally coined by Schumpeter (1934) in his explanation of why industry leadership changes over time. According to his ideas, there will always be companies that are motivated to create new success and simultaneously destroy the current state of affairs.

Fundamental to Schumpeter's process of creative destruction is the creation of new combinations, which disrupt the industry's established order and initiate economic change. These new combinations not only involve the introduction of new products and processes, or the opening up of new markets and alternative supply routes. They also concern "the carrying out of the new organisation of any industry" (1934: 66). Schumpeter was clearly not only thinking of innovation in the more limited sense of technologies. Instead, he was especially interested in the behavior of those companies that search for new ways of competing and make rival firms' positions obsolete. The Schumpeterian view of competition has received increasing attention in contemporary strategic management thinking. Baden-Fuller and Stopford (1994) labeled firm actions that initiate creative destructions as 'strategic innovation,' whereas D'Aveni (1994) refers to them in terms of 'disrupting the market.'

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2 Prototype studies are Prahalad and Hamel (1990) and Stalk, Evans and Shulman (1992).

ENDOGENOUS VIEWS OF COMPETITION

The cardinal question to be answered before any analysis of the competitive behavior of firms over considerable periods of time can be launched is: What really determines the progress of industries in their capacity as evolving socio-economic systems? In other words, what is the nature of the forces that drive the development of industries as consisting of struggling rivals? Schumpeter was probably the first to tackle this issue explicitly in his theory of economic development, based upon his principles of creative destruction.[3] The logic underlying his arguments not only provided him a suitable answer to these questions, but also addressed economic science's right to exist. Schumpeter (1934: 63) argued that if "the economy, in itself without development, is dragged along by the changes in the surrounding world," there would be no economic development as the reasons for such progress lie "outside the group of facts which are described by economic theory."

Dynamic Competition as an Endogenous Force of Development

According to Schumpeter, economic progress is, as a rule, the outcome of innovative actions of those companies that are determined to crush the competition. In this sense, development is a product of the competitive hustle, that is, 'a force from within.' In fact, this emphasis on progress as an endogenous outcome had already been proposed some fifty years earlier by Charles Darwin (1859): "Some make the deep-seated error of considering the physical conditions of a country as the most important for its habitants; whereas it cannot, I think, be disputed that the nature of the other habitants with which each has to compete is generally a far more important element of success." Although Darwin and Schumpeter differed in their perception of how progress unfolds – whereas the biologist emphasized a continuous flow of development, the economist was more concerned with discontinuous jumps – both regarded the force of rivalry as the internal motor of development.

Despite this long-standing wisdom, the field of strategic management has apparently been more impressed by the arguments of both industrial organization economics and early writings within the research territory of

[3] Although this thesis refers to the 1934 English translation, Schumpeter had originally published his work in 1911 under the German title of *Theorie der Wirtschaftlichen Entwicklung.*

population ecology.[4] In these disciplines, the idea was that exogenous factors such as technology, information or legal and fiscal constraints were the true determinants of both company behavior and industry development (e.g., Hannan and Freeman, 1977; Shepherd, 1979). The prominence of this idea within strategy thinking can be observed in one of the most influential publications on strategy of the 1980s. In their article on strategic change, Hrebeniak and Joyce (1985: 337) defined the alignment of firm competences with changing environmental conditions as "proactive or reactive organizational behavior in anticipation of or reaction to exogenous variables." Instead of looking at the competitive interactions between rivals within the industry atmosphere, the idea was to study the interactive nature of an individual firm with its wider environment.

This exogenous outlook made strategy schools of thought disregard the role of competition in their understanding of why and how industries develop over time. In the industry-analysis approach proposed by Porter (1980), industry evolution is primarily determined by changes in exogenous elements such as uncertainty of information, consumer behavior, demographics and trends, technological developments, costs of capital and wages, and government policies. Resource-based views do not seem to be interested in the issue of industry dynamics, but do point to environmental turbulence as a force of external change when discussing the need for companies to adapt their organizational assets to new situations (Grant, 1991). The fact that both perspectives regard industrial development as an outcome of mainly exogenous forces is not a surprise if we remember from the previous chapter that their core notion lies in shielding off rivals: the first builds upon the idea of barriers to entry, while the latter depends on barriers to imitation.

Indeed, Levinthal (1995) expressed his deep concerns about the strategy field's exclusive focus on exogenous change and its ignorance of a new stream of research into population dynamics. This growing body of literature came into existence during the 1980s as a response to the 1977 publication of Hannan and Freeman's seminal work on population ecology. A crucial argument within these follow-up studies was that, as Astley (1985: 229) argued, "homeostatic forces within populations," instead of some other external forces (that is, pressures from outside the respective system), were regarded as determining both the path and the rate of evo-

[4] Of course, another possibility is that, from the late 1970s on, the field of strategic management was largely ignorant of the existence of the alternative argument that development is endogenous in nature.

lutionary change.[5] In a similar way, McKelvey and Aldrich (1983) noted that the environment is not some sort of Big Brother watching over a cluster of rivals, and punishing those that are out of line. Rather, competing organizations influence each other by means of their actions, and development occurs when new possibilities or opportunities for some firms evolve out of the activities of others.

Some of the critique directed at the original proposals of Hannan and Freeman (1977) was concerned with definitional problems around the concepts of species and populations. But the main point of attack was directed at the fact that a solid model of competition was missing in their analysis (Young, 1988). Indeed, this endogenous driving force has been further explored by more recent studies into population dynamics (e.g., Boeker, 1991; Barnett, Greve and Park, 1994; Barnett, 1997). In a different academic setting, but at approximately the same time, another small group of researchers turned their attention to the endogenous nature of development. That line of work, according to economist Romer (1994: 3), "does not invoke exogenous technological change to explain why income per capita has increased by an order of magnitude since the industrial revolution [...] it tries instead to uncover the private and public sector choices that cause the rate of growth." Those involved were economists with strong feelings for the creative aspect of technological innovation.

To overcome the shortcomings of economic neoclassical growth models, these scholars aimed to capture two neglected facts into realistic models of growth: (1) discovery is endogenous in nature in that it is determined by things that people do, and (2) firms are able to enjoy (temporary) monopoly returns on these discoveries (Romer, 1994). Stimulated by research into technology by academics like Dosi (1984) and Freeman (1982), models of a neo-Schumpeterian nature were developed in which industrial innovation is at the heart of economic development. It was the work of Nelson and Winter (1982) that explicitly integrated the competitive element into the notion of technological innovation from a dynamic point of view. They argued that the interplay between these ingredients makes "firms evolve over time, with the condition of the industry in each period bearing the seeds of its condition in the following period" (1982: 19). Thus, the forces of change are endogenous to the industrial system itself.

[5] Clearly, research into population dynamics conforms to Darwin's original idea of gradual evolution, as opposed to Schumpeter's discontinuous jumps.

Dynamic Competition as an Endogenous Force of Industry Evolution

So if industry development is not triggered by exogenous conditions like consumer demographics or basic technologies, but instead is propelled by the endogenous force of competition, then industry structure can never be the driver of that force. Instead of shaping the competitive process, industry structure (as seen at a specific point in time throughout its development) is merely an outcome of the competitive process that continuously changes its texture (Hill and Deeds, 1996). A crucial question therefore seems to be: What is the engine that drives the process of competition? It has already been argued that firms' motivation to compete with each other in an industrial arena in essence drives the process of rivalry. Ambitious companies are eager to show their superiority, while lagging firms are stimulated to challenge the position of such industry leaders in order to share their success or to simply survive.

But the mere existence of motivation at one, a few, or even all of its organizational members will not give the firm sufficient grip in its ambition to compete successfully. It can, however, be very helpful in its task of developing organizational assets that are needed to create competing products and services. Without the required resources and capabilities, companies will not win over, or catch up, with rivals whatever their ambitions may be. It is simply not enough for companies to want something; they also have to do something to achieve these aims. In this respect, firms need to create property and knowledge as a basis on which they can compete. Such company behavior culminates in the creation and development of new capabilities. So although firms compete with one another via product markets where consumers act as biased referees, the basis of such rivalry lies within the rivals themselves. Capabilities-based competition is essentially interaction between what organizations are able to do.

This idea that competition, and as a result industry evolution, comes from the things firms do, is core to the endogenous perspective outlined above. Technology, for example, does not drive an industry's development; it is what firms do with it that determines the course of industrial evolution. Due to technology's public availability, companies can only effectively compete if they have unique capabilities that make the best of the opportunities derived from a particular technology (Teece, 1987). In this respect, firms have to exploit a given technology better than their rivals do as "technology cannot be management's primary solution because it is every competitor's potential solution" (Clark, 1989: 94). Winter (1987) even argued that firms should shift their emphasis from producing

technology to making use of competitive 'weapons' other than technological innovation. Due to the speed with which basic technologies are diffused over rivals (see Exhibit 3.1), creative behavior of firms can better be defined in terms of its implications for competitive success, and such behavior is shaped by the presence of firm capabilities.

Exhibit 3.1: Diffusion of Innovations

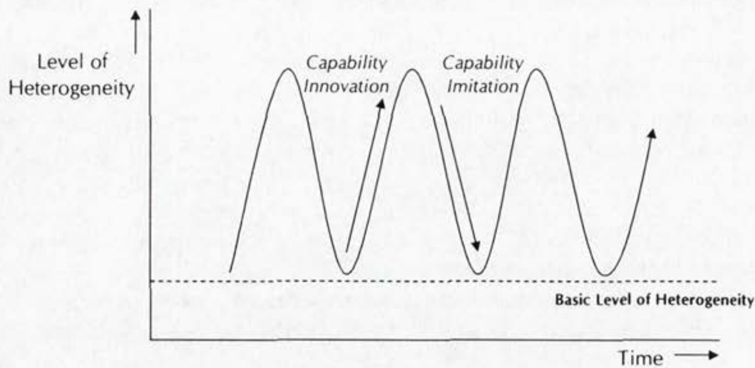
In their attempt to catch up with a pioneering company, various replication instruments enable imitators to significantly reduce the period of time over which the innovator enjoys its first-mover or competitive advantage. An investigation by Mansfield (1988), for instance, showed that, on average, rivals often do not need more than 12 months to acquire the necessary information on the basis of which, in no more than three more years, they can copy technological product and process innovations. And there's more to it than just time effects: in another study, Mansfield, Schwartz and Wagner (1981) found that development costs for followers are 35 percent less than those originally incurred by the innovator. Late movers achieve even further cost advantages because they are able "to 'free-ride' on a pioneering firm's investments in a number of areas including R&D, buyer education, and infrastructure development" (Lieberman and Montgomery, 1988: 47).

It's not only technology that spreads out rather rapidly over an industry; Porter (1980) already stated that any advantage based upon proprietary knowledge forms attached to experience or learning will unavoidably be destroyed through rivalry. Teece (1987) not only argued that trade-secret protection is strictly possible for chemical formulas or when the underlying technology of a product can be kept secret, but also mentioned that the significance of patents is often grossly overestimated. Apart from some industries such as pharmaceuticals, patent protection is largely ineffective "because the legal requirements for upholding their validity or for proving their infringement are high," and, as a consequence, "many patents can be 'invented around' at modest costs" (1987: 188). Finally, advantages based upon geographic preemption and investment tactics in plant and equipment, as well as first-mover benefits derived from economies of scale or access to distribution channels, frequently do not resist the imitating power of rivals (Lieberman and Montgomery, 1988).

It is thus assumed in this thesis that the progress of an industry as a collection of rivals is an endogenous matter. Figure 3.2 illustrates how this process is determined by the creation and development of capabilities at rival firms as an expression of their motivation to interact on a hostile basis. As argued before, those organizational assets that underlie a firm's competitive advantage are inevitably imitated by competitors. At the same time, this tendency of companies to become perfect replicas is halted by the assumption that firms are different from each other just like human

beings are. Such a basic level of firm heterogeneity will therefore always leave room for the creation of new competences by those motivated to overthrow the establishment (Rumelt, 1984). As a consequence, new capabilities do not only inject the adrenaline into the process of competition, but also are the upshot of rivalry as companies learn how to deal with competitive challenges (Barney and Zajac, 1994).

Figure 3.2: Industry Evolution as an Endogenous Process



In other words, the competitive beast never comes to rest as the endogenous character of capabilities-based competition keeps the 'wheel of competition' turning. Indeed, Marshall (1890: 286) noted that "the progress and diffusion of knowledge are constantly leading to the adoption of new processes and new machinery which economize human effort." In this regard, Mahoney and Pandian (1992) pleaded for the development of an endogenous theory of heterogeneity in response to resource-based views' basic flaws. They continued that the key to such a theory was the incorporation of existing evolutionary thoughts. This thesis conforms to the above assumptions on endogenous development as are embraced by Schumpeter's theory of economic development and its contemporary descendant, Nelson and Winter's (1982) evolutionary theory of economic change.[6]

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[6] Although these publications differ somewhat in their level of analysis, both are regarded as landmark studies that deal at a conceptual level with 'evolutionary economics' theory (Rumelt, 1984). The latter term is therefore used in this thesis for matters of practicality.

By focusing on the endogenous dynamics of competition, it is however not claimed that exogenous factors are not relevant to firm strategy. Indeed, new laws or regulation imposed by government, shifts in technology external to the industry, or changes in market characteristics may impact the industry's development. But, as argued above, such factors only seep through as a result of the providential behavior of distinct firms in the industry. Thus, it is argued here that in the field of strategic management the role of exogenous forces in the development of industries has traditionally been overemphasized at the cost of the incorporation of a competitive process perspective. A long time ago, military strategist Carl von Clausewitz argued that war is a destructive act in which force and intelligence are used to achieve superiority over the enemy. At the same time, he noted that conditions of locality, time of day and weather are "circumstances which always attend the application of the means" (Von Clausewitz, 1982).

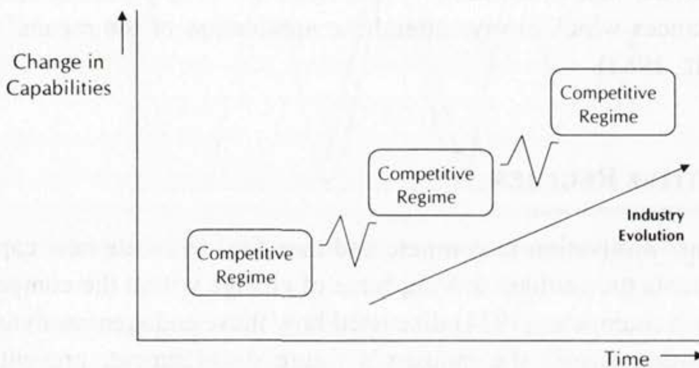
COMPETITIVE REGIMES

Rival firms' motivation to compete and therefore to create new capabilities represents the cardinal driving force of change within the competitive landscape. Schumpeter (1934) discussed how these endogenous dynamics of competition ensure the industry's future development, preventing a collapse of the industrial system. According to him, acts of creative destruction by entrepreneurial firms are repeated over time, so that the rules of competition are redefined again and again. Each time, pioneers create new bundles of capabilities, enforcing their rivals to replicate these organizational assets and conform to the new competitive doctrine. The ideas in this book reflect Schumpeter's notion of industry evolution as subsequent phases of disequilibrium competition over time. During each of these phases, dynamics of innovation and imitation induce uniformity among the population of rival firms in terms of competitive capabilities.

Figure 3.3 illustrates this repetitive pattern in which industry evolution is determined by changes in capabilities on which rivals compete. It visualizes how industry evolution is driven by subsequent phases of competition in which new competitive capabilities are introduced and imitated. In this thesis, such phases are referred to as 'competitive regimes:' periods during which competition as a dynamic process of innovation and imitation evolves around a particular theme or set of competitive rules,

based upon distinct bundles of capabilities.[7] An industry can therefore be characterized as consisting of different competitive regimes over time. As old competitive regimes are substituted for by new ones, new rounds of development prevent a breakdown of the industrial system (Day, 1984). It is not the industry that is created again and again, but rather the formation of new regimes that constitute the development of the industrial system: "A complete reorganisation of the industry occurs, with its increases in production, its competitive struggle, [and] its supersession of obsolete businesses" (Schumpeter, 1934: 131).

Figure 3.3: Competitive Regimes and Capabilities



A new competitive regime does not signal the arrival of a new industry. Instead, it reorganizes an industry's existing collection of capabilities that underlies established business practice on the basis of which firms compete in an industry. The pioneering firm that introduces this revolutionary package of capabilities clearly does things radically different if compared to the way competition evolved in the past. As a consequence, the innovator renders established practice obsolete. The scalariform pattern of industrial development displayed in Figure 3.3 indicates how the innovator's introduction of new capabilities and competitive rules to the industry disconnects subsequent competitive regimes from one another. In this sense, Schumpeter (1934: 216-217) remarked that "as a rule the new does not grow out of the old but appears alongside of it and eliminates it

[7] In accordance with Dosi (1982) and Nelson and Winter (1982), the term regime has been adopted to stress the idea that each period has its own distinctive paradigm of competition.

competitively," and that "the development which then starts again is a new one, not simply the continuation of the old."

In a Schumpeterian world, a creative destruction represents a disequilibrating force upon the industry's development, initiating a new competitive regime. However, the subsequent force of imitation is a more gradual and equilibrating one, which brings the rival population back at an equivalent level of capabilities and competition (Iwai, 1984). In other words, competitive regimes arise in line with the so-called 'punctuated equilibrium paradigm' originally posed by the natural historians Eldredge and Gould (1972). According to this Kuhnian outlook, industries evolve through relatively long periods of incremental development, punctuated by creative destructions that mark the beginning of a new competitive regime. Abernathy and Clark's (1985) longitudinal analysis of the American automobile business indeed shows such a pattern in which different successful car manufacturers over time disrupted the industry and established new competitive regimes on the basis of new capabilities.[8]

This process of radical substitution has also been noted by academics into population dynamics who investigated the rise of new populations and the fall of existing ones.[9] Although both population dynamics and evolutionary economics recognize the importance of competition to the process and path of industrial development, these disciplines remain at odds regarding their primary principles. In studying the survival and demise of organizational forms over time, population dynamics emphasizes the relationship or *fit* between a particular population and its environment. In contrast, evolutionary economists are more interested in the endogenous driving forces of long-term *change*. This crucial distinction was noted by Winter (1990), who also commented on population ecology's belief that individual firms are subject to environmental and exogenous selection forces that undermine their ability to change. Opposing such a deterministic view of why firms fail to survive over long periods, he mentioned how "evolutionary economics emphasizes that organizations do not just adapt to change, they cause it" (1990: 293).

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[8] A punctuated equilibrium view of industry evolution opposes the idea that industries evolve through stages of emergence, growth, maturity and decline (e.g., Levitt, 1965; Porter, 1980). Thus, "the implicit (or sometimes explicit) biological life cycle metaphor seems to be misleading" (Abernathy and Clark, 1985:14).

[9] For example, McKelvey and Aldrich (1983: 124) argued that "sudden increases in organizational mortality rates ('shake-outs') do not happen all the time – they are not continuous – but rather happen at uncertain intervals for many populations."

SUMMARY

In our quest to study coevolution from an integrated point of view in which both firm idiosyncrasy and uniformity play a part, a Schumpeterian view of competition seems to be suitable as the second theoretical building block. Whereas population ecology's notion of competition focuses on the rise and fall of populations in their attempts to achieve a fit with exogenous environmental forces, the Schumpeterian outlook regards the competitive process as an endogenous force of change in which capabilities of rival firms matter. As Table 3.1 summarizes, Schumpeterian theory of competition takes the industry as the primary unit of analysis, in which competitive interactions among innovators and imitators shape the industry's evolution over time. It therefore assumes that, in each competitive regime, rival firms show a tendency towards uniformity at the industry level. Like the previous chapter on capabilities, the current one thus addressed the first two of the original research questions.

Table 3.1: Schumpeterian Competition Summarized

Key Arguments and Core Concepts	Roots and Conceptual Studies
Competitive advantage originates from innovative acts of *creative destruction*	Schumpeter (1934), Baden-Fuller and Stopford (1994), D'Aveni (1994)
Competitive advantage is only *temporary* in nature because	
• imitation processes make heterogeneous firms more *uniform* in their capabilities	Schumpeter (1934), Nelson and Winter (1982), Iwai (1984), Lieberman and Montgomery (1988), Jacobson (1992), D'Aveni (1994)
• competitive regimes continue to punctuate the *industry*'s evolution	Schumpeter (1934), Day (1984), Abernathy and Clark (1985)

The Schumpeterian view does accept some basic level of firm heterogeneity, for without it, future acts of creative destruction would not be possible. Still, much of its focus is on how the competitive process induces uniformity among rivals (and thus results in temporary competitive advantages) without paying explicit attention to firm idiosyncrasy in that process. This bias can also be found in most of the empirical work on

Schumpeterian competition published in management journals so far (of which the most important ones are comprised in Table 3.2). Apart from the observation that four out of six studies treat industry-specific technological developments as the paramount force of competition, it is remarkable to find that the competitive behavior of rival firms is considered to be rather homogenous.

Table 3.2: Main Empirical Works on Schumpeterian Competition

Empirical Study	Research Focus	Research Method
Abernathy & Clark (1985)	Typology of technological innovations in industry evolution	Historical analysis of the automobile industry
Tushman & Anderson (1986)	Impact of technological discontinuities on competence	Longitudinal analyses of 3 industries
Meyer *et al.* (1990)	Typology of firm responses to industry discontinuities	Historical analysis of the hospital industry
Garud & Kumaraswamy (1993)	Impact of technology networks on competitive dynamics	Case study of 1 firm in the computer industry
Stopford & Baden-Fuller (1994)	Common attributes of strategic innovation	Multiple-case study of 7 firms
Tripsas (1997)	Role of complementary assets in surviving creative destructions	Longitudinal analysis of the typesetter industry

Although these empirical research efforts do describe competitive behavior at individual firms, this is only done for those who initiated the creative destructions (that is, the strategic innovators that enforced the new rules of the game upon the industry). Moreover, such behavior is described in terms of its impact on the industry's evolution, instead of adopting a more process-oriented view of how these companies created the capabilities that eventually transformed their industry. Meyer, Brooks and Goes (1990) and Stopford and Baden-Fuller (1994) seem to be the exceptions to this last point, as they did generate insights on what firms actually do. However, both did not investigate this behavior in a competi-

tive context of innovation and imitation (like the other studies displayed in Table 3.2 did).

Whereas resource-based thinking lacks a view of firm uniformity in its analysis of competitive advantage, the Schumpeterian perspective does not seem to pay explicit attention to the role of firm idiosyncrasy in its inquiry of competitive dynamics. To exploit these mutual and complementary strengths and weaknesses, the next chapter integrates both views into a framework of coevolution of capabilities and competition, building upon the notion of search as posed by behavioral theory.

CHAPTER 4

Coevolution of Capabilities and Competition:
An Integrative and Multi-Level Framework

The previous two chapters on capabilities and competition showed that the behavior of firms is hard to grasp without due consideration of their competitive environment. At the same time, they pointed out that competitive processes at the industry level are difficult to judge without a proper appreciation of what its constituent rivals actually do. A coevolutionary perspective requires a synthesis of both morals, and is therefore framed around the idea that rival firms in a particular industry context tend to display two basic types of behavior. On the one hand, organizational processes make sure that distinct, firm-specific capabilities arise in individual companies. On the other, forces of competition ensure that, in the end, firms choose those strategies that make their capabilities compatible to the rules of the competitive game. Whereas organizational behavior at the firm level tends to increase rivals' idiosyncrasy, competitive behavior at the industry level tends to raise their uniformity. This chapter presents a framework of coevolution in which both points of view are integrated, in the process generating a number of tentative propositions. In this sense, coevolution refers to the reciprocity between capabilities and competition, which shapes the development of an industry and its constituent firms.

INTRODUCTION TO THE SEARCH CONCEPT

The 'behavioral theory of the firm,' which has originally been developed by Cyert and March (1963), pays attention to both organizational and competitive behavior, which makes it indispensable for a coevolutionary view of capabilities and competition. This theory assumes that firms have some degree of control over their market environment, and that they adapt

to their habitat through learning processes.[1] Learning takes place after feedback loops bring new market knowledge to the organization, which confronts the firm with particular problems. Firms respond to such problems through what is called 'search' behavior by which they pursue new or alternative ways of doing. According to Cyert and March (1963), firms display two basic types of search behavior: (1) they can search in the neighborhood of current practice, or (2) they can search for radically new alternatives. Cyert and March treated this distinction primarily in organizational terms, but stressed its applicability at the competitive level.

Nelson and Winter (1982) embraced this dichotomy by referring to it as local and distant search. Here, problem-solving behavior is directed at (1) the amplification and improvement of current practices, or (2) the creation of something entirely new. This dual nature of search closely resembles March's (1991) paradox of exploitation versus exploration. Whereas exploitation involves the "refinement and extension of existing competences, technologies, and paradigms," exploration refers to the "experimentation with new alternatives" (1991: 85). According to March, both phenomena are characteristic for how firms learn – in other words, for how their search behavior takes shape. By incorporating behavioral theory as the third major building block of an integrative approach to coevolution of capabilities and competition, this thesis assumes that competitors can be involved in exploitative and explorative search behavior at both the firm and the industry level.[2]

It appears that inclusion of the search concept into the management literature has been rather limited, and this would indeed account for its lack of an integrative or coevolutionary perspective.[3] Moreover, theory on search has so far been somewhat ambiguous as far as levels of analysis are concerned (with the exception of March (1991), who did discuss the implications of exploration versus exploitation at the organizational and competitive level). Early publications on search (Cyert and March, 1963; Nelson and Winter, 1982), for example, primarily discussed the search concept from a firm point of view, although they did mention its competi-

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[1] Cyert and March (1963) adopted a rather broad view of the firm's market environment, whereas this thesis obviously focuses on only a part of that context, that is, the competitive environment.

[2] From here on, neighborhood or local and distant or global search will only be referred to in relation to others' work; otherwise, exploitative and explorative search are used exclusively to avoid confusion.

[3] Important exceptions, as we will see, are Lant and Mezias (1990), Barnett *et al.* (1994), Barnett and Hansen (1996), and Stuart and Podolny (1996).

tive consequences. More recent work (e.g., Barnett and Hansen, 1996; Stuart and Podolny, 1996) studies search without explicitly considering its process and content at interrelated levels. In this chapter, it is attempted to fill that gap in the literature, and to theorize on search behavior of rival firms at the distinct but interrelated industry and firm levels of analysis.

COEVOLUTION FROM AN INDUSTRY-LEVEL PERSPECTIVE

Chapter 3 discussed that firms cannot be considered as simple stand-alone entities in a largely undefinable operating context. Instead, firms build capabilities in an industry environment where they compete with other rivals, each of which employs its bundle of capabilities in the competitive process. Some firms create competitive advantages by introducing new capabilities to the industry, but others will unavoidably manage to replicate these capabilities. As more rivals find ways to build the capabilities required for competing under the new rules of the competitive game, the pioneer's advantage eventually disappears. Moreover, rival companies become increasingly homogenous as to their strategy and capability bundles. Such interaction patterns of innovation and imitation form the endogenous driver of an industry's evolution (Schumpeter, 1934). It appears that, in a competitive context, many rivals are involved in search behavior to upgrade their capabilities.

This is in line with Cyert and March's (1963: 177) premise that behavioral theory can be "a basis for describing the behavior of certain aggregates of firms – specifically for an industry." In a behavioral view of the firm, rival firms are related to each other as each of them searches for new capabilities to compete in their industry. Indeed, in so-called "ecologies of competition, the competitive consequences of learning by one organization depend on learning by other organizations" (March, 1991: 81). In other words, actions taken by one company in search of capabilities have implications for the direction of search behavior at its rivals.[4] In their study of firms' local search for technological positions, Stuart and Podolny (1996: 36) remarked that "firms do not search in isolation; rather they search as members of a population of simultaneously searching organizations." Companies become rivals not simply because they happen to operate in the same habitat, but because they influence each others' search behavior.

[4] In this sense, there is a similarity with contemporary approaches to game theory which aim to model strategic interactions between competitors.

Competition as a process of capabilities-based innovation and imitation creates dynamic pressures for rivals to search for capabilities, either as leaders or as laggards. Such forces are not some abstract outcome of competition as a general phenomenon, but are a direct consequence of the explicit actions of the firms that make up an industry. Because "competition triggers self-reinforcing, reciprocal effects in an ecology of learning organizations," it is not something external to the firm, but can best be understood as integral to an organization's search behavior (Barnett and Hansen, 1996:141).[5] After all, in their search for capabilities, firms not only evolve in their role as competitors, but also activate new search behavior at the other players in a particular industry. The idea that it is the search behavior of players which underlies the competitive dynamics of an industry can be rephrased into the following

Proposition 1a: *Coevolution of capabilities and competition is shaped by search behavior of rival firms in a process of innovation and imitation at the industry level.*

The Foundation and Proliferation of Capabilities

That competition evolves around the dynamics of innovation and imitation is common knowledge these days.[6] Even before Schumpeter, Marshall (1890: 635) had already observed that "the services rendered to society by employers and other undertakers are of two classes, those who open out new and improved methods of business, and those who follow beaten tracks." Intuitively, one would think that innovation and imitation of capabilities at the industry level resemble practices of exploration and exploitation respectively: new capabilities are introduced by the innovator, while the imitators take care that these capabilities are further spread throughout the industry. Such reasoning would, however, ignore the notion that imitators "exercise entrepreneurship as much as the innovators

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[5] It is important to note that Barnett and Hansen (1996) aimed to integrate the concept of search with population ecology theory, and therefore embraced a Darwinian view of competition in which rivalry evolves as a continuous process. This thesis, in contrast, attempts to integrate the notion of search with evolutionary economics and therefore adopts the Schumpeterian idea of rivalry as a discontinuous process. This difference, however, does not negate the relevance of Barnett and Hansen's argument presented in the text.

[6] Obviously, there are differences of opinion regarding the speed with which innovations are being imitated. Whereas resource-based views and neo-classical economics take opposite stands in this respect, evolutionary views appear to be somewhere in the middle of this 'short-long' time dimension.

themselves" (Jacobson, 1992: 788). One should not forget that even from the imitator's point of view, the search for new capabilities embodies a highly innovative activity (Winter, 1984).

In other words, exploitation of an innovation at the industry level should not be mistaken for the diffusion process of that innovation. Like the pioneering company, imitators are involved in explorative search for new capabilities, and are less likely to be engaged in exploitative search (Nelson and Winter, 1982). Still, there is a notable difference between the search behavior of innovators and imitators: while the pioneer has to first define the right question before finding an answer, laggards only have to search for the right answer as the question is already known. The hard act of detecting a new question is characteristic for the Schumpeterian entrepreneur who searches for new ways of competing and makes rivals' positions obsolete. Recently, Baden-Fuller and Stopford (1994: 53) introduced the strategic innovation concept: "the creation of combinations of actions hitherto deemed impossible," enabling the pioneer to redefine the rules of the competitive game and force rivals to compete on a new basis.

Competitive behavior of firms in terms of strategic innovation thus produces a creative destruction in the industry. Crucial to such behavior are radical changes in the cognitive structures and mental models of the (managers of the) pioneering firm that, as Schoemaker (1990) argued, lie at the core of strategy. It is grounded in the search for alternative conceptions of rivalry and "the rejection of simplistic ideas that success is predetermined by mechanistic formulas" (Baden-Fuller and Stopford, 1994: 26). In the end, the pioneer introduces new capabilities to the industry, and forces its rivals to be engaged in explorative search to imitate its capability base and to conform themselves to the new competitive rules. The industry is marked by a period of turmoil in which both the innovator and its imitators engage in explorative search for new capabilities. Creative destruction is at the heart of the *foundation* of new capabilities at the industry level which, according to Schumpeter (1934), acts as a disequilibrating force.

Still, the growing prominence of imitation during an industry upheaval represents an equilibrating force that brings rival firms back to an equivalent level of capabilities, strategies and competition (Iwai, 1984). From the moment the industry's rivals have managed to adopt the new competitive rules, they concentrate their subsequent efforts on getting every ounce out of them. In other words, competition does not turn into a state of perfect equilibrium once the industry leader's competitive advan-

tage has been eroded through imitation. Instead, competitive behavior of rival firms centers around further modification of the latest competitive recipe, "yet relying on the fundamental designs pioneered by the innovator" (Teece, 1987: 190). Instead of exploring radically new alternatives, rivals are now involved in exploitative search behavior, which is directed at the stabilization of industry-wide conventional competitive practices over time (Cyert and March, 1963).

Here, the industry's rivals engage in the further *proliferation* of the capabilities initially founded during the preceding episode of creative destruction. Search behavior is directed at the improvement of current and accepted practice. Although competition is still characterized by the dynamics of innovation and imitation, capabilities tend to disperse more quickly among the population of rivals. The reason is that close resemblance in thoughts, capabilities and activities places competitors "in a much better position to imitate or learn and build from each others' work than firms with different strategies and capabilities" (Nelson, 1991: 70). This implies that even temporary competitive advantages are difficult to realize as relatively minor adaptations to capabilities are subject to rapid imitation forces.[7] In such an environment, "the production techniques of firms will tend to be bound together more closely [and] the competitive race would be 'closer'" (Nelson and Winter, 1982: 217).

The use of the search behavior concept in a coevolutionary view of capabilities and competition suggests that exploration and exploitation at the industry level do not equal the innovation-imitation dynamic. Instead, the competitive process of imitation and innovation functions as a context in which rivals display two basic types of search behavior. On the one hand, explorative search involves the pursuit of alternatives far removed from previous competitive formulas, and results in the foundation of novel capabilities at the industry level. On the other, exploitative search involves the hunt for expansion in the neighborhood of current competitive recipes, and causes further proliferation of these capabilities. Still, rivals interact competitively in both situations, be it that there may be differences in the 'closeness' of competition and the presence of competitive advantages. In sum,

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[7] One would therefore expect that in such a context small improvements in capability bundles are hard to assign to individual firms.

Proposition 1b: *Explorative and exploitative search behavior of rival firms results in the foundation and proliferation of capabilities at the industry level.*

Obviously, capabilities are difficult to relate to search behavior at the industry level as their origins unavoidably lie at the firm level. Indeed, most definitions of capabilities focus on their attributes that contribute to the firm's unique organizational behavior.[8] Furthermore, today's strategic management research stresses the value of knowledge as a deeply hidden but fundamental component of a firm's capabilities (e.g., Hedlund, 1994; Nonaka and Takeuchi, 1995; Grant, 1996). However, this focus on knowledge has led to a neglect of other organizational resources in strategy research (Conner and Prahalad, 1996). Physical assets, property rights, reputation and other forms of capital on which capabilities are built are often overlooked, "but there is no *a priori* reason why they should not be included in a more comprehensive evolutionary theory of the firm" (Foss *et al.*, 1995: 6).

The distinction between managerial, input-, transformation- and output-based capabilities offered by Lado *et al.* (1992) and further elaborated by Lado and Wilson (1994) does encompass various kinds of organizational capital next to knowledge (see Table 4.1). Moreover, this particular typology allows for the explicit incorporation of search behavior as fundamental to capabilities, and also recognizes the significance of mutual interaction patterns between capabilities and competition. The first category, managerial capabilities, points at search behavior in terms of abovementioned (changes in) cognitive structures and mental models which underly a strategic vision. Input-based capabilities concern search behavior regarding the acquisition and/or mobilization of specialized and unique assets. Transformation-based capabilities involve innovation, firm culture and organizational learning. Finally, output-based capabilities refer to (in) visible assets like physical outputs, brand name, reputation and relationship networks.

[8] Still, definitions vary from integrated clusters of idiosyncratic assets (Teece *et al.*, 1997), a firm's capacity to deploy resources via distinct organizational processes (Amit and Schoemaker, 1993) to bundles of firm-specific knowledge sets (Leonard-Barton, 1992).

Table 4.1: Categories of Capabilities

Managerial Capabilities	Input-Based Capabilities	Transform-Based Capabilities	Output-Based Capabilities
"The unique capabilities of the organization's strategic leaders to articulate a strategic vision [and] the unique ability to enact a beneficial firm-environment relationship" (p. 703)	"The physical resources, organizational capital resources, human resources, knowledge, skills, and capabilities that enable a firm's transformational processes to create and deliver products and services that are valued by customers" (p. 704)	"Organizational capabilities required to advantageously convert inputs into outputs [which] include innovation and entrepreneurship, organizational culture, and organizational learning" (p. 705)	Physical outputs and "all knowledge-based, invisible strategic assets, such as corporate reputation or image, product or service quality, and customer loyalty" (p. 708)

Source: adapted from Lado and Wilson (1994)

Over time, these types of capabilities are proliferated at the industry level, but it seems unlikely that each individual capability is exploited in its own right. As these various categories of capabilities are essentially components to be combined in a more holistic construct (Lado *et al.*, 1992), one would expect that proliferation increases the complexity and cohesiveness of collections of individual capabilities over time. In the end, such collections make up distinct activities, and this is why, according to Nelson and Winter (1982) exploitative behavior is reflected in the cultivation of activities. In accordance with Lado *et al.* (1992), proliferation of capabilities may thus be reflected in the exploitation of activities which link firms to their input markets, as well as to their output markets. Both are tied to one another in the firm's organization that represents the fundamental context in which capabilities are shaped and culminate into systems of activities (Hedlund, 1994; Volberda, 1998).

A Coevolutionary View of Competitive Regimes

The premise that capabilities are proliferated at the industry level once competitors are on an equal footing regarding their understanding of the competitive rules, seems to bear some profound implications for the industry's evolution. When the search behavior of rival firms in an industry

shifts towards exploitation of known capabilities, the danger exists that, in the hypothesized end, incremental adaptations to these capabilities will no longer emerge. Firms have a natural tendency to be engaged in exploitative search behavior as its returns "are positive, proximate, and predictable" (March, 1991: 85). In theory, the best strategy for any individual rival firm is therefore to "emphasize the exploitation of successful explorations of others" (Levinthal and March, 1993: 104). But this would eventually drive out any act of innovation, which would endanger the survival of the industry as a whole. Endless proliferation of capabilities via excessive exploitative search behavior drives the industry into a downward spiral.

Still, industries may survive and continue to evolve as a result of two possible occurrences. Although uniformity among rivals increases significantly as they display a growing amount of exploitative search behavior, there will always be a basic level of diversity among the industry's constituent firms (Nelson, 1991). There will therefore always be a chance that one of these rivals restores its hopes into explorative search and introduces a new strategic innovation to the industry. A second possibility is that the requisite variety comes from outside the industry. After all, the tendency of industry players to continue their focus on exploitative search makes them rigid and susceptible to new entrants whose critical attitude towards established practice may return the industry to a state of creative destruction (Levinthal and March, 1993). In both situations, competitive dynamics "comprise powerful countervailing forces to the tendency for experience to eliminate exploration" (March, 1991: 85).

Repeated over time, this dynamic between explorative and exploitative search behavior represents a principal and endogenous driving force of industry evolution in which capabilities are founded and proliferated again and again. This implies that the industry evolves through multiple competitive regimes, in each of which competition is based upon particular competitive recipes and capabilities. Competitive regimes are characterized by distinct product markets (Porter, 1980), technologies (Tushman and Anderson, 1986), and stress particular points in the organization's value chain (Porter, 1985). The creative destructions that start a new competitive regime make the industry go through a series of discontinuities. This idea opposes the traditional argument that such shocks are primarily the result of exogenous and abstract developments in new technology,

global communication or government policies, but conforms to findings reported in empirical studies on technological innovation.[9] As a result,

Proposition 1c: *At the industry level of analysis, coevolution of capabilities and competition embodies a sequence of competitive regimes.*

COEVOLUTION FROM A FIRM-LEVEL PERSPECTIVE

According to Cyert and March (1963), organizational learning is guided by so-called 'standard operating procedures.' These SOPs determine the degree and direction of the firm's search behavior as a response to encountered problems that arise from market feedback. Nelson and Winter (1982) translated the notion of SOPs into the concept of routines as organizational carriers of knowledge and expertise, and argued that such routines influence firms' search for new alternatives. Not only do routines shape the organizational processes underlying capabilities (Winter, 1995), but they are also key to the learning processes by which firms adapt to changes in their environment. This conforms to behavioral theory's idea that organizations have some degree of control over their habitat, and implies a voluntary perspective of firm behavior, as opposed to a deterministic one. The latter dichotomy was first introduced by Child (1972) in his discussion of environmental selection and manipulation.

Those on the voluntaristic side argue that managerial action, creativity and free will constitute a firm's strategic choice in adapting to or manipulating its environment (Bourgeois, 1984).[10] In contrast, deterministic views perceive the environment to be the ultimate source of change: organizations or entire populations of firms without a (static) fit between

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[9] In their longitudinal analysis of the American automobile industry, Abernathy and Clark (1985) documented how, over time, the industry evolved through distinct periods in which various US car manufacturers achieved success through technological innovation by redefining established industry practices. Based upon historical evidence from the computer, cement and airline industries, Tushman and Anderson (1986) elaborated on Abernathy and Clark's work by contrasting competence-destroying and competence-enhancing discontinuities.

[10] There is, however, some obscurity as to the application of strategic choice in management literature: while Hrebeniak and Joyce (1985: 337) referred to it as "proactive or reactive organizational behavior in anticipation of or reaction to exogenous variables," March (1981) discussed it in relation to the creation of endogenously changing environments by organizations themselves. Obviously, this thesis follows the latter view.

their internal and external contexts will inevitably be eliminated by environmental selection forces.[11] The strategic management field, with its rich body of research into organizational change, has come up with enough evidence that firms can and do adapt to environmental turbulence to improve performance. Gersick (1994: 11) indeed argued that the focus of management research should shift from whether or not firms adapt to "when and how organizations steer successfully through changing environments." Such a voluntaristic point of view implies that firms can either be pro-active or reactive in their search behavior.

In descending from the broader level of competition to the specific level of the firm, it seems that organizations search for capabilities in their efforts to instigate or, less ambitiously, accommodate to changes in their operating environment. Hedberg *et al.* (1976) in this respect discriminated between adaptive and manipulative actions: whereas adaptation embodies a firm's response to an environmental stimulus, an act of manipulation actually provokes such environmental reactions. Whereas "the adaptor defends, conforms or submits," the manipulator is "aggressive, proud, perhaps selfish" (1976: 46). Again, one can adopt a coevolutionary perspective as there seems to be a strong resemblance with the foregoing distinction between innovators and imitators. Whereas the manipulating firm impresses itself into its competitive environment, the adapting organization maps its competitive environment onto itself. Thus,

Proposition 2a: *Coevolution of capabilities and competition is shaped by search behavior of rival firms in a process of manipulation and adaptation at the firm level.*

The Creation and Refinement of Capabilities

As said, search behavior of firms is initiated by market feedback loops that internalize environmental knowledge into the organization (Cyert and March, 1963). According to Ghemawat and Ricart i Costa (1994: 59), firms can process information and know-how in two ways: "using it to search for improvements within a framework of fixed beliefs about how the environment behaves and responds to organizational actions vs. using it to reconsider the beliefs themselves." Intuitively, one would think that, at the firm level, manipulation of and adaptation to the competitive envi-

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[11] This is also the religion on which population ecology theory (discussed in Chapter 3) built its theoretical and empirical research base.

ronment resemble acts of exploration and exploitation respectively: while new practices are explored by manipulators, adaptors engage in exploitative search of existing practices. However, this would discount resource-based theory's idea that firms which adapt to changes in their habitat are involved in creative behavior as they dissociate themselves from path dependencies (Teece *et al.*, 1997).

Adaptation by individual firms is obstructed by the presence of idiosyncratic routines that have been built up over time. Chapter 2 already discussed how increasing commitment to existing routines reduces a firm's flexibility in changing environments and raises organizational inertia. Over time, such frictions permeate its managerial and technical systems that, together with skills and values, make up the firm's capabilities. When adaptation becomes a prerequisite for survival, firms often tend to stick to these routinized capabilities, turning them into core rigidities (Leonard-Barton, 1992). The longer the period during which an organization is soaked in plasticity forces, the more difficult it will be to adapt to changes in its competitive environment (Tushman and Romanelli, 1985). As a consequence, organizations are "typically much better at the task of self-maintenance [...] than they are at major change," even in the face of major environmental upheavals (Nelson and Winter, 1982: 9).

In other words, both manipulators and adaptors engage in explorative search at the firm level, as their organizational context facilitates or initially obstructs efforts to experiment with new alternatives. At the same time, the above argument points at an essential difference in the way manipulators and adaptors explore new capabilities. According to Schumpeter (1934), the manipulating act of creative destruction is more often than not injected into an industry by outsiders or newcomers. This is consistent with the accepted idea that new entrants are free from established routines developed for different times and places (Carroll *et al.*, 1996). In contrast, incumbent companies need time to adapt to a new competitive doctrine as path dependencies lead them into competence traps when the rules of competition change (Levinthal and March, 1993). Whereas manipulators search for new industry practices, adaptors search for ways to first escape the rigidity from current routines, and then to adopt the new practices.[12]

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[12] More recently, research by Stopford and Baden-Fuller (1994) has shown that incumbents can also manipulate their competitive environment through strategic innovation, be it that such rejuvenators were rare to find. They indeed noted that few incumbents "carry renewal forward to the point where they harness new-found capabilities to the extent of transforming their industries" (1994: 523).

Explorative search within a population of rivals is dedicated to the *creation* of new capabilities. At the industry level, rival companies will show an increasing degree of uniformity in (terms of the competitive outcomes of these) capabilities as more of them manage to adapt to the changed rules. But because individual firms have distinct histories that make them heterogeneous at a basic stratum, the way in which they create new capabilities (as well as their particulars) may differ considerably (Nelson, 1991). This variety in capabilities at the firm level increases once the various rival firms have managed to adapt, and start to *refine* the newly created capabilities. This two-phased process of capability building has been noted by Winter (1995: 151) in his distinction between a firm's ability "to amplify the contributions of present resources and expand existing lines of activity," and its more creative ability "to combine resources in novel ways and establish new activities."

Not only at the industry, but also at the firm do rivals prefer exploitative over explorative search (March, 1991). While exploitative search for capabilities is aimed at the generation of certain returns via the steady, incremental improvement of products and processes, earnings from the rapid and radical redefinition of beliefs and operating heuristics during exploration of new capabilities are much more equivocal. Explorative search behavior has little to do with regular patterns of activity, because there are no clear-cut prescriptions, elementary procedures or programs through which firms can systematize creative behavior (Schoemaker, 1990). On the other hand, the refinement of capabilities builds on established routines and cognitive structures, and enables the firm to standardize its operations to a certain degree.[13] The tendency of firms to engage in exploitative search after they have been involved in explorative search has also been noted in early studies on organizational adaptation.

For example, Tushman and Romanelli (1985) explained how organizations are often involved in periods of convergent change, in which existing structures, activities and capabilities are even further exploited. These stages of fine-tuning are punctuated by revolutionary organizational adaptation in which novel strategies, processes and capabilities are explored.[14] Such radical shifts represent "revolutionary changes *of* the

[13] It is not claimed that exploitative search is easy for firms to be engaged in, but rather that a certain degree of regularity characterizes an organization's exploitative search efforts. Problem solving is unlikely to be integrated into repeatable patterns that build a firm's creative capacity, and it is therefore highly unlikely that explorative search can be routinized.

system as opposed to incremental changes *in* the system" (1985: 185). Mintzberg and Waters (1982) found a similar pattern in their longitudinal study of Steinberg Inc. During its life, this firm went through occasional 'sprinting' phases in which adaptation was represented by opportunistic leaps into short-lived strategic windows. These entrepreneurial-driven stages were followed by periods of refinement, in which organizational stability was matched by rigid and planned firm policies. Considering the above, one could theorize that

Proposition 2b: *Explorative and exploitative search behavior of rival firms results in the creation and refinement of capabilities at the firm level.*

In their search for exploiting existing practices and exploring new alternatives, firms go through processes of organizational change (Cyert and March, 1963; Nelson and Winter, 1982). Most often, exploitative search is embodied in incremental change, by which the organization evolves through a multitude of small actions (Quinn, 1980). In this respect, exploitative search is a cumulative activity focused on areas of the firm's established capabilities (Stuart and Podolny, 1996), which accumulates organizational knowledge in ways that become routinized over time (Nelson and Winter, 1982). The creation of new capabilities, however, is more a matter of radical or strategic change, and consists of three core dimensions (Pettigrew, 1987): context, content and process. Table 4.2 shows the four drivers of strategic change that make up the change context: (1) the appointment of new top executives, (2) changes in formal ownership structure, (3) new perceptions of opportunities or threats in the industry, and (4) a decline in the company's performance (Grinyer and McKiernan, 1990).[15]

Table 4.2 also presents four firm attributes that make up the content of change (Pettigrew and Whipp, 1991): (1) its vision of where it aims to be in the (near) future, (2) its scope of activities in terms of both customers served and geographical markets covered, (3) its competitive position relative to its rivals, and (4) the core capabilities needed to attain that position. In essence, the combination of all four attributes makes up the

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[14] It has to be noted that Tushman and Romanelli (1985) claimed these upheavals to be triggered by sharp changes in technological, political or legal forces, exogenous in nature.

[15] Obviously, any combination of these four elements can trigger the start of a firm's change process.

firm's competitive strategy, which has been claimed elemental to the direction of change (Pettigrew and Whipp, 1991). Indeed, Hofer (1980) mentioned that strategic turnarounds involve a radical change in the firm's competitive strategy, and noted that firms can only make such turnarounds during the emergence of 'strategic windows' over the industry's evolution. As a result, "firms usually have fewer opportunities to improve their strategic positions than they do to improve their operating efficiencies" (Hofer, 1980: 30).

Table 4.2: Attributes of the Core Dimensions of Strategic Change

Context	Content	Process
New Executives	Strategic Vision	New Philosophy
New Ownership	Strategic Scope	Reorganization
New Threat/Opportunity	Market Positioning	Internal Ventures
Performance Decline	Required Capabilities	Novel Acquisitions
		New Alliances
		Status Reevaluation
		Learning New Skills
		Resolving Dilemmas

The table further displays a number of core features of the process of strategic change that contribute to the creation of new capabilities. Rebuilding the firm in such an explorative manner often involves an elaborate redefinition of its philosophy, the reorganization of the company's structure and processes, and a new perception of the value of particular groups, functions or activities within the company (Miller and Friesen, 1980; Tushman and Romanelli, 1985). Establishing new ventures, alliances and acquisitions can also play an important part in the exploration of new capabilities during the change process (Hamel, 1991; Barker and Duhaime, 1997). Learning new skills and resolving dilemmas represent two final components that support the search for new capabilities during radical change programs (Hampden-Turner, 1990; Baden-Fuller and Stopford, 1994). Combined, the above features may comprise explorative search behavior and result in the creation of capabilities at the firm level.

A Coevolutionary View of Organizational Change

The premise that capabilities are refined at the firm level once firms have managed to adapt to major changes in their competitive environment has implications for the way that organizations evolve over time. As firms display a natural tendency to prefer exploitative search behavior over exploration (March, 1991), the danger exists that they fall into so-called 'competence traps' (Levinthal and March, 1993). Increasing routinization of capabilities makes experimentation with alternatives progressively less attractive, simply because "knowledge about and use of old competencies inhibit efforts to change capabilities" (1993: 102). When the need to adapt to major changes in the competitive environment arises again, such organizational rigidity can preclude the firm's effective adaptation to the new circumstances. This means that, as the short run is increasingly privileged by exploitative search behavior, the long-term survival of firms may become endangered (Levinthal and March, 1993).

Still, the voluntaristic point of view incorporated in behavioral theory suggests that firms are able to turn their efforts towards explorative search behavior again. This is subscribed by Hedberg *et al.* (1976), who explained that, once the need to adapt has been recognized, a firm initially intensifies its efforts to 'do as before, but more.' This search response represents "a course of action that can be rationalized as an attempt to last out a period of adversity that is perceived or hoped to be temporary" (Nelson and Winter, 1982: 122). At a certain moment, investment postponement, cost cutting and asset reduction shape restructuring policies to regain financial stability.[16] Unlearning of established routines continues through changes in strategy, personnel and ideology. As the organization moves on, problem solving and exploration of new alternatives gradually build the routines and new capabilities required to pursue the firm's novel strategic course.[17]

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[16] Such 'operating' change is characterized by cutbacks in operating functions and the disposal of primarily fixed assets (Hambrick and Schecter, 1983). It often also involves the sudden removal of substantial numbers of employees and an improvement in operational efficiency (Robbins and Pearce, 1992).

[17] The trajectory of change proposed by Hedberg *et al.* (1976) still represents the dominant view on organizational change in contemporary management literature. For instance, in their crescendo model of rejuvenation, through which firms can break free from established mindframes and routines, Baden-Fuller and Stopford (1994) studied how, after necessary but temporary reductions in costs and activities, a new vision and business strategy channel the engineering and leveraging of novel capabilities. Ghoshal and Bartlett (1996) showed how, guided by the inspirational leadership of top executives, firms go

The above implies that firms evolve through multiple periods of organizational change, in each of which capabilities are created and refined. Routines seem to play a key role in the repetition of these capability development trajectories. This is because capabilities are built on hierarchies of routines in which inertia is hidden deep (Nelson and Winter, 1982).[18] Routines permeate the process of capability building, so that even during the creation of new capabilities inertia starts to penetrate firms' organizational structure and processes (Rumelt, 1995). Routines thus appear to be both a blessing and a curse: they are mandatory in processes of change to create new capabilities, but at the same time obstruct subsequent transformation processes as they increase inertia. Rival firms can therefore be expected to repeat the Hedberg *et al.* (1976) change trajectory over time during which the search for new capabilities at the firm level switches from creation to refinement and back. In other words,

Proposition 2c: *At the firm level of analysis, coevolution of capabilities and competition embodies a sequence of organizational changes.*

AN INTEGRATIVE FRAMEWORK OF COEVOLUTION

The separate treatment of explorative and exploitative search behavior at the firm and industry levels of analysis seems to remove some of the ambiguity with which recent literature applies the search concept to various levels of analysis. For instance, the above shows that search processes at the firm and industry level share similarities as to their direction and causality. As a rule, exploitative search follows explorative search (and vice versa), culminating into the creation/refinement and foundation/proliferation of capabilities at the firm and industry respectively. Whereas search occurs in a process of manipulation and adaptation from the point of view of the individual firm, search behavior among rival firms in an industry takes place in a process of innovation and imitation. Finally, the dynamic of explorative and exploitative search behavior drives the evolution of both the firm and the industry over time in a world where capabilities and competition coevolve.

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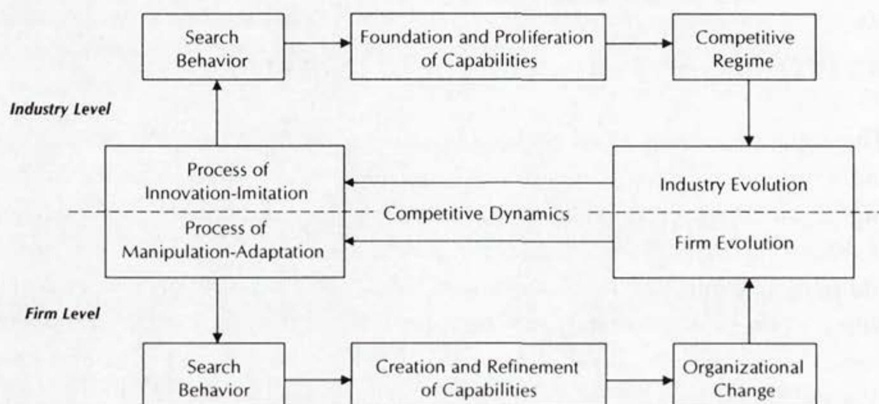
through a carefully phased transformation process in which short but disruptive periods of restructuring were followed by the creation of corporate-wide capabilities.

[18] The idea that organizational capabilities can be viewed as a hierarchy to facilitate integration of the firm's knowledge components has also been advanced by Grant (1996).

At the same time, the foregoing made it clear that it can be difficult to split up search behavior distinctively at firm and industry levels of analysis. For instance, the concept of strategic innovation was discussed from an industry-level perspective, but essentially describes individual behavior at the firm. In a similar vein, the advantage of newcomers over incumbents in terms of the absence of routines was treated from a firm-level perspective, but in truth explains collective behavior at the industry. Such complications probably account for the reported ambiguity that surrounds the concept of search, but at the same time points at its virtue in facilitating an integrated view of the reciprocal relationships between capabilities and competition. The search concept appears to be crucial in combining firm and industry perspectives of coevolution, as it not only highlights apparent similarities, but also exposes some noteworthy contrasts between the two.

Figure 4.1: An Integrative Framework of Coevolution



One of these differences concerns the difficulties encountered by rival firms in different dispositions. It has been argued that explorative search is far more laborious for the innovator than for its imitators, as the latter group of rivals searches for answers to a question already found by the pioneer. But at the same time it has been noted that explorative search is more difficult for adaptors than for manipulators as the latter are free from the rigidity arising from established routines. The irony of course is that, in a competitive environment, individual innovating and imitating firms take on the role of manipulator and adaptor respectively. Instead of

adopting a one-sided point of view towards search, an integrative perspective in which both firm and industry levels are taken into account could forestall such biases. One possible integrative framework of coevolution of capabilities and competition is presented in Figure 4.1, which centers around the unifying concept of search behavior.

The framework shows how coevolution of capabilities and competition results from a firm's interactions with its competitive environment, that is, with the other rivals in the industry. At a concrete level, the firm searches for capabilities to adapt to, or even manipulate, its competitive context. But as a collection of rival companies, firms are engaged in the search for capabilities at the more abstract level of competition where the dynamic of innovation and imitation rules. Obviously, the creation and refinement of capabilities by firms impacts the development of capabilities at the industry level in terms of foundation and proliferation (and vice versa), simply because they coexist in an ecology of competition. Over time, these reciprocal relationships shape both firm and industry evolution as competitive forces make the search for capabilities alternate between the rejuvenating properties of exploration and the self-destructive tendencies of exploitation.

In this regard, the integrative framework explicitly addresses the third research question raised in the Introduction on the search behavior of firms in a coevolutionary process. Moreover, it also presents a tentative answer to the second research question: How does coevolution of capabilities and competition unfold at the firm and industry levels of analysis? Derived from the constructed propositions, the framework displays how competitive regimes and organizational change processes shape the evolution of both industry and firm. In turn, these regimes and transformations are shaped by the (interactive) search behavior of rival firms. Again, this shows how the various research questions are related to one another as they move from a specific to a general level of understanding. This can also be observed in the fact that these 'lower-level' questions, visualized in Figure 4.1, culminate into the first research question on the synthesis of opposing views on firm differences and similarities.

Indeed, the framework of coevolution appears to deal effectively with the ostensibly contrasting points of view that, over time, rival firms move toward a higher degree of idiosyncrasy (as assumed by resource-based thinking) versus uniformity (as proposed by Schumpeterian competition theory). On the one hand, rival firms tend to become increasingly idiosyncratic as they refine earlier created capabilities at the firm level; the het-

erogeneity in routines among organizations makes them different in the specifics of their capabilities, and exploitation indeed reinforces such distinctiveness. On the other hand, rival firms that together make up a certain competitive population tend to become progressively uniform once they compete under the same rules; exploitation at the industry level indeed amplifies such homogeneity in strategy and capabilities. A coevolutionary approach as depicted in Figure 4.1 seems to support and converge both Schumpeterian and resource-based ideas on firm differences and similarities.

Finally, the integrative framework explicitly incorporates an endogenous and cyclical perspective on the development of firms and industries. The reciprocity between capabilities and competition as an outcome of rivals' search behavior appears as a repetitive and two-way switch from firm heterogeneity to homogeneity and back. Thus, rival firms can display increasing degrees of idiosyncrasy and uniformity at the same time in a coevolutionary world. Although firms in an industry search for similar capabilities in terms of competitive behavior, elemental differences in organizational behavior make sure that the way in which these capabilities are created and come about varies. In the following chapters, the foregoing propositions are tested in the empirical setting of the music industry. But before proceeding to a description and analysis of data from the record business, Chapter 5 first discusses the methodology applied in the collection, organization and interpretation of the empirical material.

CHAPTER 5

Research Methodology:
An Empirical Study into Coevolution

The previous chapters presented the research project's aim and questions, explored the value of theory on capabilities and competition, and generated some propositions and an integrative framework of coevolution. But before testing the latter in an empirical setting, academic rigor demands an explicit discussion of the methodology applied in such an investigation in order to legitimate the study's results. This chapter starts with a reflection on the overall research design of the thesis as already touched upon in the first chapter, and discusses the primary reasons for why this particular design has been adopted. The following section explores the empirical study's first component, a historical study, in terms of data collection, analysis and validity, and argues why such an inquiry was undertaken in the first place. These steps are repeated in a final section that discusses the empirical study's second component, represented by a multiple-case study. Both the historical and multiple-case study involved the empirical setting of the music industry and were longitudinal in character.

RESEARCH DESIGN

Intuitively, the idea that competition is in a state of continuous disequilibrium seems to be incorrect: if competition is involved in permanent change, one should treat such movement as a *process* instead of a state. Indeed, this is why this thesis often refers to the competitive process when dealing with the concept of competition. In line with the endogenous perspective advocated earlier, it is further assumed here that this process is shaped by the actions of its contestants as they search for capabilities. These players usually reveal themselves as organizations in the shape of a company or business firm. It is thus important to recognize that it is the

collective behavior of the organizational members that matters (Pettigrew, 1992). Because their actions, and therefore those of their companies, continue to evolve over time, the coevolution of capabilities and competition needs to be regarded as a cumulative sequence of events. In other words, a study of coevolution has to address the dimension of *time*.

Indeed, the notion of time is elemental to this study's research design, and thus impacts the choice of methods applied. To put it quite simply, a processual approach requires empirical research methods that incorporates the dimension of time, in contrast to more conventional exercises in comparative statics which are often involved in cross-sectional strategic management studies (Pettigrew, 1992). According to Montgomery (1995), a broad window of time is imperative to address the dynamics of competition. D'Aveni (1994: 17) stressed that "strategy requires a theory that pays attention to the sequential moves and countermoves of competitors over long periods of time." Also, Pettigrew (1990: 272) argued how conducting a longitudinal study "allows the present to be explored in relation to the past and the emerging future." Moreover, such studies enable the investigation of coevolutionary dynamics by management academics, the practice of which "is still at a very rudimentary stage" (Henderson and Mitchell, 1997: 6).

But before an account of the methods applied in the current research project is given, the exact meaning of the term process has to be specified to forestall potential confusion in the coming pages. According to Van de Ven (1992), three approaches to process are commonly used in the strategy literature: (1) a logic that explains a causal relationship between independent and dependent variables in a variance theory, (2) a category of concepts or fixed variables that are operationalized as constructs, and (3) "a sequence of events or activities that describes how things change over time" (Van de Ven, 1992: 170). In line with the above approach to coevolution, the current study adopts the third meaning of process, as it stresses historical development and focuses on incidents and stages (Van de Ven, 1992). Crucial in process research is to explain how and why processes change over time, questions that are elemental in studying the coevolutionary interactions between capabilities and competition.

Moreover, this third approach to the notion of process is the only one in which there is room for dealing with multiple levels of analysis (Pettigrew, 1992). As noted, resource-based views have been subject to the criticism that research has mainly been an issue of how firms develop capabilities without much attention to the competitive process. For instance,

Henderson and Cockburn (1994: 63) remarked that "studies of the evolution of capability at individual firms have greatly enriched our understanding of the nature of particular competencies [...] but by and large these insights have not been incorporated into studies of aggregate firm behavior or systematic studies of competition." Such a unilateral approach thus tends to discount the impact of rivalry upon firms' development of capabilities, which subordinates competition to a property of markets (Barnett and Hansen, 1996). In this sense, Levinthal (1995) stressed that research into capabilities must link firm and industry levels of analysis.

This study not only assumes that rivals compete on capabilities at the industry level, but also acknowledges that organizations have to breed these capabilities at the level of the firm. The integrative framework on coevolution developed in the previous chapter illustrates how the concept of search links both levels of analysis. Firms have to search for new capabilities to perform well in their competitive environment, while competitive pressures, in turn, confront companies with the need to search for a novel capability base. The process is one of continuous movement, which was reflected in the propositions generated in Chapter 4 that all evolve around the idea that search processes shape the development and evolution of both firms and their industry over time. To test these propositions, a 'dual methodology' has been employed in the empirical part of this research project to investigate processes of search and coevolution at these different levels of analysis.

First, processes of search and coevolution at the industry level were primarily investigated through a historical study of the music industry. In line with most of the empirical work listed in Table 3.2, this study into its competitive dynamics (as forces driving the industry's evolution over long periods of time) is longitudinal in character. It covers the period between 1877 and 1990, and this makes it possible to detect shifts in competition over time. In contrast, processes of search and coevolution at the firm level were mainly examined via a multiple-case study of individual record companies. In line with most of the empirical work displayed in Table 2.2, this study into firms' organizational change processes covers several firms and the more limited time frame of the period 1990-1997. The fact that the scope of the empirical data displayed and explored in this thesis has been confined to the music industry means that a trade-off has been made between the breadth and depth of data collection and analysis.

HISTORICAL STUDY

In defense of longitudinal research methods, Porter (1991) noted how studies into the dynamics of strategy should nudge into the world of the historian. Building upon this idea, Van den Bosch (1993) proposed a Chandlerian approach to theory development, claiming that history matters to strategy. In a new introduction to his 1962 publication on strategy and structure of the industrial enterprise, Chandler himself mentioned how he, as a young historian, was struck by the enormous attention his book received from managers. Although he composed the historical development of four individual firms, Chandler performed an additional activity traditionally not undertaken by scholars in history. His descriptions were followed by a comparative analysis from which he derived his findings on organizational innovation. Chandler thus practiced comparative history as he managed to bridge the historian's role as storyteller with the social scientist's responsibility of interpretation.

Application and Setting

While historians tend to be primarily concerned with the particular and the unique in their descriptions, social scientists are often especially interested in the general and the repetitive in their explanations. In response, Berkhofer (1969) suggested a behavioral approach to historical analysis in which there is room for both narration and meaning. After all, "the type of description of a phenomenon determines the type of explanation needed for understanding that phenomenon" (Berkhofer, 1969: 282). Indeed, Megill (1989: 634) discussed how the prejudice for universality, or "the general elevation of explanation over description," has been challenged in more recent years. Although the imbalance still exists in the fields of economics and sociology, it is accepted today that description is no longer the simple act of data collection. While description was traditionally regarded as a neutral exercise preceding the 'grand' work of explanation, it is now perceived as an activity that displays actual processes.

So instead of treating change as a number of successive events on a linear time scale, change is being understood as a process dependent on particular dynamics. This alternative approach to the notions of time and change enables a convergence between description and explanation (Berkhofer, 1969). The history of the music industry that is presented in Chapter 6 adopts such an approach: it not only describes the industry's evolution in terms of facts and figures, but also analyzes the particular

processes that drove its development. In this sense, historical description and contemporary analysis of what happened are performed simultaneously. The scope of the historical study has been limited to the American segment of the music industry for two reasons. First of all, the US record industry is unique regarding the availability of data for the extensive time period under consideration. Secondly, the events that shaped the industry's evolution primarily concerned American record companies (at least until the eighties), while US-based music has for a long time dominated international markets.[1]

Data Collection

According to Tuchman (1994: 311), "attributing *meaning* to patterns is quite another matter" than the detection of these patterns, and involves the disclosure of processes. In addition, he emphasized the usage of qualitative over quantitative data in historical studies because the first is more meaningful. Although it is more difficult to discover patterns in qualitative than in quantitative data, the first type is richer and provides far better opportunities to apply meaning to the information once the patterns have been detected. Indeed, the historical study of the music industry builds to a large degree on data of a qualitative nature that has been disclosed in a variety of articles and books on the record business outside the boundaries of strategic management research. Still, quantitative data has been employed in this part of the empirical study to illustrate and support the description of certain developments, be it that the existence of structured quantitative information was found to be rather limited.

The many secondary sources from which the qualitative data was retrieved can be roughly divided in three streams of cultural studies into the music business. First, research publications on the economics of the music industry offered insights into topics of industry organization, musical innovation and structural changes. The second domain involved writings on record companies in general and on individual firms, and provided intelligence on the activities and organization of record companies as well as the technologies they applied. Finally, studies in communication supplied information on the relationship between the record business and the media industries. Quantitative data was collected from three respected industry associations: the Recording Industry Association of America (RIAA), the

[1] Still, any developments of a more international nature that somehow impacted the US record industry's progress have been taken into consideration, and were incorporated in the historical study to prevent inappropriate exclusion of relevant data.

National Music Publishers' Association (NMPA) and the International Federation of the Phonographic Industry (or IFPI). In effect, the historical study does not present any new or previously unpublished data, be it that its longitudinal compilation has not been performed earlier in such detail.

Data Analysis

To provide an input for analysis, the accumulated data was structured along four basic dimensions. First of all, the historical study's emphasis on the dynamics of time called for a chronological organization of the data set. Furthermore, the assembled evidence was structured according to the treatment of various prominent record companies that continued to come up across sources at different points in time. In addition, the data set was framed on a competitive dimension, which essentially involved the identification of changes in the industry's oligopolistic setting – and this included major transitions in the industry's value system from company to consumer – over time across different sources. Finally, the collected data was organized to particular developments in music markets or, in other words, changes in consumer demands for music. Together, these dimensions allowed for a structured and longitudinal description and analysis of the music industry's historical development.

In line with Pettigrew (1997), analysis of the organized data set was performed along two related activities: (1) a search for patterns in processes out of a sequence of events, and (2) a search for the underlying mechanisms that shaped these patterns. To test the propositions on coevolution at the industry level as advanced in Chapter 4, the first of these activities involved the detection of various competitive regimes in terms of distinct product markets, organizational value points and technologies. In a similar vein, the second activity concerned the identification of record companies' capabilities around which competition evolved during a particular competitive regime. These were classified according to one of four capability categories: managerial, input-based, transformation-based and output-based capabilities. Chapter 6, in which a process-based description is linked to an explanation for why these processes happened as they did, reflects this combined search for patterns and mechanisms.

Data Validity

As said, the secondary sources used in the historical study can be roughly divided into three streams of cultural studies. Although these sources fo-

cused on radically different research questions, the data presented was considered to be useful in the current study on coevolution of capabilities and competition. For example, a large body of research that focused on the economics of the music industry study the relationship between concentration and innovation (e.g., Peterson and Berger, 1975; Lopes, 1992; Burnett, 1992; Christianen, 1995) has measured the performance of record companies in terms of their (album or single release) appearance in the Top 100 charts. But in doing this, this type of research essentially looked at end products – in other words, the outcomes of firms' competitiveness – whereas this thesis aims to study the capabilities of record companies as *determinants of their competitiveness*. Still, this does not obstruct us to incorporate the rich data on which these sources based their findings regarding market concentration ratios.

Similar arguments can be made for research into record company activities and into the relationship between these firms and the media industries. Whereas studies on record company operations (e.g., Peterson and Berger, 1971; Hirsch, 1972; Denisoff, 1986; Negus, 1992) investigated the relationship between organization and innovation in music, this thesis aims to gain insights on the development of capabilities that lay hidden in the organization, and focuses on *innovation in capabilities*. In a similar vein, communication and media studies into the music industry (e.g., Gronow, 1983; Laing, 1992; Malm and Wallis, 1992; Burnett, 1996) focused on the cultural role of music to specific countries or regions of the world in its institutional setting. However, the current study sees music as an outcome of record companies' commercial performance in a business or *competitive setting* in their attempt to bridge the creative community and the consumer market.

While all three research streams obviously concentrated on different research issues, the accumulated data and corresponding findings were of value to an empirical investigation into coevolution. So although the historical study displayed in Chapter 6 does not present any radically new data, it does provide a radically new interpretation of the existing data set. An additional advantage of the observed diversity in secondary sources enabled a check for data consistency both within and across these streams of cultural studies. In addition to such 'within-method' triangulation (Denzin, 1978), the historical study's reliability was enhanced by means of 'between-method' triangulation (Jick, 1979). This was achieved via a confrontation of the longitudinal body of qualitative data with the more robust and quantitative data that had been collected at the various industry

associations, and covered parts or most of the 120-year period under consideration.

MULTIPLE-CASE STUDY

This thesis incorporates a historical study of coevolution at the (music) industry level because (1) the impact of innovation in capabilities and (thus) in competition can only be understood *ex post* (Schumpeter, 1947), (2) this type of research appears especially useful in the development of coevolutionary theory which is still in its infancy (Zald, 1996), and (3) it allows for a non-deterministic approach to the interpretation of past events (Kieser, 1994), which conforms to an endogenous perspective of coevolution. Building upon the research questions stated in Chapter 1, the above is in line with Yin (1984), who reasoned that the historical study is a suitable research method when the original research question has been stated in the 'how' form, when there is no control over behavioral events, and when there is a focus on past events. When the same rules apply but the focus is instead on contemporary events, Yin (1984) proposed the case study as the appropriate research strategy. The second part of the empirical research, which studies coevolution at the firm level within the music industry, thus consists of a multiple-case study.

Application and Setting

Whereas the historical study deals with coevolution over various periods of competition, the multiple-case study is directed at these reciprocities between capabilities and competition during a particular competitive regime, that is, one period dominated by particular rules of the game. In line with Eisenhardt (1989), the multiple-case study method was applied for two reasons. First, organizational transformation as a mechanism of search at the firm level is by definition a process that takes time to unfold, and this perfectly suits the case study's distinctive property to master such dynamics. Second, observing several settings facilitates the integration of findings from individual cases via comparative analysis, and allows for the discovery of "different causal or development paths to the same basic phenomenon" (McPhee, 1990: 394). Whereas the focal issue of inquiry at the various case companies was their search for new capabilities, differences in the way these companies searched were of special interest to the researcher.

In contrast to the historical study, which focuses on the American industry, the multiple-case study involves companies operating in the British music industry.[2] Over the years, the significance of this part of the music industry has increased, both within the UK and to music markets in the rest of the world. A report by the National Music Council showed that the music industry contributed £2.5 billion to the British economy in 1995, surpassing other businesses like water supply, shipbuilding and chemicals. During the 1997 elections, Tony Blair mentioned how "the music industry doesn't get the recognition it deserves," and created a special taskforce for the country's creative industries only six months later.[3] With a present sales value of over £1 billion, the UK is the world's fourth largest market, but the BPI claims that the UK music industry is far more important as an international repertoire provider. And this makes it one of the country's most successful exporting industries.[4]

Data Collection

It was acknowledged that different types of record companies operated in the industry, and that different firms could thus experience different types of change processes. The case companies were therefore selected through theoretical sampling, in which cases were chosen for theoretical categories instead of statistical reasons (Eisenhardt, 1989). In order to generate findings which would be generalizable across the music industry, seven record companies were investigated, divided over one of four categories: (1) independent labels acquired by majors, (2) UK operating companies of multinational majors, (3) independent companies, and (4) new entrants. Table 5.1 displays these case companies, and provides basic features such as ownership, age, number of employees and UK market shares. With

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[2] At the point where the historical study ran over into the multiple-case study, preliminary interviews were held with top managers at the Dutch operating companies of BMG and PolyGram, as well as with the directors of MTV Benelux and local music TV channel The Music Factory (who could provide a more remote view of the music industry in the Netherlands). A collective finding that emerged from these interviews was that innovations and organizational change processes most often happen in the US and UK industries. Due to its geographical proximity, the latter was chosen as setting for the cases.

[3] Talbot, M., "Blair and Major Vie for Music's Support," *Music Week*, 8 February 1997, p. 1. The taskforce concerned the music, film and fashion industries, and both V2 owner Richard Branson and Creation founder Alan McGee were appointed to this team (Talbot, M., "McGee and Branson: We'll Fight for Music," *Music Week*, 26 July 1997, p. 1).

[4] Source: *BPI Statistical Handbook 1998*. This publication also reports on a 1998 survey conducted by Gallup that indicated that "more than 50% of [other] UK exporters thought the success of British music internationally was helping them to sell their products."

hindsight, choosing these research sites was a process of 'planned opportunism' (Pettigrew, 1990), based on three criteria: (1) firm access and category, (2) its reputation within the industry, and (3) general knowledge whether the particular company had indeed been involved in a process of transformation.[5]

Table 5.1: Case Study Record Companies

	Case Category	Formal Owner	Incorporation	Employees	UK Market Share
Island Records	Acquired independent	PolyGram	1962	62	2.0 (1.4-2.6)
Virgin Records	Acquired independent	EMI	1973	161	8.5 (6.4-10.7)
BMG International UK	Major operating company	Bertelsmann	1980	303	6.4 (4.7-8.3)
Warner Music UK	Major operating company	Time-Warner	1970	330	10.4 (7.2-12.6)
Roadrunner Records	Independent	Private	1987	7 (120)	0.1 (0.1-0.2)
Independiente	Independent	Private	1983/1996	17 (19)	0.9 (0.2-1.5)
V2 Music Group	New entrant	Virgin Group	1996	85 (251)	n/a

Notes:
(1) Incorporation refers to date of establishment in the UK.
(2) UK Market Share refers to the annual averages for the period 1990-1997; figures between brackets are highest and lowest values during this period.
(3) The figures between brackets in the Employees column are worldwide ones.
(4) In May 1998, Philips sold PolyGram for an amount of $10.4 billion to Seagram that aimed to integrate the company with Universal.
(5) Independiente was formerly known as Go! Discs (which explains for the two dates of incorporation); UK market shares therefore concern the Go! Discs label in the period 1990-1996.

[5] This preliminary knowledge was retrieved from the yearly "MBI United Kingdom Report" published in the 1994, 1995, and 1996 December issues of *Music Business International*.

Table 5.2: Case Study Interviews

	Interviewee	No.	Date	Duration	Period	Taped
Island Records	Managing Director	2	24-09-97 27-01-98	2 x 90 minutes	1990-1997	yes
Virgin Records	Co-Managing Director	1	17-09-97	60 minutes	1992-1997	yes
BMG International UK	Director Business Affairs	2	16-10-97 19-11-97	2 x 45 minutes	1990-1997	yes/no
Warner Music UK	General Manager	1	17-11-97	90 minutes	1990-1997	yes
Roadrunner Records	Managing Director *and* Director Business Affairs	2	05-11-97 *and* 03-09-98	45 *and* 90 minutes	1996-1997 *and* 1993-1997	no *and* yes
Independiente	Managing Director	2	21-11-97 28-01-98	45 + 90 minutes	1992-1997	no/yes
V2 Music Group	Chief Executive Officer	1	30-01-98	90 minutes	1996-1997	yes

In each company, a top manager was contacted and asked to participate in the research project. With the insurance of first perusal into the eventual case descriptions, these persons agreed to cooperate via one or two interviews. These key informants had personally supervised or witnessed the changes under consideration, and had been part of the company during the total period covered by the case study. This means that the time-consuming exercise of mining multiple informants throughout the company was traded off for the top manager's position as the most knowledgeable about the (impact of) changes within the firm (Glick *et al.*, 1990). Although this was desirable in terms of the time-intensive nature of the adopted dual methodology in this thesis, and suited the phenomenon that personnel turnover is rather high in the record industry, a single source of information was obviously a disadvantage. To partly offset this

bias in data collection, further public information on the case companies was accumulated, primarily through the inspection of all issues of two respected industry trade journals, *Music Week* and *Music Business International*, for the period 1990-1997. In addition, all six editions of *The UK Record Industry Annual Survey* (from 1993 to 1998), edited by Cliff Dane at Media Research Publishing, were consulted to retrieve financial and accounting data on individual record companies.

The interviews were semi-structured in the sense that general questions, which had been framed around the preliminary data, provided a context and guiding line for the actual conversation (see Appendix A). This allowed for details to surface as the interview unfolded, while at the same time a number of broad topics were discussed, such as changes in (1) strategy and business philosophy, (2) organizational processes, (3) perspectives on competition and cooperation, and (4) firm performance. Table 5.2 displays who was interviewed when at each company, the period of discussion under consideration, for how long the conversation lasted, and whether the interviews were tape-recorded or not. Afterwards, recorded interviews were written out in full detail; otherwise, extensive notes were transcribed immediately after the conversation had taken place. If deemed necessary by the researcher and/or the executive, a follow-up interview was arranged for in-depth discussions of one or more of the topics under consideration.

Data Analysis

For each case company, a 'data collection file' was created in which all longitudinal data was chronologically ordered. These company files came to be the groundwork for (1) in-depth case descriptions of organizational change at each of the companies, and (2) tables that outlined the major events during the period of transformation. Both the case descriptions and the event tables were reviewed, corrected and commented upon by the interviewees, and provided a basic input for further analysis. In each case, the three core dimensions of organizational change as defined by Pettigrew (1987) were explored to test the advanced propositions on coevolution at the firm level. First of all, the *context* of change was analyzed along four possible drivers of transformation. In addition, the *content* of change at each case company was explored in terms of its vision, scope, positioning and capabilities – in other words, its competitive strategy.

In line with Huberman and Miles (1994), cross-case analysis on the content of change was performed by means of a matrix that visualizes the

changes in competitive behavior of the case companies during the period 1990-1997. Whereas the context and content of change concern questions as 'Why did the change take place anyway?' and 'What was the exact nature of the change?,' the change *process* answers the question 'How did the change itself take place?' This third dimension was measured in terms of the attributes listed in Chapter 4 as deduced from the most prominent management literature on strategic change. This exploration into the change process was performed for each case company, which in the end facilitated cross-case analysis on the role of change in record companies' search for capabilities. Again, description and analysis are combined in Chapter 7, where the individual case companies are embedded in an account of the major developments in the music industry during the nineties.

Data Validity

It has to be noted that qualitative data collection and analysis is much more exposed to negative side effects of subjective interpretation if compared to quantitative methods (see also Exhibit 5.1). This is true for the historical study, where the past has been interpreted from today's perspective (Megill, 1989), and for the multiple-case study where the ultimate quality of research findings from qualitative approaches varies with a researcher's social and conceptual skills (Numagami, 1998). In contrast to the historical study, however, the multiple-case study does present significant new data on the music industry, and this makes the issue of validity particularly important. Traditional positivist approaches to research (that often refer to studies of a quantitative nature) in this regard emphasize the concepts of internal, external and construct validity. However, Denzin and Lincoln (1994) suggested that, in qualitative studies, these concepts should be replaced by notions of credibility, transferability and comfirmability.

Whatever label one uses, the general issue of validity remains in the sense that the quality of the research method under consideration must be open to judgement. As a start, the multiple-case study's internal validity concerns verification of the causality between key constructs (Leonard-Barton, 1990), and appears to be significant: all the individual case studies displayed how their search for capabilities embodied a process of organizational change which, in the end, determined their market performance. This pattern was verified across the different company categories that had been defined in advance of data collection and analysis through theoretical sampling. Furthermore, the in-depth case descriptions facilitated the

construction of an explanation that was consistent across all seven cases. This explanation was based on 'pure' descriptive material as presented in the so-called 'Case Boxes' in Chapter 7, and was not subject to any preliminary analysis.

The multiple-case study's external validity concerns the generalizability of its findings (Yin, 1984), and seems to be high for the music industry: seven companies, which together held an average share of 30% of the UK music market over the period 1990-1997, were studied in up to four different types of companies. In addition, more general data on other record companies (which is also discussed in Chapter 7) identified some major similarities to the change processes observed in the case studies, increasing the reliability of the findings. The multiple-case study's construct validity deals with the question whether the gathered evidence truly supports its findings (Eisenhardt, 1989), and appears to be at an acceptable level: both data sources (private and public) and data collection techniques (executive interviews and article tracking) were subjugated to triangulation, whereas the case descriptions and event tables were reviewed by the interviewees (i.e., the key informants) themselves.

Exhibit 5.1: Research Limitations

The dual methodology of historical and multiple-case study applied in this thesis is in line with previous empirical studies into competition and capabilities respectively (see Tables 2.2 and 3.2). At the same time, investigating an empirical setting by employing these methodologies might reveal more regarding the proposed issues of exploration than concerning those of exploitation. With respect to the historical study, it seems to be unavoidable that, over significant periods of time like the one observed here, not all relevant information may have been preserved. Moreover, it is highly likely that more striking or outstanding events, instead of the more ordinary or conventional ones, have been registered for later use. In other words, much more data may have been stored on events of an explorative nature than those with an exploitative character.

In a similar vein, the multiple-case study may be subject to such an imbalance, be it that in this case the time period under consideration is too short. By investigating organizational change, one essentially studies a particular movement from an old to a new situation in which previously unknown or unusual processes are bound to replace the routine or customary ones. Thus, data sources may very well have been focused more on explorative than on exploitative events. It is therefore expected that the findings that rise from the dual methodology may be biased towards issues of exploration. Still, the next two chapters contain ample information to come up with new findings on exploitative search at both the industry and firm levels of analysis. It is here where the coevolution of capabilities and competition within the music industry is narrated.

CHAPTER 6

Coevolution at the Industry Level:
A Historical Study of the Music Industry

Thomas Edison, the legendary American inventor, once wrote in *The New York Times* that he was proud of the fact that he had never invented any weapons to kill. Still, most of his creations came to be 'competitive weapons' which were at the roots of Edison's business success. Not only did he achieve fame by means of his extraordinary ability to develop technological devices, but Edison also gained large fortunes through the commercialization of these inventions. Many of his path-breaking discoveries, like the incandescent lamp and the motion-picture projector, established and dominated new industries in which his company came to be the crown competitor. But there was one industry where Edison did not triumph, and even failed to compete successfully on a long-term basis with other rivals: the record industry. While Edison had pioneered the phonograph, his initial technological lead was not enough to forestall others with even better capabilities that came to shape competition in those early days.

Starting near the end of the nineteenth century, this empirical chapter presents a longitudinal study into more than a hundred years of coevolution of capabilities and competition in the music industry. In line with the methodological objectives of the previous chapter, the aim is to narrate the record industry's long-term development so that description and analysis are combined. As the first part of this book's empirical investigation, the current chapter describes and analyzes coevolution primarily from an industry level perspective. As a consequence, the historical study of the music industry focuses more on similarities between firms than on the differences between them (which is the focus of inquiry in the next chapter). As said, the availability of reliable data has been the principal reason to confine the investigation to the American music industry. Still, international developments that somehow influenced the US record industry's pace of progress have been included.

THE CREATION OF STANDARDS

It is perhaps hard to imagine that today's music industry with its global presence and worldwide sales of more than 40 billion US dollars has its foundations in the vision and determination of two individuals. The first was Thomas Edison who invented the phonograph in 1877. This device was essentially a box-shaped cabinet that produced sound emerging from a large acoustic horn. By means of a swing, a tin-foiled cylinder on which the respective sound was prerecorded could rotate for a short period of time. Simultaneously, a stylus moved up and down along prefabricated grooves pressed in the cylinder, making the creation of mechanically reproduced sound a reality (Gwinn *et al.*, 1987). Edison was convinced that the most important applications of his new phonograph lay in the reproduction of speech for purposes of dictation and education (Schicke, 1974), as was reflected in the name of his enterprise: the Edison Speaking Company.

Competition for Technology

However, Edison's focus on reproducing the human voice resulted in a short supply of recordings and a lack of an acceptable degree of fidelity, and this limited consumers' adoption of the phonograph. These shortcomings, together with the fact that Edison saw little or no commercial value in the phonograph, made him decide that he could better devote his time and energy to the development of the electric light bulb. But he was forced to go back in business after the year 1886, when Bell Laboratories came up with the graphophone (Jones, 1992). Bell's graphophone was an enhanced version of Edison's phonograph: the cylinders were made of wax, and the machine embodied a new system of sound amplification as well as a variable speed rotation mechanism. Edison reacted quickly and adopted Bell's wax cylinder, realizing that this material was better suited to protect the cylinder's surface from the incisions made by the stylus.

After 1888, companies such as the North American Phonograph Company and the Dictaphone Corporation acquired licenses to both the phonograph and graphophone, and attempted to market them as dictating machines. But the public showed virtually no interest at all and these ventures turned out to be absolute disasters. However, there appeared to be one particular company that learned from initial market responses in those years. The Columbia Phonograph Corporation noticed how its machine's sound-producing characteristics attracted a fair amount of public

at penny arcades, fairs and amusement centers (Frith, 1992). To Columbia, this indicated that the real commercial value of the phonograph was to be found in the entertainment sector, instead of in the office equipment business. This discovery, and the fact that Columbia's suppliers of prerecorded cylinders responded only slowly to an increase in demand at the time, stimulated the corporation to manufacture its own cylinders with recorded music as a form of public entertainment.

The capacity to envisage prospective market demands was even more present at the early industry's second core character, Emile Berliner. Unlike Edison, Berliner mastered both technical and market skills, which was fundamental to the success with which he commercialized his latest invention, patented in 1887. In contrast to the rivaling phonograph, Berliner's gramophone reproduced sound through a horizontal movement of the stylus over a flat disc that rotated on a turntable. More significantly, Berliner recognized that the gramophone's commercial value was hidden in its ability to bring entertainment – especially music – right into people's homes (Schicke, 1974; Frith, 1992). Whether or not he had learned from Edison's shortcomings is not clear, but Berliner did realize that a minimum supply of high-quality sound recordings was a prerequisite to make his product attractive to the consumer market.

Berliner thus developed a system for the efficient manufacturing of recordings by using a zinc plate as master record, from which large amounts of ebonite records could be duplicated. At the same time, the lateral rotation movement incorporated in this procedure increased fidelity. Edison had used a fairly simple duplicating process through which a maximum of only 200 prerecorded cylinders could be manufactured. In his view, it was not a necessity to produce high quantities of prerecorded material, as his cabinet enabled its user to make his or her own home recordings. But the public was not interested in making its own sound productions on fairly expensive unwritten cylinders. Instead, they were more eager to listen to someone else's voice and music for entertainment. By separating the recording process from the reproduction stage, Berliner was able to make much more duplicates at far less costs and of much higher quality. In addition, distribution of prerecorded music became far less complicated as discs were easier to handle than cylinders (Jones, 1992).

Berliner's gramophone was introduced on the market for home entertainment in 1895 by the United States Gramophone Company, and this new competition forced Edison to respond fast. He improved his product

by developing a spring-motor driven phonograph and at the same time established the National Phonograph Company in 1896 (Jones, 1992). Together with Columbia, this corporation was responsible for the introduction of the phonograph on the home entertainment market. Over the next five years, rivalry between disc and cylinder manufacturers was governed by fights over patent rights and minor technological innovations (Negus, 1992). During this period, Edison, in an attempt to keep up with Berliner, developed a molding process that enabled him to mass produce his prerecorded wax cylinders. Berliner, meanwhile, ran into a machine shop operator named Eldridge Johnson, and the combined strength of Berliner's technical and marketing expertise and Johnson's talents in organization and finance resulted in the launch of the Victor Talking Machine Company in 1901.

What followed was an increase in competition as other recording firms noticed the lucrative nature of the market for home entertainment and followed Victor into this business. Johnson, who had managed to create a structured organization out of Berliner's chaotic laboratory, licensed Victor's technology to other rival firms such as Columbia. Together with a growing consumer preference for the disc system, this proved to be crucial to Victor's triumph in the 'standardization battle' between disc and cylinder, which was evident to the industry around 1907 (Schicke, 1974). Guided by improvements in the duplication process of prerecorded material – which paved the way for mass production and distribution of recordings – the stage was set for the rise and formation of the recording industry. While the initial technological developments were primarily an American matter, the industry already took on an international character during the first decade of the twentieth century.

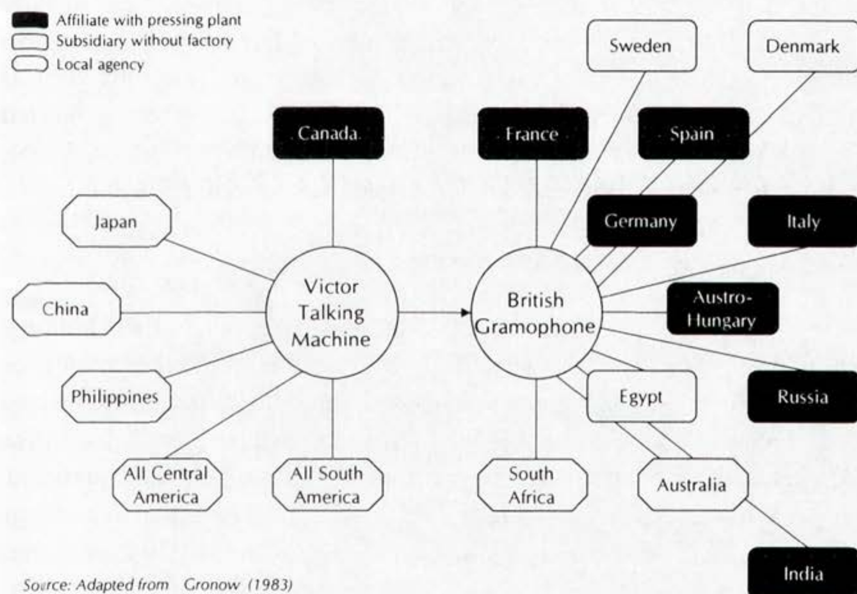
International Developments

In Europe, British Gramophone Company and Deutsche Grammophon were founded in 1898, and Pathé Frères, established one year earlier, even had its own type of disc. Already in those years, gramophones and recordings were sold in countries outside the United States and Europe such as Russia, Egypt and India. During the first decade of the new century, most of the larger companies pursued a sweeping internationalization strategy (Gronow, 1983). The principal objective was to create a worldwide network of local factories, subsidiaries and agencies, through which products could be offered to consumers in every corner of the globe. The implementation of this strategy varied according to whether the company

was European or American in origin. Regarding the latter type, Edison's National Phonograph Company and Columbia concentrated all manufacturing operations in the US; they exported their products to subsidiaries in London, from where the items were marketed on the European continent through an extensive sales network.

In contrast, European companies benefited from their governments' presence in the rest of the world. The colonies of various European empires were not only used to extract large amounts of natural resources, but were also regarded as new markets for Western products. Gramophone furniture and recordings were no exception, be it that these products could only be afforded by Western administrators and richer local inhabitants. European recording companies such as the German Lindström Company and the French record firm Pathé Frères not only set up factories in various European countries, but also established local subsidiaries and agencies in overseas territories (Gronow, 1983). Although Edison, Columbia, Lindström and Pathé were respectable firms in terms of size and world market coverage, none of them was the equivalent of the Victor Talking Machine Company, especially after the company teamed up with British Gramophone.

Figure 6.1: The Victor-Gramophone Alliance



Source: Adapted from Gronow (1983)

The mutual agreement between these corporations, not coincidentally triggered by a fifty percent ownership stake of Victor in Gramophone, was the first horizontal strategic alliance of the record industry (see Figure 6.1). This pact made the partners split up the world by respecting each other's dominant presence in various territories (Gronow, 1983). As an American recording company, Victor took care of its home market in the United States and established agencies in Central and South American countries, as well as in China, Japan and the Philippines. British Gramophone, in a far more decentralized manner, set up actual pressing plants in Russia, India and the main countries of Europe, from which smaller countries and colonies in Africa, Southeast Asia and the Middle East were managed through agencies. Victor's strategic alliance with Gramophone stretched its strategy of achieving maximum consumer adoption of its disc system towards the international level.

At the end of the first decade of the twentieth century, a number of events took place that influenced the industry's further progress. As said, it was obvious that, in the end, the disc would be triumphant in the technological standardization battle that had faced the record business. During the first century, the consumer market, influenced by Victor's aggressive advertising and promotion campaigns (Schicke, 1974), had shown strong preference for Berliner's gramophone and associated disc. As a consequence, Columbia – which until that time had produced both formats – decided in 1909 to stop its cylinder manufacturing activities and to fully concentrate its efforts on production and sales of lateral shellac discs. So Edison had no choice but to conform, and began to develop his vertical diamond discs that were first marketed in 1912. Still, his strong-headed character would not allow him to stop making cylinders (Gracyk, 1996), and this, as will soon be clear, would ultimately lead to his downfall.

Foundation and Proliferation of Capabilities

In the early 1900s, a set of new capabilities was founded at the industry level which guided the new rules of competition as introduced by Victor (see Table 6.1). Victor's managerial-based capabilities were represented by its deviant knowledge that it was not the marginal market for office equipment but the latent market for home entertainment that mattered. This idea required the availability of a minimum amount of recordings and the presence of a maximum degree of fidelity to satisfy consumers. Physical resources like the horizontal disc system and a zinc masterplate, and human knowledge at the part of Berliner and Johnson provided the

input to the fruition of Victor's strategic innovation. The transformation-based capabilities that embodied its entrepreneurial behavior culminated into a structured organization, an efficient flow plant for the assembly of large numbers of recordings, and the separation of the actual recording process from the manufacturing stage.

Table 6.1: New Capabilities in the Early 1900s

Managerial	Input-Based	Transformation	Output-Based
Market for home entertainment	Horizontal disc technology	Structured firm organization	Quality gramophone discs
Availability of minimum software	Zinc masterplate for recording	Efficient manufacturing plant	Technology license agreements
High fidelity of recordings	Knowledge of finance and technology	Separate recording and manufacturing	International strategic alliance

Output-based capabilities reflected the physical gramophone discs and license agreements, as well as the more intangible alliance that supported Victor's strategy on an international level. After ten years in which various technologies were introduced to the market for soundboxes, Victor managed to redefine the rules of the competitive game and created a competitive advantage during the first decade of this century. But most of its rivals had recognized the superiority of the disc system, and managed to adopt the new rules and copy the new capabilities near the end of that decade. From here on, many of them proliferated the new capabilities internationally as they built world-wide networks of factories, subsidiaries and agencies. However, a more explicit understanding of proliferation by record companies cannot be generated from the data. A possible explanation can be that there simply wasn't enough time for proliferation to take place on a large scale as the rules or rivalry were altered again on rather short notice.

THE SHIFT TO SOFTWARE

Now that the issue of standardization was set and Victor's basic patents had expired in 1914, it was somewhat more safe for smaller investors to jump into an attractive and fast-growing market. However, the costs involved in acquiring production facilities were high and the process of manufacturing prerecorded discs was complex. Even so, a limited number of entrepreneurs established small recording companies in Europe, but it was not very long before these ventures faced bankruptcy and were taken over by their larger counterparts. But independent production on a small scale was given another chance: at the time, it was possible to place special recording orders at major companies that did have the necessary technological capabilities and infrastructure. This opened up the possibility for smaller companies to market their own products, recorded and pressed by larger companies, on a private label. Thus, it was already in the period between 1910 and World War I that a relatively large number of small and local labels lived in coexistence with a small group of large multinational corporations (Gronow, 1983).

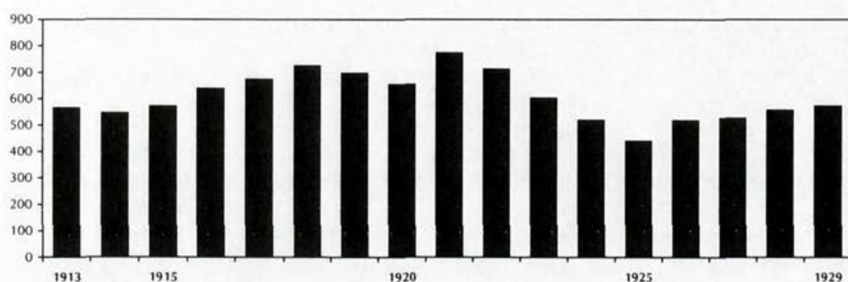
Competition for Records

These business practices by small record companies made their bigger counterparts aware of the primary distinction between selling gramophones and trading recordings: whereas the market for cabinets would eventually be saturated because buying such a machine was an expensive but non-recurrent matter, demand for recordings would not come to a halt. Once consumers owned a gramophone, they would continue to buy new records at relatively low prices to bring the latest music in their living rooms. As a result, the relationship between equipment and prerecorded material changed in a fundamental way (Frith, 1992). In the early years in which the industry was born, a certain minimum supply of recordings had been a precondition to capture the home entertainment market for gramophones. In order to sell sufficient numbers of cabinets and make recording companies' operations commercially viable, consumers had to be attracted to their product by offering a minimum amount of recordings.

But by now it was clear that selling recordings in large quantities was a much more profitable operation. As equipment was in widespread use, consumers demanded more and new recordings. Most of the record corporations recognized this switch from hardware to software, and aimed to capture the biggest piece of the market. As variety in music increased be-

cause dancing became a popular pastime (making jazz and ragtime flourish), the market became segmented. The common approach was to respect the variety of taste present in different countries or socio-cultural groups. As a result, record companies issued fairly large amounts of new releases in their hunt for market share across these diverse market segments, but the number of copies per release was moderate compared to present times. Firms accepted sales of a few thousand records per title, which meant that average sales were low because economies of scale could not be realized (Gronow, 1983).

Figure 6.2: Constant Value of Music Sales in the 1910s and 1920s (in US $ Millions)



Source: See Appendix B

During these years, recording companies were managed and (partially) owned by engineers, supported by a predominant technical staff (Frith, 1992). The emphasis in the firm's policies was therefore largely technological in character: resources were primarily directed at a gradual improvement of the company's manufacturing and recording processes. At the same time, technically skilled managers decided on what was to be released on record, but they were only to a minor degree interested in the music itself. Edison, for example, personally approved or rejected potential songs for release, and his opinion that music should be simple and loud more often than not clashed with the appetite of the larger public. Berliner, on the other hand, was claimed to have great musical knowledge and feeling of what could be a hit record, but he was one of the few decision makers in the American record industry at that time who seemed to have such skills (Gracyk, 1996).

As illustrated by Figure 6.2 and Table 6.2, the focus on records instead of cabinets triggered an increase in music sales. However, the First World War frustrated the rapid growth process of the industry. Consumer

demand fell as household budgets decreased, and governments placed restrictions on the use of primary materials in the manufacturing process of cabinets and recordings. Furthermore, continuing war activities in colonies prevented safe export overseas and distribution inland. A fine example of how the war triggered flexible responses of recording companies is Victor's invention of a special stylus: with a reproducing tip made of tungsten, the company managed to circumvent the restrictions on the commercial use of steel (Gracyk, 1996). This again illustrates the strong emphasis of leading record corporations on technological matters in their strategy during the first decades of the twentieth century.

Table 6.2: Current Value of Music Sales in the 1910s and 1920s (in US $ Millions)

Year	Current Value	Year	Current Value
1912	43	1921	106
1913	43	1922	92
1914	42	1923	79
1915	44	1924	68
1916	53	1925	59
1917	66	1925	70
1918	84	1927	70
1919	92	1928	73
1920	100	1929	75

Source: See Appendix B

Market Strategies

The impact of World War I on the economies of Europe and the United States differed greatly. Europe's main countries experienced a lack of financial resources, and on the continent infrastructures and cities were ruined. Whereas the American record industry boomed right after the end of the Great War to a sales level of more than 100 million records in 1921, its European counterpart started to expand again only in 1925 (Gronow, 1983). While the same statement can be made for the colonial markets of the Middle East and Africa, the impact of the war had been limited in Asia and South America where sales remained at a more or less constant level. Still, worldwide sales took a sharp rise and reached levels of up to four times higher than before the Great War (Gronow, 1983). As the market in

geographical terms had remained essentially the same, this explosive increase in sales was mainly the effect of market penetration strategies.

During the pre-war years, firms had targeted the more wealthy and respectable classes in society. Production costs of cabinets and records were fairly high, resulting in prices that only few households could afford. The continuing work on product and process innovation at the technologically oriented recording companies changed all this in the years after the First World War. Apart from learning effects, which stimulated costreducing innovations in the manufacturing process, a different price strategy was realized during the 1920s that was based upon a number of new product innovations. Whereas special gramophone models that featured electric motors were introduced in relatively small numbers, newly-developed portable wind-up gramophones were manufactured and sold in huge quantities (Gracyk, 1996). While portable and other wind-up models were directed at the lower-income segment of the consumer market, the luxurious and motor-driven versions were aimed at its higher end.

This dual price policy was fruitful in reaching as many households as possible, and culminated in an explosive growth of record sales, at least in the industrializing Western markets. In 1929 more than 150 million records were sold in the US, while approximately 110 million units were consumed in Europe, with the United Kingdom, Germany and France as its primary markets (Gronow, 1983). It is estimated that in those years, between 35% and 50% of the total number of households in the Western world owned at least one piece of gramophone equipment for entertainment purposes. Although this percentage was much lower in the European dominions and even more so in underdeveloped countries (because only a small part of their populations could afford such luxury goods), record sales were still large enough to attract the attention of major record firms. Through import companies, sales agencies, and local factories, more than a total of 300 million records were sold in these various national markets in that same year of 1929.

Under these circumstances, it is not surprising that, even after the war, recording companies continued to focus on the technological aspects of their business. Even their advertising campaigns were primarily technology-oriented: ads emphasized the new product's latest technological advances, its design features, and the company's innovative reputation (Negus, 1992). This stress on technology-related issues impacted the content of record companies' release policies. Even before the war, the leading firms had competed for a limited number of well-known and very

popular theater and opera performers, often releasing exactly the same songs or new versions of those recordings. These imitative policies were even further amplified through low-cost recordings of popular songs or via concerts by anonymous studio performers and symphony orchestras (Frith, 1992). Instead of pursuing a more entrepreneurial policy of promoting and releasing new and promising artists, major record companies kept doing the same over and over again.

Foundation and Proliferation of Capabilities

Table 6.3 shows the bundle of capabilities that were founded when the industry's rules of competition shifted during the mid-1910s. Managerial-based capabilities embodied the strategic knowledge that the endless market for recordings was a far better source of revenues than the ending market for gramophones. A major condition to success in this market, however, was that a minimum amount of cabinets had to be present in the consumer market. Regarding the input-based capabilities, theater or opera performing stars represented the inflow of human capital, whereas the technological skills of both managers and staff comprised recording firms' knowledge structure. Transformation-based capabilities covered incremental innovations in manufacturing and recording processes, and included the capacity-based production of recordings to serve as many market segments as possible. All this culminated in a large variety of releases and a growing corporate reputation in terms of technological innovation.

Table 6.3: New Capabilities in the Mid-1910s

Managerial	Input-Based	Transformation	Output-Based
Market for music recordings	Theater and opera performers	Innovations in recording and manufacturing	High release variety in recordings
Availability of minimum hardware	Technological skills and experience	Capacity-based production	High technological status

However, the data are not clear as to a positive identification of the company that introduced these new rules and capabilities to the recording

industry. At a rather abstract level, one could say that the minor record companies, which initially ordered their records at their larger counterparts, had been the pioneers; they had stepped into the new market for recordings without becoming involved in gramophones. Still, the major record companies managed to replicate the necessary capabilities, and after the war proliferated them in two respects. First, they enlarged the minimum amount of cabinets available in the consumer market through a market penetration strategy in which different gramophone models were targeted at different market ends. Second, record companies released new issues of popular recordings previously released, and contracted anonymous performers and orchestras to record songs and concerts at low cost.

THE GREAT DEPRESSION

An era in which a new industry had been born and international markets were created abruptly came to an end when the New York Stock Exchange crashed in late October 1929. This event marked the beginning of a worldwide economic slump that lasted for almost a decade. Like all businesses, record companies were into a harsh struggle for survival. Until the Great Depression, both large and small record firms had existed on a marginal basis; profits were relatively low due to the absence of scale economies and the lack of a focused market strategy, and their weak financial positions had made most record companies especially vulnerable. Moreover, the depression had rapidly lowered the public's income and forced it to look for other forms of entertainment, as gramophones and recordings were still considered as luxury goods. As it happened, two substitute forms of entertainment became widely available during these years of poverty as a consequence of continuous research efforts into the reproduction of sound and vision: radio and talking movies.

Movies and Radio

The entertainment value of sound films surpassed that of records on three fronts. First, talking movies were something new: until then silent films had been accompanied by small orchestras and a person who recited the necessary text, but now the characters in a movie actually spoke words that could be heard immediately. Furthermore, talking movies delivered both sight and sound, one dimension more than records could bring you. Finally, talking movies were shown in theaters, and in these troublesome

times going to the theater was a way to deal with the discomforts of the depression. Under more normal circumstances, record firms should have been able to fence off this new threat of substitution that crossed the borders of the market for home entertainment. Indeed, the largest part of the damage done to the recording industry during the Great Depression was not a consequence of the introduction of sound films, but was instead a result of the widespread availability of radio.

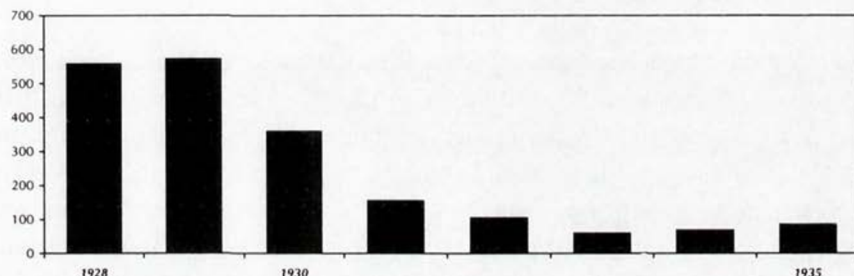
Building upon new research by physicians like Maxwell and Hertz during the 19th century, Marconi's development of wireless telegraphy, Fleming's invention of the diode, and De Forest's discovery of oscillating properties of his Audion tube all led to the possibility of transmitting sound over long distances (Gwinn *et al.*, 1987). The application of the electron tube in the early 1920s was the result of investments in collective research activities in America and Europe, and culminated into the initial production and consumption of radio receiving sets. In those years, hundreds of local transmitting stations were set up in the US until permanent networks of radio stations were established in the second half of the 1920s. In 1926, the Radio Corporation of America (RCA) – founded in 1919 by General Electric – incorporated the National Broadcasting Company (NBC), which was divided in a Red and Blue Network due to an excess of affiliates in the same cities. The other major radio network was Columbia Broadcasting System Inc. (CBS), incorporated in 1927.

These privately owned broadcasting networks were dependent upon incoming revenues from advertisers, and radio programming was therefore directed at reaching the widest public possible. The situation was different in European countries, because governments set up public broadcasting companies that were financed by the annual fees of listeners. Most European countries followed the course of action pursued in the United Kingdom, where Parliament in 1925 had ruled that the privately-owned British Broadcasting Company had to be liquidated and replaced by a public firm, the British Broadcasting Corporation, today's BBC. These established structures in both parts of the Western world were fully developed when the radio became a common property in many households and the artistic potential of radio came to a rise in the late 1920s and early 1930s (Gwinn *et al.*, 1987). The record industry, already struggling for survival in these harsh times, was hurt badly by the introduction of radio.

Although market prices of radio receivers almost equaled those of gramophone cabinets, listening to the first appliance was considerably cheaper. Compared to record prices, license fees for European listeners

were negligible, while the American public did not face any costs at all. Moreover, radio brought a variety of entertainment forms into people's homes instead of merely music (Gwinn *et al.*, 1987). News, stage drama, documentary programs, light entertainment and poetry reading were programmed next to live musical performances. At the time, many saw the success of radio broadcasting as the definite end of the recording industry. The choice between radio and record was easily made by the public in times when a job was hard to find, and the new medium offered more fun for less or no money. As a consequence, record sales fell from 150 million units in 1929 to 25 million copies in 1935 in the United States (see Figure 6.3 and Table 6.4) while figures in Europe and the rest of the world were in proportion to the American data (Gronow, 1983).

Figure 6.3: Constant Value of Music Sales in the Great Depression (in US $ Millions)



Source: See Appendix B

As a consequence, the record industry was thoroughly restructured. Many of the small and locally oriented record companies were not able to stand the combined forces of radio and recession; the larger part went into bankruptcy while some lucky survivors were purchased by their larger counterparts (Frith, 1992). But even major record companies were not able to make it on their own, and a number of formidable mergers and acquisitions transformed ownership structures in the recording industry. In Europe, the leading companies could only survive by means of a combination and in 1931 Electrical and Musical Industries (EMI) was formed under British ownership (Gronow, 1983). EMI was incorporated through the merger of British Gramophone and British-owned Columbia Ltd. that had acquired the American Columbia company already in 1921. At the same time, France's Pathé and Germany's Lindström joined the EMI con-

glomerate, which expanded itself even further by swallowing a number of smaller labels.

Table 6.4: Current Value of Music Sales in the Great Depression (in US $ millions)

Year	Current Value	Year	Current Value
1928	73	1932	11
1929	75	1933	6
1930	46	1934	7
1931	18	1935	9

Source: See Appendix B

THE STAR SYSTEM

The leading competitors in the US of the 1920s were Victor, Columbia, Edison and Brunswick. The latter was originally a billiard equipment firm that had diversified into the recording industry in 1919, and became the second largest rival in rear of Victor (Gracyk, 1996). In 1930, Warner Brothers Pictures acquired Brunswick, but already in 1932 ownership was changed again: newly-formed American Records bought Brunswick, and reinforced itself only two years later by merging this company with Columbia (American Records bought Columbia from a British manufacturer of radios, which in the meantime had acquired the company from EMI). Edison departed from the scene at the start of the depression as his company went into bankruptcy, and most of the small recording companies vanished as debts were insurmountable. Victor was the luckiest of all; a reasonably safe financial position had been taken just in time when it was purchased by RCA in 1929.

Competition for Markets

So instead of four dominant companies and a host of smaller labels, the US recording industry at the end of 1935 consisted of only two major companies (RCA-Victor and American Records), the newly incorporated American Decca Records, and a limited number of minor companies. A similar situation could be seen in Europe where, apart from some small local firms, EMI faced competition from Telefunken and the British

Decca Record Company. The restructuring wave during the first half of the 1930s was supplemented by cost-cutting policies at record companies; vast amounts of personnel were fired, expensive artists were dropped and field recording was minimized. How badly music firms were in need of money was shown by Victor: in 1935 the company was forced to withdraw its shareholdings from EMI, terminating a long-standing 50% ownership of British Gramophone, and loosing its link with Europe (Sanjek, 1991).

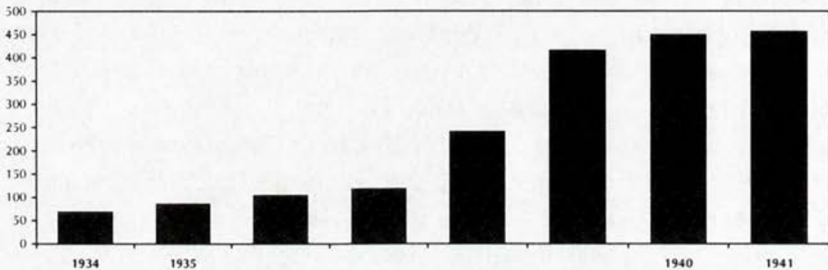
When the worst years of the Great Depression subsided at the start of 1935, the industry still existed. Record sales started to recover again, partly due to a rejuvenated interest from the public, but mainly as a result of one record company's pioneering activities. Decca Records, incorporated in the United States in 1934 by Jack Kapp and Ted Lewis, was the first record company that created scale economies in an industry characterized by high initial costs of recording and relatively low reproduction costs. Kapp, a former general manager of Brunswick, realized that he needed to sell massive amounts of a limited number of releases in order to make his business extremely profitable. Instead of investing his partner's $250,000 in gramophone manufacturing, Kapp dedicated his resources solely to records. On top of that, he developed the 'star system,' a new business concept that was based on his ability to discover fresh market opportunities and to design new marketing techniques.

Kapp built his idea of Decca's limited release policy on his knowledge that the majority of record consumers appreciated music from popular celebrities and that their buying behavior could be influenced. He created a compact artist roster of stars such as the Dorsey Brothers and Bing Crosby, who he had lured away from Brunswick when he left the company. In addition, he developed aggressive marketing and promotion campaigns to bring new releases of his established performers under the attention of the public (Frith, 1992). To really boost record sales, these campaigns required heavy investment, which could therefore only be designed for a limited amount of releases, and this perfectly suited the size of Decca's roster. The established popularity of the company's celebrities almost certified a successful launch of each new release, while sales were pushed by tailored marketing campaigns and promotion budgets.

Furthermore, Kapp knew that his unorthodox ideas suited the emerging market for coin-operated machines, and that obtaining a substantial market share in the supply of records for jukeboxes could be a very profitable operation (Sanjek, 1991). He thus focused Decca's strat-

egy on providing highly marketable music indirectly to groups of consumers in public places. In this respect, the record company's numerous low-price contracts with jukebox operators and elaborated network of distribution channels were indispensable. In 1939, Decca sold more than 13 million records, while its share of the jukebox market rose to 90%. But it was not long before the jukebox market segment was targeted by RCA-Victor and CBS-Columbia who had noted Decca's success. The entrance of these major record companies triggered a rapid growth of the jukebox business segment, which by then accounted for approximately 60% of all record sales (Sanjek, 1991).

Figure 6.4: Constant Value of Music Sales in the 1930s and 1940s (in US $ Millions)



Source: See Appendix B

While responding to Decca's successful strategy, the major record companies changed their organizations in fundamental ways. The technically skilled inventor that had traditionally headed recording firms in the pre-recession years was replaced by a business-oriented CEO with a strong personality, and cash instead of technology became the name of the game. The domination of technical staff was reduced as technological research activities were disconnected from record business operations and transferred to the parent company (Negus, 1992). Furthermore, brand-new departments were installed with large marketing and promotion staffs. Inevitably, other record firms had noticed Decca's competitive advantage and managed to imitate its highly profitable market strategy. The immediate result was that both the amount and variety of new releases declined considerably, but that the quantity produced of each release was enormous (Sanjek, 1991). In the US, record sales in 1938 had an estimated value of $26 million compared to $6 million in 1933, the bottom year of the depression (see Figure 6.4 and Table 6.5).

Table 6.5: Current Value of Music Sales in the 1930s and 1940s (in US $ millions)

Year	Current Value	Year	Current Value
1934	7	1938	26
1935	9	1939	44
1936	11	1940	48
1937	13	1941	51

Source: See Appendix B

Promotional Policies

However, returns in 1938 were still just a third of what they had been in 1929, and it did not take record company executives long to realize that most of their money went to the expensive contracts they had with established stars. This, and the fact that radio was still the record industry's main competitor, forced the major firms to reconsider their strategy in the early 1940s. Instead of focusing their business on established but expensive celebrities, developing and building new (but relatively cheap) recording stars became the primary objective (Frith, 1992). In other words, the emphasis shifted from serving existing and identified demand patterns to creating new musical market segments. Whereas the public used to buy recordings from popular artists known from the theater or concert hall, the new aim was to sell music from company-created stars to consumers whose first contact with these artists was through the record itself. As a consequence, live performances became replications of recordings instead of the other way around.

This new relationship between records, artists and markets confronted record firms with the problem of finding an adequate outlet for the promotion and marketing of new stars which could reach every possible buyer. Up to that moment, billboards and newspapers had been used, but market coverage of these tools was limited and was not expected to be very effective in the promotion of new and unknown acts. To the music business, radio with its extensive broadcasting networks and nation-wide coverage seemed to be the most proper outlet. Whereas radio stations presented record companies the opportunity to extensively promote their newly developed stars, record companies, on their turn, provided radio with a cheap form of programming (Sanjek, 1991). In effect, the record industry very effectively dealt with the two issues it was confronted with

in the late 1930s: the answer to the matter of expensive star contracts created the problem of finding a strong and quick channel of promotion, and solving this issue diminished concerns about the impact of radio on record sales.

Although the details of the link between radio networks and record companies varied due to differences in ownership structures between the American and European radio stations, this novel relationship could be observed at both sides of the Atlantic. However, it was in the United States where the star system with its numerous links to other industries and mass markets really flourished (Sanjek, 1991). As noted, Victor had been purchased by the RCA corporation with its NBC radio network in 1929, and in 1938 CBS acquired American Records, bringing back the Columbia label to where it belonged. Both RCA and CBS had links with the film industry, and in this way new stars were exploited on three fronts: film, radio and records (Frith, 1992). This was the time of Bing Crosby, Benny Goodman and Glenn Miller, and the start of a new era in which music such as jazz and bigband came to dominate record companies' classical repertoire. Revenues increased even further as public advertisers showed their interest in these stars.

Whereas in most European countries record sales only marginally increased after the worst years of the depression, the excessive cultivation of the star system in America really boosted record sales: 1940 revenues doubled those of 1938 while more than 100 million records were sold (Gronow, 1983). Record companies' focus on mass markets and the necessity of collaborating with radio networks did have its negative effects, however: radio became a gatekeeper, strongly determining which records were being broadcast and therefore responsible for the homogenization of public tastes (Frith, 1992). As a consequence, record companies were forced to produce music that suited radio programming formats and tastes of individual radio personnel. This dependence upon people outside the firm's organizational boundaries only strengthened the record industry's belief in the benefits of the star system, which moved companies gradually away from the consumer market. Leading record firms competed on the same strategy, and recorded artists according to radio network acceptance instead of meeting varying consumer demands.

Foundation and Proliferation of Capabilities

Right after the Great Depression, new capabilities were founded at the industry level as Decca changed the competitive rules in the record in-

dustry. Table 6.6 displays the set of capabilities according to the familiar distinction. Managerial-based capabilities encompassed the strategic knowledge that record buyers tend to prefer music made by celebrities, and that high record sales were closely related to the idea that consumers can be influenced at a mass level. Input-based capabilities covered a human capital component (a limited roster of foolproof celebrities) and a financial resource element (via a number of extensive marketing and promotion budgets). Transformation-based capabilities referred to entrepreneurship in terms of aggressive marketing campaigns and a professional business approach to revenues and costs. Output-based capabilities embodied elaborated networks of distribution channels and low-price contracts with jukebox operators.

Table 6.6: New Capabilities in the Mid-1930s

Managerial	Input-Based	Transformation	Output-Based
Consumer preference for celebrities	Compact roster of celebrities	Avant-garde marketing campaigns	Network of distribution channels
Manipulation of consumer taste	Marketing and promotion budgets	Economic approach to costs and revenues	Network of jukebox contractors

Once Decca's advantage had been eroded by rivals like Columbia and Victor, the above capabilities were proliferated at the industry level. Instead of contracting big stars, record companies started to develop their own acts in an effort to reduce costs. From here on, artists were built as recording stars in contrast to simply signing celebrities who had become famous on stage. Furthermore, marketing campaigns were elaborated and directed towards radio promotion, as record companies established links with radio networks (even through legal ownership structures). Artist promotion was even further exploited as newly developed acts got substantial free publicity when embraced by the film industry and public advertisers. Crucial in these growing networks of marketing and promotion were the extensive relationships between individual persons at record companies and the various promotion channels.

The Second World War

The Second World War seriously affected the structure of the global record industry. In Europe, the only companies that made money were a few German recording firms sponsored by the Nazi regime in its abuse of film, radio and records for propaganda purposes. Harsh times made the wallets thin and, just as in WWI and the Depression, demand for records collapsed, as did the European recording industry. Although EMI was based in Great Britain, it faced serious problems as sales fell and government placed restrictions on material usage. Furthermore, the firm's UK-based headquarters was out of touch with its French and German affiliates that had played a crucial role in the formation of EMI. In the United States, the effects of World War II were far more prosperous. Although the government put a ban on the manufacturing of gramophones and radios for home usage, major record companies became the sole supplier of music to be shipped to all regions of the world where American GIs were fighting (Sanjek, 1991).

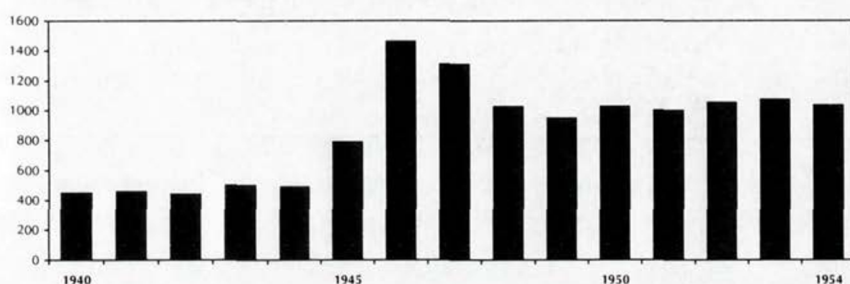
Tape and Vinyl

Apart from this governmental demand for records, record companies also increased sales by recording songs that were supposed to influence or target the morale of the American population during wartime. There was even room for a new record corporation as the establishment of Capitol Records in 1941 showed. When the war ended in 1945, the European recording industry only existed in name, whereas its American counterpart had reached sales figures it never had known. For the first time since 1921 when sales hit an all-time high value of $106 million, US record industry revenues surpassed this figure by $3 million, while sales at the start of the war had an estimated value of only $48 million (see Figure 6.5 and Table 6.7). The Second World War not only boosted American sales but also increased companies' international revenues. Worldwide popularity of US-based music flourished as American soldiers, functioning as exporters, liberated many European countries (Gronow, 1983).

The growing export of US-based music strengthened the dominant position of the leading American record firms, both in their home market and in most European countries. The world war not only proved to be an effective exporting vehicle for American records and tastes, but also was responsible for a cheap inflow of a new technology called tape recording. Although the early principles of magnetic recording had already been in-

vented by the Danish engineer Poulsen in 1900, the development of this technology had stagnated in those years as researchers were more interested in the gramophone's twofold capacity of recording and reproducing sound. But in the late 1930s, German engineers had enhanced and perfected the audio tape and its corresponding recording device, and turned it into a major component of Goebbels' Nazi-propaganda machine. When Berlin fell, a number of tape recording gadgets were shipped across the Atlantic by the US Army (Jones, 1992).

Figure 6.5: Constant Value of Music Sales in the Post-War Years (in US $ Millions)



Source: See Appendix B

After tape technology had been analyzed by military engineers, the American government made it available to private companies in 1946. During the first five years after the war, the application of a number of new technologies changed both product and process operations within the record industry. While small companies like Ampex invested huge amounts of money on R&D in tape technology to make it suitable for commercial purposes, two of the leading recording corporations started research on microgroove records (Mittelsteadt and Stassen, 1994). Backed by its parent CBS, Columbia developed the long-playing record, which was introduced to the market in 1948. This new format stored up to twenty minutes of music on both sides and was made of vinyl, a new plastic. The application of this material made the record far less breakable (and far more durable) than the traditional shellac records. Furthermore, the LP had a higher musical fidelity, which significantly reduced the amount of distortion and made the reproduction of sound very similar to the original material.

Columbia demonstrated the LP to a team of executives at RCA and offered to transfer this technological know-how. Although the advantages

of enhanced storage capacity, less breakability and improved sound quality were obvious, RCA was too proud a company to adopt anyone else's technologies but its own (Sanjek, 1991). The corporation immediately started its own research on microgroove records and, within just one year, was ready to market what came to be known as the single (Mittelsteadt and Stassen, 1994). This record format had a much smaller diameter and was played at a speed of 45 rpm instead of the slower 331/3 revolutions per minute of the LP (the original shellac record turned at a speed of 78 rpm). The introduction of the single by RCA as a response to the development of Columbia's LP provoked another battle of standardization on formats. Equipment manufacturers did not wait for this contest to be resolved and fabricated new record players that could play all three speeds.

Table 6.7: Current Value of Music Sales in the Post-War Years (in US $ Millions)

Year	Current Value	Year	Current Value
1940	48	1948	189
1941	51	1949	173
1942	55	1950	189
1943	66	1951	199
1944	66	1952	214
1945	109	1953	219
1946	218	1954	213
1947	224		

Source: See Appendix B

The battle ended in 1951 when the American government placed the two rivals at the negotiating table, where they agreed to stop their campaigns and to make both singles and LPs. Whereas the LP came to be the format used for classical music, the single was reserved for more popular music as its compactness proved especially effective and efficient in the profitable jukebox segment of the market (Sanjek, 1991). In the meantime, research activities into tape technology had taken a quick flight, and in the late forties Ampex was ready to mass produce tape recordings through a high-speed copying system. The early adopters of this system were the radio networks of NBC and CBS who used it for programming purposes. Although these tape machines required enormous initial investments compared to gramophones, costs of tape itself were extremely

low. Furthermore, tape could be re-used, while many more hours of programming material could be stored efficiently. Tape technology was introduced in the record industry when reel-to-reel tape equipment became available in 1951 (Jones, 1992).

These units were promptly purchased by major record companies and within a few years tape recording had replaced the electric recording process that had been in use since 1925, as the advantages of tape recording were numerous (Jones, 1992). First of all, tape was cheap and more than eight hours of music could be stored on just one spool of tape. Second, the sound recorded on tape could be edited and spliced. Also, recording time (and therefore costs) was shortened as the need for multiple takes was reduced. Next, the equipment was more portable, enhancing mobility. Furthermore, various tracks, taken at a different time, could be captured on tape and mixed together onto the mastertape. Finally, even the sound quality of tape was better. In short, tape technology provided record firms with new recording possibilities and significant cost reductions (Mittelsteadt and Stassen, 1994). Initially, new developments in recording and vinyl formats strengthened the majors' positions. During the first decade after the Second World War, the American (and thus the international) recording industry was dominated by what was called the 'big four:' RCA, Columbia, Capitol and Decca.

The core strength of these major record companies was their ability to control (Peterson and Berger, 1975). The cultivation of the star system and their cooperation with radio networks enabled them to control the market and the successful entrance of new artists. The in-house development of new technologies had put them in control of recording and manufacturing. They monopolized record distribution with their control over highly structured distribution channels. These firms also controlled the European part of the record industry, badly hurt during the recent war, via international licensing deals (Sanjek, 1991). In 1951, Columbia signed a distribution agreement with Dutch electronics manufacturer Philips, which operated in the industry via its record division PPI. At about the same time, Capitol formed ties with Telefunken in Europe and EMI in Africa. Already in 1949, Decca had stepped into a similar cooperative venture with Deutsche Grammophon. RCA was the only major without any significant European interests.

In those first years after the war, management of leading record firms deemed it necessary to restructure their company and personnel around the concept of control. As said, the cultivation of the star system had re-

sulted in a significant decline in the variety of products, because of a focus on efficiency and mass products. As a result, the major companies gradually changed into formal bureaucracies with large numbers of hierarchical levels and many segregated functional departments (Peterson, 1990). Decisions were made at the top, where risk-avoiding policies dominated, while the degree of vertical control was high. While the amount of internal entrepreneurs with musical knowledge declined, the number of administrators focused on figures rose. Management's unlimited desire to raise short-term profits made companies unaware of what was happening in the market. RCA, Columbia, Capitol and Decca suspiciously watched each other's moves but forgot to keep track of other developments and, moreover, neglected new musical trends that proved to be highly appreciated by the consumer market.

THE CREATION OF STYLES

The first official television broadcast was the BBC's coverage of King George VI's coronation in 1937. The pictures were of a quality that would have made today's high-definition viewer grimace, but the transmission was a landmark after a decade of intense research. Using the Nipkow principle, both Baird in the UK and Jenkins in the US had heated up corporate research activities with experiments in 1926. In 1932, the RCA laboratories produced the first electronic television, whereas in Europe both EMI and Philips were involved in the development of this new revolutionary medium. In 1939, RCA's broadcasting company NBC displayed the TV publicly at the opening of the New York World Fair. In the same year, the NBC network started broadcasting, to be followed only a few months later by its main rival CBS. At that time, the number of broadcasting hours (two hours per week) and owners of television sets (approximately 10,000) in America were limited (Gwinn *et al.*, 1987).

Competition for Music

The technological and market development of this new medium stagnated during the Second World War; electronics companies on the European continent were destroyed or confiscated by the German army, and electronic manufacturing companies in Great Britain and the United States were forced by their governments to obey Army orders. But it was clear to companies, especially in the US, that the global conflict would only be

a temporary restriction to the inevitable expansion of the TV broadcasting industry. Multi-millionaire Noble spotted enormous opportunities and purchased RCA's Blue Network in 1944; thus was the American Broadcasting Company (ABC) brought to life. And at the end of the war, the stage was set for a renewed growth of the television broadcasting industry in the United States, its main competitors being NBC, CBS and ABC. The industry's growth was indeed explosive: 1 million TV sets had been sold in 1949, while more than 10 million receivers had reached the American market at the end of 1951 (Gwinn *et al.*, 1987).

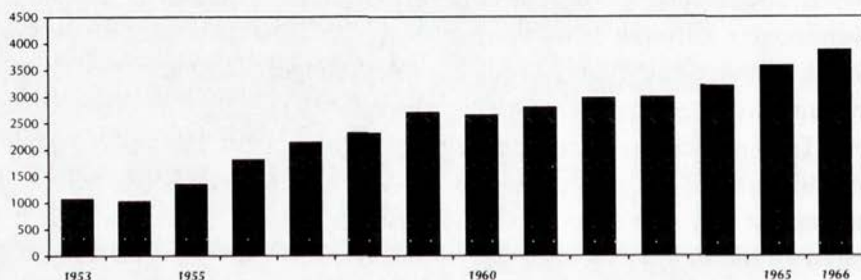
Industry experts expressed their opinion that the rising popularity and success of the television would indisputably lead to the end of radio broadcasting. Why would anyone listen to a radio when a television set was able to bring both sound and images into one's living-room? This line of reasoning dominated among top executives of the leading broadcasting companies, and resulted in the transfer of most radio programs, program formats and programming personnel to their newly incorporated television departments (Peterson, 1990). By the end of 1954, the large American radio networks experienced a significant lack of resources: corporate headquarters almost exclusively invested capital in television broadcasting, the amount of experienced personnel was limited, nation-wide advertisers directed their marketing budgets to television instead of radio, and news, documentaries, drama and various other entertainment programs were now within the strict domain of television. Radio executives therefore began to direct their heavily curtailed budgets to the cheapest form of programming: recorded music (Peterson and Berger, 1975).

This new demand for records from radio networks was advantageous to major record firms. As more records received continuous airplay, the amount of promotion and publicity for these records grew, which triggered an increase in record sales on the consumer market (Sanjek, 1991). But there was another, more revolutionary effect on the US record industry linked to the rise of television broadcasting at the expense of radio. During the first ten years after the war, major record firms had primarily been involved in the production of classical music on the one hand, and jazz and big-band as alternative forms of popular music on the other. But already in 1948, a small record label called Atlantic Records had stepped into the R&B (rhythm and blues) segment of the market. Under the supervision of Ahmet Ertegun, it had moved into white pop music by 1953, followed by other small independent but highly entrepreneurial labels such as Imperial, Dot, Sun and Chess. The major corporations, mean-

while, considered these segments as too limited in size to be qualified for commercial purposes or, being far too bureaucratic and lacking market knowledge, had not even noticed them at all (Gillett, 1988).

Atlantic and other small independent record labels effectively met a growing market demand as they cooperated with local radio stations serving specialized markets. The latter had traditionally suffered from the oligopolistic market power of the large radio networks, but now that these networks themselves were in trouble, the number of local stations expanded rapidly (Mittelsteadt and Stassen, 1994). Like the independent record labels, local radio stations realized that what the market really wanted was more variety in music styles. They perceived the market as a collection of various segments, each of which evolved around distinct musical styles and taste patterns. To meet this variety in musical demands, local stations concentrated their programming tactics on one or a few of these market sections, a strategy that was soon followed by the local affiliates of the radio networks in their response to the rise of television (Peterson and Berger, 1975). It was now possible for small independents to get their records played on air by a large number of radio stations.

Figure 6.6: Constant Value of Music Sales in the 1950s and 1960s (in US $ Millions)



Source: See Appendix B

But the new radio landscape in the United States was not the only factor in the emerging success of independent labels that searched for new musical styles. The technological innovations of tape recording and microgroove records also played a role in the rise of independent record companies – in a way, major record firms themselves were responsible for creating a new wave of competitors. Before World War II, initial investments and operating costs of vintage recording studios and equipment had been extremely high; only large and wealthy record firms could afford to

be involved in the recording and duplicating process (Schicke, 1974). But the cost advantages of tape recording and the mobility of its equipment enabled small record companies to create their own studios and recordings at acceptable cost. Moreover, the new editing possibilities of tape recording, enhanced by the development of the two-track system and the invention of 'stereo' in 1958, also contributed to the development of new musical styles as artists and producers experimented with tape's new opportunities (Jones, 1992).

As said, majors had complete control over distribution channels until the mid-1950s. But the invention of the microgroove record made it possible to distribute more records at far less costs. The substitution of the easy-to-break shellac 78-rpm record by the almost unbreakable black vinyl record accounted for an easier, cheaper and faster distribution process. As a consequence, a host of independent distribution companies were born, functioning as the minor record companies' lifeline to the retail market (Peterson, 1990). Independents mainly released individual songs on singles, and these 45-rpm records took far less storage space and handling time than the larger 331/3 LPs. Moreover, the number of different places where one could buy a record expanded as a result of these new distribution channels. Next to the traditional retailers, records were also sold at departments of warehouses or other specialty stores, and even by mail via record clubs (Mittelsteadt and Stassen, 1994).

The independent companies were quick to react to these developments, and profited from them at various stages of their value chain. First, they recorded artists in company-owned low-cost studios with affordable but high-quality recording equipment. Furthermore, independent record labels managed to close lucrative deals with independent distribution companies that spread the compact singles at low cost throughout the country. Finally, the new radio landscape with its growing number of audience-targeted broadcasters was a very effective promotional vehicle for a growing number of independent record companies (Peterson, 1990). After 1955, a host of small but entrepreneurial record labels were responsible for a significant increase in both the variety and number of new releases. In these years, artists like Elvis Presley, Jerry Lee Lewis, Chuck Berry, and Little Richard achieved tremendous success.

The independent sector flourished: whereas the big four owned approximately 75% of the $277 million US record market in 1955, their share tumbled to 34% of a growing market which reached a value of $603 million only four years later (see Figure 6.6 as well as Tables 6.8 and 6.9).

The rigid organizational structures of the major corporations inhibited a timely response to new market conditions. Here, the person responsible for artist development was more like a decision-maker; he selected the act from the firm's established artist roster to record a new song written by the company's in-house songwriters. In contrast, the person responsible for what came to be known as A&R (artist & repertoire) at the independent record firm was in fact an entrepreneur; he had a feeling for what kind of music or artist could very well be successful in the future, depending on his gut feeling and knowledge of the market. Furthermore, he was an expert on all aspects of the business, from producer to promoter, and was often in charge of the firm (Peterson, 1990).

Table 6.8: Current Value of Music Sales in the 1950s and 1960s (in US $ Millions)

Year	Current Value	Year	Current Value
1953	219	1960	600
1954	213	1961	640
1955	277	1962	687
1956	377	1963	698
1957	460	1964	758
1958	511	1965	862
1959	603	1966	959

Source: See Appendix B

The significance of the A&R role and the key position of radio disc jockeys as gatekeepers to be influenced were not immediately recognized by the lagging major companies. Instead, these firms aimed to recapture lost market share by directing their attention towards the LP instead of the single, and by offering discounts to most of the country's distributors. But it lasted until 1964 before the big four realized that the new music styles of R&B and rock'n'roll were not just passing fads. The market had continued to grow in these turmoil years, and this growth was a direct consequence of the independent record firms' discovery that these new music styles strongly appealed to the youth part of the market (Frith, 1992). The majors had never really addressed this younger generation, but it did not take the independents very long to realize that the teenager market was a very lucrative one and, moreover, fitted their new music perfectly. The uprise of the indies in the second half of the fifties unlocked this youth

market, which even today represents the record industry's most important consumer group (Denisoff, 1986).

Table 6.9: How Independents Replaced Majors in the Charts

Year	C4 Ratio	Firms	Year	C4 Ratio	Firms
1953	71	11	1960	28	39
1954	73	12	1961	27	39
1955	74	14	1962	25	41
1956	66	20	1963	26	36
1957	40	23	1964	34	37
1958	36	31	1965	37	35
1959	34	42	1966	38	31

Source: Adapted from Peterson and Berger (1975)

Note: The number of firms and the C4 concentration ratio have been based on their presence in Billboard's weekly Top Ten list for singles in the popular music market.

A&R Structures

At about the same time that independent labels started their crusade against the major record corporations in the United States, the heavily injured European record industry got to its feet again. Apart from UK-based EMI, most of the European record firms had incurred heavy damage from the Second World War and had to build their business almost from the ground up. In order to do this, they needed a strong financial base on short terms, without the cash-consuming process of developing and recording their own artists. The licensing and distribution agreements with the American majors suited the European companies very well, as such contracts were a logical response to their financial difficulties. The primary objective for US-based majors was to collect additional revenues from European sales of their recordings while keeping costs at a minimum. But as the European record companies regained vigor and vitality, direct competition with the American majors inevitably emerged.

During the early 1950s, up to 35% of all records sold in Europe were actually American records. The use of old-fashioned recording and manufacturing equipment made record prices in Europe fairly high in those days, which prohibited a significant sales and market growth. But after the establishment of the European Common Market in 1958, the European

industry came to stand on its own feet. Tariff barriers were lowered, and rusty equipment was replaced by large and efficient manufacturing plants (Sanjek, 1991). As a forerunner of the coming rise of European record firms, EMI had acquired Capitol, one of the four American majors, in 1955. It was the first time that a foreign firm took control of a major American record company, and it would not be the last. Now that EMI had its own organization through which it could market British records in the US, the company terminated its agreement with RCA in 1957.

Just like RCA, another American major lost its valuable European distribution outlet in 1961, when Philips Phonografische Industrie (PPI) terminated its ten-year-old alliance with Columbia. Philips Electronics had incorporated its record division in 1950, which had been flourishing on an international level through Philips' worldwide network of local subsidiaries. A couple of months after its split with Columbia, PPI purchased full-grown independent Mercury to keep its link with the American market (Sanjek, 1991). Again, the US had been invaded by a foreign company at the cost of American record firms at both the national and international level. In 1962, Philips expanded its interest in the record industry via the creation of a joint venture between PPI and Deutsche Grammophon that operated internationally under the label Polydor. The US majors that had been so successful in the first decade after the war, were not only being hurt by a host of successful independents, but were also under attack from foreign companies that entered their home market.

Confronted with the need to restore its presence in Europe, RCA entered into a number of distribution arrangements with medium-sized European record companies. At the same time, it incorporated a separate international division that was responsible for running the company's new agreements with British Decca in the UK, Telefunken in Germany and Musikvertrieb in Switzerland (Sanjek, 1991). After its divorce from Philips, Columbia was also forced to install an international division, but its approach was different. The company had learned from its experience with PPI, and considered the risks of being dependent on local partners for international distribution too high. Columbia thus launched a new strategy to set up an international distribution network, and installed subsidiaries in the Netherlands and France in 1963 (Sanjek, 1991). Still, these new initiatives did not alter the main objective of US firms in Europe: to generate additional revenues from American recordings (Laing, 1992).

While European firms were deeply involved in the development of local music and artists, the American majors had no such plans. Market-

ing their repertoire on an international level was the most they could do, as the majority of their resources was involved in the restructuring of their operations in the US. The independent labels had taken over business in their home base, and the majors gradually became aware of the fact that the increasingly diversifying and growing youth market would indeed be of a lasting nature. They had no choice but to reorganize their companies and to alter their traditional market strategies. Emphasis was placed on discovering and developing new talent in the popular music field, and special A&R departments were created (Peterson and Berger, 1975). By 1964, Columbia and Capitol showed that they had been able to adjust to the changing market conditions when their newly incorporated A&R departments achieved success with the discovery of hot acts like the Beach Boys and Bob Dylan.

Both companies also invested heavily to intensify their relationships with the industry's main promotion channels. Key persons within their promotion departments developed a network of close relationships with the most important radio disc jockeys around the country. Apart from the benefit of radio stations as promotion vehicles, TV broadcasting provided a brand-new opportunity to the record industry. The rise of the independents had not only been due to the development of new music styles and acts, but also to their understanding that these new-born stars were people with a distinctive personality and style. Recording stars not only had their own typical style of music, but also propagated a unique and eccentric image; it was in these turbulent years that sound and image became unseparable (Frith, 1992). In this respect, free publicity via television was a perfect way in which record companies could create new stars for the popular music market (Negus, 1992). Next to the cultivation of intimate ties with the TV-broadcasting industry, the rebounding majors directed massive marketing budgets and campaigns towards this medium.

In 1964, the British pop scene came to a rise with the Beatles as its progenitor. EMI had put considerable effort into local artist development, which culminated in its Beatles contract. Their success in America proved to be a goldmine for Capitol which licensed and distributed records from its parent EMI in the US. The heydays of rock'n'roll came to an end when British rock acts like the Rolling Stones, signed up by British Decca, became successful in the United States (Frith, 1992). CBS and Warner, attracted by the commercial potential of these British competitive products, quickly established subsidiaries in London. Here, they discovered and developed acts like Led Zeppelin who made it big on the US market. Al-

though this was the first time that US record firms sought new talent out of their home base, they still did not have a real multinational artist development policy.

Indeed, the United Kingdom was the only European country where American record companies set up branches with the explicit purpose of new talent development. In all other countries where subsidiaries had been formed, marketing and distribution of US-based records continued to be the main objective. Furthermore, the activity of discovering new and successful British acts was guided by their commercial potential on the American market. In contrast, UK-based record labels initially developed new acts for their home market, with the additional advantage of marketing them on a broader and international level. Nevertheless, it was this period that marked the establishment of a long-lasting Anglo-American dominance in global record sales (Laing, 1992). From here on, American and British companies primarily pursued the development and marketing of English-speaking acts in both their own and foreign countries.

RCA and Decca, the two leading majors of the original big four, were not able to retain their position during the sixties (Peterson and Berger, 1975). RCA failed to establish itself in the market for popular music, and the company could only survive through its superior position in classical music (and its highly profitable contract with Elvis Presley, who was signed up after recording his first singles at Sun Records). But compared to the explosively growing popular music segment, the market for classical records was steady and mature. In the end, RCA tumbled from the first to the very last position in America's top ten record companies within ten years. Even Decca, once a prominent entrepreneurial record company and pioneer of the star system, was not able to retain its competitive position. Decca did have a few top-selling records in the popular music market, but as its rivals released hit after hit, the firm's market share continued to fall. Both RCA and Decca were not able to break away from established suppositions, structures and strategies, and became victims of their own past successes.

Foundation and Proliferation of Capabilities

During the mid-1950s, the competitive rules of the game shifted again as capabilities were founded through the innovative behavior of independent labels, with Atlantic as their forerunner (see Table 6.10). Managerial capabilities reflected the strategic vision that the pivotal consumer base of the future was represented by the growing youth market. Here, tastes

could even be created by providing a constant stream of new artists and popular music forms, demanding a high degree of market responsiveness. Input-based capabilities comprised the company's roster of newly created and popular artists as a source of human capital, as well as its more tangible low-cost recording studio. The entrepreneurial management culture, the firm's talent discovery skills, and the label's emphasis on innovation in music encompassed the transformation-based capabilities. Output-based capabilities embodied company networks of both local radio stations and independent distributors, as well as the label's reputation for hot music.

Table 6.10: New Capabilities in the Mid-1950s

Managerial	Input-Based	Transformation	Output-Based
Upcoming popular youth market	Roster of unproven and popular artists	Artistic talent discovery and development	Distribution network of independents
Continuous generation of artists and music	Low-cost recording studios	Entrepreneurial management	Network of local radio contacts
High market responsiveness	All-round skills of owner-manager	Label culture of musical innovation	Label reputation

Once rival firms competed on the same competitive principles and capabilities, proliferation of these capabilities took place at three different levels of activity. First, record companies expanded their artist discovery activities to artist development via image building. Related to this was the further exploitation of artist promotion, where relationship networks were built with radio networks (surpassing local radio stations) and TV broadcasting corporations, to market artists' distinctive personality and style. Finally, record companies began to elaborate their A&R activities by incorporating growing A&R departments (instead of the more individually operating A&R persons that initially dominated the independent labels). The proliferation of capabilities was directed at the further cultivation of the growing youth segment that constituted an increasingly diverse popular music market.

THE FEDERAL SYSTEM

From now on, popular music and its main customer base, the youth segment, were key to a record company's success and survival. Spending money of younger generations increased as the wealth and economies of the Western industrialized world exploded during the sixties, while the youth's position as a social class was subject to a similar pattern of development. But whereas economic prosperity flared, the global political situation turned into a snowstorm. The cold war reached its zenith when JF Kennedy made Chroesjtsjov bow during the Cuban missile crisis and capitalism confronted communism in the bloody bushes of Vietnam. Many youngsters on the European and American continents expressed their doubts about the validity of the moral factors that lay behind this worldwide political turmoil. This heightened social awareness came to be manifested in anti-government demonstrations and protest marches.

Competition for Labels

Music turned out to be the perfect medium by which these thoughts and feelings, also known as flower power, were spread among young people. A host of new acts such as Jimi Hendrix, Janis Joplin and the Doors came to life that preached a new religion and propagated a more critical view of the world. This presented enormous opportunities for record companies in the increasingly expanding and demanding youth segment of the music market. The problem was that the message propagated in the music was not compatible with the younger public's view on large corporations in general, perceived to be the same sort of inhuman and power-oriented bureaucracies the government was believed to be. True record labels, the story went, were big in image but small in size. Traditional major record corporations such as RCA and Decca, which once dominated the industry through policies of structure and control, were definitely out of favor.

Their places had been taken in the early sixties by newcomers such as Motown and A&M, independent labels that had been able to manage their growth process in a prosperous way. But the most remarkable new entrant during the 1960s was Warner, a diversified firm that achieved success by introducing a new way to build and structure a record company organization. In 1958, the big movie corporation Warner Brothers had noticed the ease with which independent labels had ruined the dominance of the major record companies. As a consequence, it stepped into the lucrative record business by creating Warner Bros. Records, while Frank Sinatra's

Reprise Records was acquired in 1963. When Steve Ross, president of Kinney Corporation, gained financial control of Warner Seven Arts (the holding company), he reconfigured Warner's music assets, in the process acquiring three of America's most successful independent record labels (Sanjek, 1991). Between 1967 and 1973, Ross brought Atlantic, Elektra and Asylum into his Warner music company.

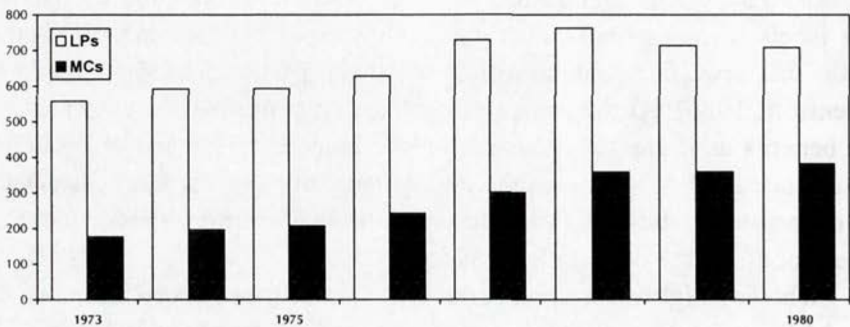
Instead of integrating these smaller companies into the Warner Bros. Records label, Steve Ross developed the 'label federation' concept, in which individual labels continued to operate in a relatively autonomous manner. Under the Warner umbrella, separate divisions were created according to music genre: middle-of-the-road (Warner and Reprise), rock (Elektra and Asylum), and R&B and soul (Atlantic). This formula enabled the labels to maintain their original innovative character in accordance with the specific characteristics of their particular target markets (Denisoff, 1986). At the same time, the parent company reaped synergistic benefits as it created a company-wide manufacturing and distribution setup called WEA. Although there was plenty of room for label managers to cooperate, in the end a climate of internal competition for the number one spot drove the corporation's success.

Whereas highly entrepreneurial and market-specific operations such as A&R, promotion and marketing were left to the distinct labels, the Warner corporation took care of the more administrative activities such as record manufacturing, finance and distribution to exploit economies of scale (Lopes, 1992). As the first record company with a multi-divisional organizational structure, Warner became the leader of the US record industry only ten years after its diversification into recorded music. Together with Columbia, it held a 15% market share in 1969, followed closely by Capitol (Peterson and Berger, 1975). Rank four and five in the \$1.6 billion market were taken by Motown and A&M, which had both managed to grow substantially without losing their feeling for the popular market. Especially Motown, with its impressive roster of black R&B artists, released numerous hits.

Opportunities for record firms to export their products at the international level increased during the early 1970s when a new sound carrier was introduced. Already in the late fifties, both RCA and Philips had experimented with tape cartridges. Although the record industry itself had been primarily concerned with tape's potential from a recording point of view (being the development of multi-track tape and equipment for engineering use in professional recording studios), this research was more in-

volved in the application of tape technology to the consumer market. RCA had started mass production of its system during the 1960s, but the target market responded merciless. Consumers experienced severe limitations in tape's recording possibilities, regarded the corresponding high-tech equipment as too complicated to operate, and missed a system for fast-playing the tape forward and back. RCA's new business venture came to be one of the biggest disappointments in the corporation's history, and was canceled in the early seventies (Jones, 1992).

Figure 6.7: Combined Unit Sales for Major World Markets (in Millions)



Source: Data comprised from Hung, M. and E. C. Morencos (1990), World Record Sales 1969-1990: A Statistical History of the World Recording Industry, *London: IFPI*

Dutch electronics firm Philips had considerably more success with its version of the tape cassette, which had initially been introduced in 1963. The equipment on which the cassette was played was easy to handle, while its compactness and the low price of tape were highly valued by its users. Sales experienced an explosive growth after 1969 when the Dolby noise reduction system was applied to tape decks and cassettes (Jones, 1992). During the seventies, ca-settes were sold in huge quantities to the youth market, not only because they could be listened to via car systems, but also because prerecorded tapes were considerably cheaper than records. Furthermore, these lower price levels triggered the development of new music markets in Asia and Africa where incomes were much lower compared to those in the Western industrialized countries (Shuker, 1994). Although cassettes were a direct substitute for records, worldwide sales of prerecorded music increased rapidly during the 1970s (see Figure 6.7 in combination with Table 6.11). Faced with such bright figures, the record

industry did not bother to pay much attention to tape's illegal copying possibilities.

Table 6.11: Individual Unit Sales in Major World Markets (in Millions)

Year	Am LP	Am MC	Eur LP	Eur MC	Jap LP	Jap MC
1972	n/a	n/a	152.8	27.0	n/a	n/a
1973	310.1	114.2	185.0	41.6	62.8	21.0
1974	308.0	122.8	216.6	54.8	67.0	19.2
1975	288.8	123.5	236.0	62.5	67.7	21.0
1976	311.9	145.1	240.2	72.1	75.7	25.3
1977	390.0	183.7	264.5	89.1	73.8	27.7
1978	395.2	217.8	292.3	103.7	74.4	37.2
1979	372.2	207.5	271.1	103.0	70.7	49.0
1980	375.2	212.0	260.2	106.4	72.4	64.0

Source: Data comprised from Hung, M. and E. G. Morencos (1990), World Record Sales 1969-1990: A Statistical History of the World Recording Industry, *London: IFPI*

Note: Am represents North American Unit Sales from Canada and the United States combined; Eur represents European Unit Sales from France, Germany, Italy and the United Kingdom combined; Jap stands for Japan.

The major record companies had other things on their mind. Warner, the new industry leader, became a role model as its rivals aimed to replicate its radically new organizational approach to the record business. Its method of divisionalization, further cultivated by the acquisition of independent record label Asylum in 1973, had enabled Warner to develop an impressive roster of successful rock acts and an extremely hip corporate image. In 1969, Columbia purchased Bell Records, renamed it Arista, and placed the label in a separate and semi-autonomous division. The Music Corporation of America (MCA), originally a talent agency, had stepped relatively unnoticed in the record business by creating its own label, and had in 1967 acquired Decca. Both CBS and MCA followed Warner's successful course of action during the early seventies, incorporating promising independent labels into their divisionalized structure (Lopes, 1992). As a consequence, the number of successful independent labels declined, while the US industry returned to an oligopolistic setting (see Table 6.12). But while all eyes were focused on Warner, an ambitious European record company began to strengthen its position on the US market.

Table 6.12: How Majors Regained Control of the Charts

Year	Singles			Albums		
	C4 Ratio	No. of Labels	No. of Firms	C4 Ratio	No. of Labels	No. of Firms
1965-1966	37.5	49.5	33.0	n/a	n/a	n/a
1967-1968	41.0	48.5	32.5	n/a	n/a	n/a
1969-1970	46.5	48.5	30.5	54.5	37.0	20.5
	(46.5)	(44.5)	(27.0)			
1971-1972	47.5	51.0	22.0	60.5	39.5	16.5
	(46.5)	(47.5)	(20.5)			
1973-1974	57.0	43.0	18.0	62.0	39.5	15.5
1975-1976	56.5	44.0	17.0	61.0	42.0	16.0
1977-1978	65.5	38.0	16.0	66.5	34.5	16.5
1979-1980	74.5	33.0	11.5	76.5	39.0	11.5

Source: Adapted from Lopes (1992) and Peterson and Berger (1975)

Note: Whereas Peterson and Berger (1975) investigated the presence of record companies in Billboard's weekly Top Ten list for singles in the popular music market, Lopes (1992) investigated the presence of record companies in Billboard's annual Top 100 for both singles and albums in the popular music market. Peterson and Berger's data have been put between brackets where the data of both works overlap in the singles columns.

Overproduction Tactics

After ten years of successful cooperation, Polydor (formerly Deutsche Grammophon and under the umbrella of German electronics manufacturer Siemens) and Phonogram (PPI, the original record division of Philips Electronics) restructured their operations and created PolyGram in 1972. The American record firm Mercury was acquired from Philips and got its own division within the new company. To expand its interest in the American record industry, PolyGram purchased RSO Records in 1975 and invested in Casablanca Records. With its newly formed organization, its novel American outlets, and subsidiaries all over the globe, PolyGram at once became the number one record company in the world. Together with EMI, which still benefited from its profitable Beatles contract, the incoming giant headed towards global sales over $1 billion in 1975 (Sanjek, 1991). For more than three decades, the world record industry had been dominated by American firms, but America's finest – CBS and

Warner – suddenly found themselves ranked three and four behind two European companies.

The main reasons for this shake-up lay in the differences between European and American majors regarding the development of distribution channels and international market presence. Except for the American market where both were dependent on the presence of Mercury and Capitol, PolyGram and EMI had created a strong distribution network over the world (Wallis and Malm, 1984). EMI was a direct descendant from British Gramophone, which already by 1910 had expanded through a large number of foreign subsidiaries. EMI had been able to maintain and expand its heritage, enabling the corporation to distribute products via its self-built channels. Over time, PolyGram had constructed a similar international distribution capability. Philips' global network of affiliates had enabled PolyGram to set up its own subsidiaries in a large amount of countries, through which it distributed its products. Apart from distribution, EMI and PolyGram were also heavily involved in local artist development (Laing, 1992).

American majors, however, operated on different principles, and the scope and nature of their international activities were much more limited. They were at the very start of creating their own subsidiaries in foreign countries, and exporting home-made records was more on their mind than the discovery and development of local talent. In most cases, American majors still distributed through local companies, cutting down operating expenses (Christianen, 1995). Although they had a presence in South America, the prevailing focus was on the main European music markets. Apart from their more limited international coverage, the Americans were also faced with an uncontrollable variety of distribution channels in the United States (Denisoff, 1986). Guided by the rise of the independents in the 1950s, multiple distribution channels and retail points had come into existence. Apart from specialized independent distribution companies, other players like the 'one-stop' and the 'rack jobber' had stepped in.

The one-stop's original objective had been to serve jukebox operators singles from a variety of record companies. But as the years passed, it expanded its influence and transformed into a wholesaler for individual retail shops. The rack jobber had started out by stocking records at discount chain stores, and gradually moved into drug stores, supermarkets and warehouses (Mittelsteadt and Stassen, 1994). Although the number of places where records could be consumed swelled, margins of American record companies dropped. This setback was a direct consequence of an

increase in bargaining power at distributors, which took no risk but cashed high profits (Denisoff, 1986). In effect, the American majors, with their limited international outlook, owned a big share of their home market but could not control its distribution channels. On the other hand, the European majors occupied only a modest portion of the US market but managed to compensate this shortcoming with a broad international presence where they did have control over distribution.

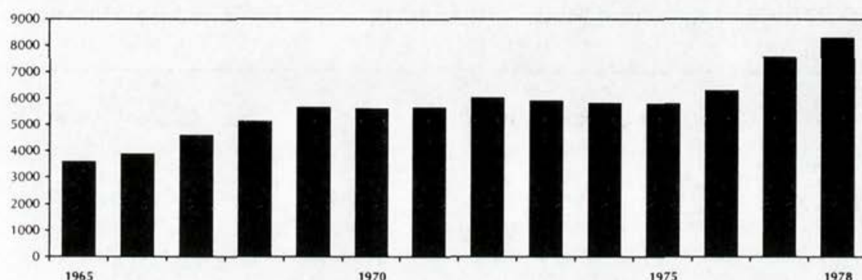
Another cost-inducing factor of distribution was related to record companies' focus on the LP as the main product for the popular music market, instead of the much smaller single (Lopes, 1992). This emphasis was closely tied to companies' aim in the mid-1970s to sell immense amounts of records of new and established star acts. The single evolved into a promotional tool, which was used to announce a new release of a star album and to boost its sales (Denisoff, 1986). Maximization of album sales became the prime objective, and it was in this era that new marketing and promotion tools such as cover graphics, radio and TV advertising, live concerts, press interviews and photo sessions were developed and refined (Frith, 1992). More and more, major record companies relied on their base of superstars such as Elton John, Paul McCartney and Stevie Wonder, whose new releases guaranteed sales of over one million copies even before being available at the retailer.

It has already been said in Chapter 1 that whereas the success of an established artist can be predicted without too much difficulty, forecasting whether a newcomer's album will be a hit is near to impossible in the record industry. This uncertainty has much to do with the continuous path of progression of the popular music market and the unmeasurability of what consumers like and dislike. During the 1970s, the majors started to cope with this market uncertainty by means of spreading their risks through what has become known as the 'buckshot theory of record releasing' (Denisoff, 1986). As the average chance of success for a newly developed act was even less than 10 percent, major corporations began to release an enormous amount of new products. The logic of this strategy of overproduction was grounded in two assumptions. First, the more records brought to the market, the higher the overall chances of coincidental success. Second, the more records produced, the higher the chances of recouping fixed costs efficiently (Hirsch, 1972).

But without established superstars, such a strategy of overproduction was not viable. Guaranteed sales of stars were necessary to cover the losses and make profits. In the meantime, numerous new releases of un-

known acts were thrown at the market and the inevitable accidental hits made money for the record company in times when superstars did not release new albums (Denisoff, 1986). This double-barreled strategy, implemented by all big record firms, of being on the safe side and drawing your lucky number, was at the time criticized for a lack of musical creativity and innovativeness. But that did not matter to the majors as the industry experienced a sales growth from $2.0 billion in 1973 to $4.1 billion in 1978 (see Figure 6.8 and Table 6.13). At the same time, such a strategy was extremely effective in curtailing majors' increasing cost base; apart from the voluminous marketing and promotion budgets primarily tied to superstar releases, costs involved in producing and recording albums had also raised significantly.

Figure 6.8: Constant Value of Music Sales in the 1960s and 1970s (in US $ Millions)



Source: See Appendix B

Whereas in previous times records were pressed immediately after music had been recorded, multi-track tape equipment made it possible to manipulate sounds and pay much more attention to the final result through editing and mixing. This made the specific sound of a record, and therefore the producer's role, much more important. As a consequence, the producer became a highly-paid professional, while recording time and costs increased significantly from the start of the seventies. At the time, recording and studio costs, including the producer's fee, were between $100,000 and $300,000 (Denisoff, 1986). In order to cut costs, the major record corporations began to outsource the recording process from staff producers to independent producers, which had created their own small companies. This policy matched the majors' cost-cutting strategy of which reliance on superstars and the system of overproduction were the fundamental components.

In a similar way, the major firms reorganized other functions. Corporate A&R departments were abandoned in line with new divisionalized organization structures. Responsibilities for fruitful A&R management were placed right down at the level of the various labels themselves, where the process of artist discovery and development originated. Furthermore, the majors got rid of their own recording studios to scoop the extreme costs of underutilization and maintenance. But they all knew that in order to upgrade profits, cutting costs was not enough. Sales had to increase as well, and the dual market strategy of star reliance coupled to overproduction was very effective in this respect. The American majors, however, recognized even more opportunities to enhance sales levels on an international level as they had noticed how EMI and PolyGram with their lower US market share had still managed to become the worldwide top-selling record firms.

Table 6.13: Current Value of Music Sales in the 1960s and 1970s (in US $ Millions)

Year	Current Value	Year	Current Value
1965	0862	1972	1924
1966	0959	1973	2001
1967	1173	1974	2186
1968	1358	1975	2378
1968	1586	1976	2732
1970	1660	1977	3501
1971	1744	1978	4131

Source: See Appendix B

With the cassette as medium, CBS and Warner started in the second half of the 1970s to open up new subsidiaries in the newly developed markets of Africa and Asia (Wallis and Malm, 1984). Although Warner and CBS followed the example set by EMI and PolyGram, little attention was paid to local artist development. Marketing American records was still the primary objective, but at least the significance of being present on an international level was finally recognized by the American giants. They had no other choice if they wanted to catch up with PolyGram and EMI, and in light of this goal CBS and Warner also altered the nature of their activities in Europe in these years. Next to selling US-based records, their European units became more and more involved with the develop-

ment of local acts and the creation of national artist rosters (Laing, 1992). Likewise, they built company-owned distribution channels in most of the countries on the European continent.

Foundation and Proliferation of Capabilities

At the end of the sixties, new capabilities were founded at the industry level that guided a new competitive doctrine introduced by Warner. Table 6.14 shows how these capabilities can be categorized into the familiar classes. First, managerial capabilities referred to the strategic knowledge underlying the federal system: a multi-divisional corporation that covered a multitude of taste markets through the incorporation of several labels. Input-based capabilities were represented by the individual labels that were acquired in the process, and by the corporate-level knowledge of how to create a diversified firm. Transformation-based capabilities embodied the innovative process through which individual labels maintained valuable autonomy with respect to A&R and marketing & promotion. In the same vein, a central administrative & finance department and a common manufacturing & distribution setup created synergies.

Table 6.14: New Capabilities in the Late 1960s

Managerial	Input-Based	Transformation	Output-Based
Multiple market coverage	Collection of acquired record labels	Label autonomy in A&R and marketing	High musical variety in album releases
Federal system of labels	Knowledge at corporate headquarters	Common administration and P&D setup	Popular corporate image

Finally, the output-based capabilities not only reflected physical outputs in the sense of increased musical variety in album releases, but also concerned the firm's hip corporate image. As rival companies such as CBS and MCA copied these capabilities, their behavior moved towards proliferation on three levels of activity. The initial idea of artist variety was exploited through a strategy of overproduction in which stars and unproven acts supported each other in terms of revenues. More elaborated marketing tools were developed to maximize album sales of superstars,

and involved an increase in promotional effectiveness and artist publicity via press, radio and television. The idea of a common distribution setup was further exploited on an international level as major record companies began to build multinational distribution channels through the launch of foreign subsidiaries.

THE SECOND DEPRESSION

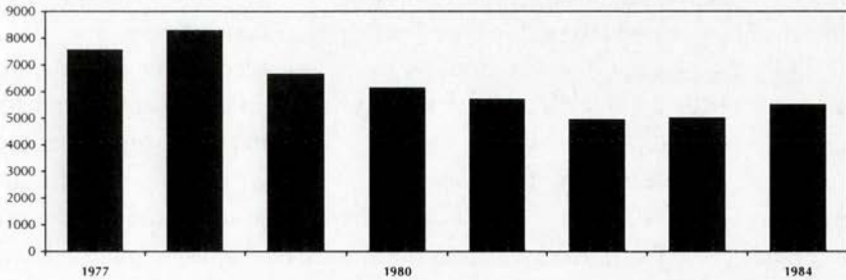
In 1978, the global record industry flourished like it had never done before. But this sunny situation was severely clouded when the industry went into a painful recession during the final months of 1979. The first indicator of this slump had been the divestment of underperforming record divisions by American movie corporations. Like Warner, they had stepped into the record business during the fifties, but had not been able to match its performance. In the beginning of 1979, EMI acquired United Artists Records for $3 million, while MCA purchased Paramount Records and a number of small labels, such as Dot and Blue Thumb, from ABC (Sanjek, 1991). Again, a European record corporation and a former independent managed to strengthen their position on the American market. Still, sales forecasts in those early months of 1979 were very dark, but record executives claimed that such a decline in sales would only last for a few months (Denisoff, 1986).

MTV and CD

As a matter of fact, the recession continued for more than two years. The major record firms were convinced that the music styles of the middle and late 1970s (punk, reggae and disco) would be of a lasting nature. But the market decided differently and sales tumbled between 1979 and 1983 (see Figure 6.9 and Table 6.15). In response, the major companies restructured their organizations: marketing and promotion budgets were minimized, new talent inflow came to a halt, and artist development was restricted. All remaining resources were directed at the cultivation of superstars (Denisoff, 1986). Thousands of employees, especially within A&R and marketing functions, were fired. The record companies directed their full attention towards the issue of home taping, which they claimed to be illegal and eating up their profits. Critics at the time claimed that major record companies should have been more involved with the future (that is,

new artist development) than with new legislation on home taping, on which record executives put the blame.

Figure 6.9: Constant Value of Music Sales in the 2nd Depression (in US $ Millions)



Source: See Appendix B

But there also was good news: in 1981, American Express and WCI created a joint venture called MTV, a new entertainment channel directed at the youth segment of television consumers. Because this new music television channel would depend on the supply of music videos from record companies for programming, the record industry had to be persuaded to provide videos without charge. Although MTV claimed itself a new promotional vehicle, which would therefore increase record sales, record firms at the time were not enthusiastic about providing the channel videos for free (Benjack and MacKeen, 1995). Their policies were directed at cost cutting, and investment in high-cost video production for an idea not yet proven was too risky. Some of the majors provided only a limited amount of their small stock of clips, while PolyGram and MCA even refused to supply any video clips. But in 1983, the major record companies reacted positively to market research results published by both MTV and *Billboard*, the American record industry's most influential trade journal, which supported the argument that television broadcasting of music videos increased record sales.

Realizing the new channel's powerful concept of combining sound and vision, majors began to produce video clips tied to new album releases, and agreed to provide MTV these videos without charge. The music channel proved to be a major promotion outlet like radio had always been (in that potential buyers were introduced to new and popular music), but MTV offered the added value of one channel covering millions of viewers (instead of a multitude of radio stations spread across the whole

country). The alternative way of promotion via MTV reduced its complexity, as a relationship with only one gatekeeper that covered a much larger consumer base was to be maintained. At another level, the production and consumption of videos became a substitution for the expensive touring through which acts had traditionally been exposed to the public. This enabled record firms to build an artist's image and introduce new acts within a time-bound period at far less costs (Denisoff, 1986).

MTV as an additional promotion channel enabled major record companies to better cope with the uncertainty of radio gatekeeping and the high costs of touring and image-building. Together with the benefit of additional sales revenues, these aspects of music television turned the production of music videos into a necessity for the majors. Furthermore, the ability of MTV to discover and build new emerging forms of music was appreciated by the record industry in the early eighties (Lopes, 1992). New styles of music such as new age and heavy metal were emphasized in MTV's playlists, and this benefited the record industry in its need for renewed consumer attention to climb out of the recession. And although there are still arguments that a clear and positive relationship between the airplay of music videos and record sales is debatable (Wallis and Malm, 1988), it is unquestionable that MTV did have a role in the resurrection of the industry (Denisoff, 1988; Banks, 1998).

Table 6.15: Current Value of Music Sales in the 2nd Depression (in US $ Millions)

Year	Current Value	Year	Current Value
1977	3500.8	1981	3969.9
1978	4131.4	1982	3641.6
1979	3685.4	1983	3814.3
1980	3862.1	1984	4370.4

Source: See Appendix B

Another development that revived consumer interest into music came right out of the R&D laboratories of Philips. Upon the discovery that digital coding of sound leads to greater accuracy and flexibility in its reproduction, a small group of researchers created the compact disc. The Philips board realized that this new digital technology was superior to existing ones, and rallied forces with Sony to market the product effectively

to the consumer. Philips' strong technological knowledge proved highly complementary to Sony's distinctive marketing competences, and the alliance was a success. The combination sacrificed its monopoly position to gain widespread acceptance of its standard by making the new technology available to other major electronics manufacturers via licensing contracts (McGinn and Nordsten, 1995). Still, the system would not sell unless a minimum amount of music software would be available on the CD format, so Philips and Sony turned their attention to the music industry.

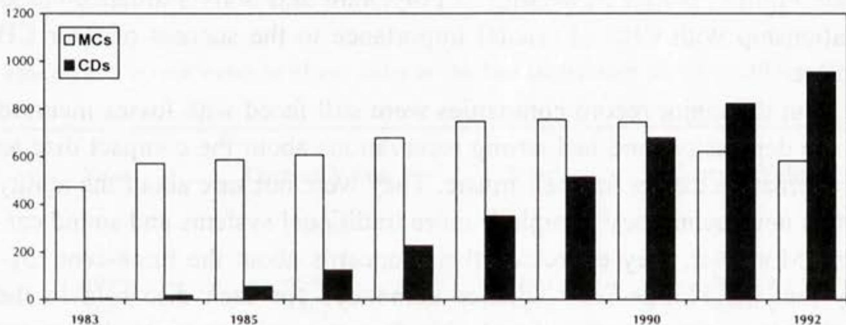
In their effort to convince the major record companies to adopt the CD system, Philips and Sony came up with at least four advantages of the CD over the traditional LP and cassette. First, as nothing in the CD player actually touches the surface of the disc, dust, scratches and grease cause almost no distortion, which would make it friendly to users. Also, when playing the compact disc, a maximum amount of fidelity in reproduction is achieved, which would increase listening pleasure. Furthermore, its compactness would make it easy to handle, minimize storage space at the consumer's home, and optimize efficient distribution for record companies. Finally, the CD's small size facilitated listening to music via a portable player or a car system (Burnett, 1996). It was mandatory that at least two majors would adopt the CD standard for the others to follow, and this made Philips' partial ownership of PolyGram and Sony's alliance-based relationship with CBS of crucial importance to the success of their CD project.

But the major record companies were still faced with losses incurred by the depression, and had strong reservations about the compact disc as an alternative carrier for their music. They were not sure about the ability of this new technology to replace more traditional systems and sound carriers. Moreover, they expressed their concerns about the three-cent royalty that the Philips-Sony alliance demanded for each disc sold in the marketplace. On the other hand, this format would undoubtedly renew consumer interest in music. Moreover, majors were especially charmed by the argument that the highly advanced nature of CD technology would undermine possible illegal copying activities. In the end, the compact disc was launched in 1983, and got the full support of all major record companies. In 1991, more than one billion CD players had been sold worldwide, while almost the same amount of CDs was sold in that year only (McGinn and Nordsten, 1995).

THE SHIFT TO RIGHTS

Although CD sales were still modest compared to LP and cassette sales, it was clear to the major record companies in the early eighties that compact discs would be far more profitable in terms of margins. Without much difference in cost base, the CD had been priced fairly high: consumers had to pay an amount of money that doubled the price of an LP, and even tripled the expenditure on a cassette. Record companies reasoned that if they could maintain this price setting, and if indications on the eventual adoption of the CD were true, the record business would experience a profitable era in the near future. Indeed, a growing number of consumers became convinced that the CD's advantages over traditional systems were numerous, and that the compact disc was not a new fad in consumer electronics. Furthermore, average market prices of CD players decreased as more and cheaper equipment was introduced on the consumer market by electronic manufacturers that had licensed the CD technology from Philips and Sony.

Figure 6.10: Combined Unit Sales for Major World Markets (in Millions)



Source: Data comprised from Hung, M. and E. C. Morencos (1990), World Record Sales 1969-1990: A Statistical History of the World Recording Industry, *London: IFPI, in combination with IFPI (1996),* The Recording Industry in Numbers 1991-1995, *London: IFPI*

Competition for Catalogues

The incentive to buy a CD player was also reinforced by the increasing availability of music on compact disc, as the record industry had made a commitment to release new albums in the near future on the new carrier.

As a consequence, increasing amounts of consumers substituted their old record players for CD equipment and expanded their collection of compact discs (see Figure 6.10). The speed with which this replacement took place varied across continents, as Table 6.16 shows. In Japan, where customers tend to have a traditional eagerness to adopt the latest technology, the new digital format became the primary medium for prerecorded music in 1988. In Western Europe, unit sales of CDs surpassed those of LPs in 1990. The inevitable replacement of vinyl for compact discs showed a similar pattern of development in the United States, but it took the CD another two years to overthrow the cassette's traditional strong position.

Table 6.16: Individual Unit Sales in Major World Markets (in Millions)

Year	Am MC	Am CD	Eur MC	Eur CD	Jap MC	Jap CD
1983	270.4	0.8	124.2	2.0	78.2	1.5
1984	373.4	6.3	132.1	6.0	66.3	5.1
1985	380.2	23.9	148.6	14.7	59.6	16.5
1986	388.8	56.3	163.0	33.1	56.7	36.1
1987	441.5	108.3	177.9	66.8	59.9	52.0
1988	484.5	158.6	199.3	119.2	63.9	72.0
1989	482.4	219.1	213.0	177.2	60.4	117.1
1990	473.6	302.4	224.9	238.4	46.2	138.1
1991	392.3	360.1	210.1	291.0	19.4	171.8
1992	395.9	440.4	170.5	331.7	16.2	181.8

Source: Data comprised from Hung, M. and E. G. Morencos (1990), World Record Sales 1969-1990: A Statistical History of the World Recording Industry, *London: IFPI, in combination with IFPI (1996),* The Recording Industry in Numbers 1991-1995, *London: IFPI*

Note: Am represents North American Unit Sales from Canada and the United States combined; Eur represents European Unit Sales from France, Germany, Italy, the Netherlands and the United Kingdom combined; Jap stands for Japan.

As consumer adoption of the compact disc was secured in the world's main music markets, the major record companies rested on their laurels. Whereas prices for CD players fell rapidly, enabling the average customer to buy this new audio equipment, the record industry maintained its original price levels for the compact disc (Burnett, 1996). Prices were not lowered and still doubled those of LP prices, while incremental innovations in digital technology resulted in cost improvements in the manufacturing process of CDs. Furthermore, the new format's compactness and solidity

made larger and easier shipping possible, cutting distribution costs. Although recording costs rose slightly during the mid-1980s, profits on compact discs were considerably higher than profit margins on LPs and cassettes had ever been. And as long as consumers believed that the higher price was worth the increase in quality of sound, record companies had no intention to change their price policy.

But there were yet even greater benefits to be reaped from the substitution of the traditional carriers by the CD. Many consumers that had made the step from vinyl to plastic were proprietors of large album collections. Pleased with the enhanced quality of the CD system, these consumers replaced their existing LP collections with a new assortment of compact discs. This demand for old music on new material was quickly recognized by the major record companies, which re-released their existing catalogue on CD. In this way, they not only benefited from sales of old repertoire, but also profited from a revival of this music among new generations of consumers. Without any investments in A&R and recording, major record firms made big money on long-dead artists like Jimi Hendrix, Elvis Presley and Jim Morrison that were now selling millions of records across the globe (Burnett, 1996).

The enthusiasm with which consumers purchased CDs containing 'old' music material made the major record companies aware of the importance of owning a large inventory of music from the past. This was tied to the fact that ownership of the rights connected to a particular piece of music automatically gives the controlling owner the right to release it. The arrival of the CD had shown the record industry that, apart from physical unit sales, there was yet another, and possibly even more important, source of income attached to the creation of music. In the mid-1980s, record companies started to realize that their business was involved in a shift from the physical manufacturing and distribution of music products to the exploitation of copyrights attached to those recordings (Qualen, 1985). Revenues could not only be generated through sales of music released on a particular format, but could also be collected by exploiting the rights connected to that piece of music.

Inspired by rising sales and bright forecasts, the major record firms looked for new avenues to exploit their rights on a larger scale. During the recession years, most of them had neglected or even terminated international operations in countries outside of Europe and America. As the future looked promising once more, opportunities for foreign investment were reconsidered, although not all majors followed this route of interna-

tionalization. EMI was hampered by major debts incurred when the company had been acquired by the British electronics corporation Thorn in 1980. RCA, at one time the biggest record company in the world, did not have any interests in what was going on outside of the US at all. Still, the other majors did recognize the importance of reinforcing their worldwide presence: PolyGram extended its already impressive multinational setup, while Warner and CBS enhanced their European organizations, as they became involved in local artist development, and launched new affiliates in other parts of the world (Wallis and Malm, 1984).

Their expansion of international operations intensified the majors' international approach to the music market. An international structure of operating companies made local artist development possible, while multinational distribution networks supported the release of records on as much markets as possible. Moreover, the major companies could cultivate their existing catalogues in new countries to new consumers. But there was another effect that turned their world-covering distribution networks into a highly valuable asset. In a way, these global distribution webs partially tackled major record corporations' inability to cope with new and promising music since the late 1970s, as they enabled access to the independent record labels that had traditionally been the experts on this matter. As both majors and independents needed each others' expertise, they started to approach one another in a symbiotic way (Hellman, 1983).

As mentioned, major record firms had exploited the double-barreled strategy of overproduction and superstar reliance during the seventies. But when the recession hit the industry, large amounts of creative staff were dismissed, and artist rosters were drastically cut. Majors only maintained contracts with big names and a few promising acts. In contrast, the main body of the artist rosters – consisting of artists who had not proven themselves yet or had signed up shortly before – was laid off, and this left the amount of contracted acts as small as 10 percent from the original rosters (Denisoff, 1986). The notion of overproduction lost its meaning in this adapted strategy, in which there was little to no room for investment in new artist development. As a consequence, the major record corporations primarily relied on superstars such as Michael Jackson and Prince, who recorded million-selling albums and were proven global celebrities.

Although independents had not been immune to the drop in consumer interest into music, the depression had hurt the major corporations more. Their entrepreneurial approach, market orientation and small size made independent record companies much more flexible in searching for ways

to survive. While the majors had focused their attention and resources on established superstars, independent companies achieved success by discovering new acts and music styles (Sanjek, 1991). Some of them, like Motown or A&M, had been around since the mid-fifties, but the most successful independents of the early eighties had established themselves in the industry during the mid-seventies. Guided by men like Chris Blackwell, Richard Branson and David Geffen, independent record labels such as Island, Virgin and Geffen combined an entrepreneurial vision and an intricate knowledge of the industry into a successful business concept. While majors took no risks in those early years of the 1980s, these labels signed up progressive rock artists that sold impressive amounts of albums and perfectly suited the innovative playlists of MTV.

However, these (and other) successful independents lacked the financial assets needed to make the video clips MTV wanted (Lopes, 1992). The creation of a video clip was an activity that consumed considerable amounts of money; thousands of dollars were needed to hire directors, equipment, actors, technicians and facilities necessary for an average clip. As independents used the revenues from successful releases to keep new talent development activities going, expensive videos were difficult to make. Another problem for independents was the absence of a company-owned distribution channel (Denisoff, 1986). Traditionally, most independents closed a deal with an independent distributor in their home base, but faced strong obstacles with respect to international distribution. Establishing agreements with individual distributors in foreign countries was a time-consuming and expensive process as different distribution companies operated in different national markets.

But as independent labels achieved international success, it became very attractive to hook up with a major record corporation that controlled a multinational distribution network and had deep pockets. Indeed, many of the successful independents closed distribution and video production agreements with a major in the early and mid-1980s (Lopes, 1992). Their records could now be sold more efficiently on an international level through the major distributor (saving time and money), while access was gained to financial resources for music video production. Evidently, these agreements were mutually beneficial: majors not only enlarged their share of worldwide record distribution at the cost of local independent distributors, but also enjoyed economies of scale in their distribution operations (Lopes, 1992). Furthermore, majors were now able to better follow new

promising acts and music styles by monitoring the products of independents in their channels (Hellman, 1983).

Multimedia Developments

For more than half a century, record companies had been convinced that making profits had primarily been a matter of delivering a maximum amount of tangible products to the consumer market. Their strategies had focused on market share growth, while the definition of markets had over time evolved in the mass consumption of prerecorded material. But during the 1980s, this notion radically changed when record companies became increasingly aware of the expanding possibilities surrounding the exploitation of their copyrights. Imagine that a record company has contracted a global celebrity. This person could write his or her memoirs, published in a biography. Such a book is turned into a film accompanied by a soundtrack. The film can be promoted on various TV channels and, later on, be issued on video. Furthermore, international advertisers and magazines might also want to profit from the movie's success, displaying the star in marketing campaigns and on front covers.

During the second half of the eighties, record companies therefore jumped into the business of music publishing, concerned with the development and cultivation of composed music material. Publishing is a very profitable business: there are virtually no production costs, while revenues can mount to almost half of the performance fees and incomes generated for the composer. Most of the major record companies already owned separate music publishing departments to integrate recording and publishing agreements into a single contract for artists that composed their own music (Wallis and Malm, 1984). Still, before the eighties, many artists signed up with independent music publishers. As the majors recognized the significance of a large back catalogue, they turned their attention to these independent publishing companies. They began to purchase small and local publishing companies, and at the same time acquired large and internationally operating publishing houses (Burnett, 1996).

PolyGram, which deeply regretted its 1984 disposal of Chappel and Intersong, invested more than $100 million to create a new publishing division called PolyGram Music only three years later. In 1987, Warner acquired Chappel and merged it with its own publishing unit into what would become the largest publishing company in the world: Warner-Chappel Music. In 1989, an amount of $40 million was involved when CBS acquired America's oldest music publishing house Big Tree. EMI, at

last free from its post-merger restrictions since its integration in the Thorn conglomerate, paid more than $300 million for the 250,000 songs of the SBK publishing company. Building a catalogue was a priority for major record companies in the second half of the eighties, and these examples represent only the big take-overs of that time (see Table 6.17). According to the NMPA, music publishing revenues on the world-wide level had grown 10% a year from 1982 onwards to more than $3.5 billion by 1990, more than 20% of which was accounted for by the US. Both the increase in acquisitions and publishing revenues indicated the strategic importance of music publishing to the record industry.

Table 6.17: Prominent Music Publishing Acquisitions

Major Purchaser	Publishing Company	Year of Takeover
BMG-RCA	Doubleday	1986
	Dell	1986
	Lodge Hall/Milsap	1989
Sony-CBS	Blackrock	1987
	Big Tree International	1989
	Conway Twitty	1990
EMI	SBK Entertainment	1989
	Combine Music	1989
	Filmtrax	1990
MCA	Mayday Mediarts Music	1989
PolyGram	Musiplex	1987
	Lawrençe Welk Music Group	1988
	Sweden Music AB/Polar Music	1989
Warner	Chappell Music Group	1987
	Mighty Tree Music Group	1990

Source: NMPA

The sudden emphasis on this secondary source of income also changed record companies' attitude towards the value of television broadcasting (Malm and Wallis, 1992). Deregulation of the telecommunication industries spurred the growth of cable companies, satellite channels and network TV, which enlarged the role of advertisers in the TV broadcasting industry (Malm and Wallis, 1992). By the end of the eighties, the

number of commercial television channels – depending in their operations on advertising revenues – had grown dramatically. To global advertisers, MTV Networks was an attractive outlet as it reached large audiences in the United States and Western Europe, which together represented the world's richest consumer base. Youth-oriented corporations like Levi's, Coca-Cola, Benetton and Nestlé therefore invested heavily in American-wide and pan-European marketing campaigns for MTV (Wallis and Malm, 1988). In order to make them successful, an international and multi-cultural element was added to these campaigns. Because music is a true global language, these giant consumer corporations used hits from the past for the promotion of their products on (M)TV.

These commercials often resulted in the return of a particular track to the hit parade (increasing direct album sales), as the ads were also shown on non-music television channels. As a result, record companies' income through rights collection strongly increased, further emphasizing the significance of these secondary revenues (Malm and Wallis, 1992). Increasingly, record firms were spotting new opportunities to license their music to a variety of outlets. For example, Hollywood's major movie production companies increased their use of prerecorded music when they noticed that musical celebrities drew more audience to their movies. In return, record companies profited from an act's exposure as the film's success increased sales of its soundtrack. The exploitation of rights across various forms of media turned into a very profitable business; revenues not only increased through direct sales of tangible products, but also through the indirect route of intangible copyrights.

Table 6.18: Current Value of Music Sales in the 1980s (in US $ Millions)

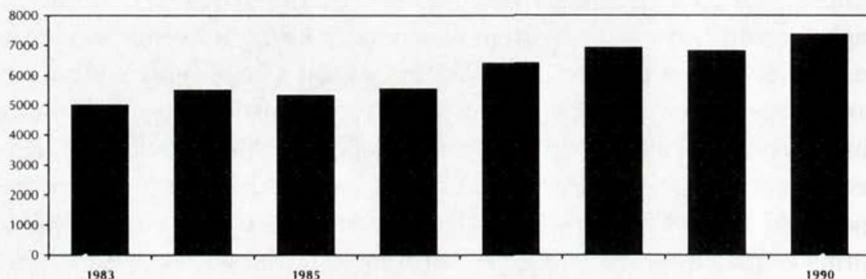
Year	Current Value	Year	Current Value
1983	3814.3	1987	5567.5
1984	4370.4	1988	6254.8
1985	4387.8	1989	6464.1
1986	4651.1	1990	7368.8

Source: See Appendix B

Company revenues were increasingly generated through licensing fees retrieved from a variety of other media companies that sold books,

magazines, videos, movie tickets and other consumer products. However, the opportunities to cultivate rights across a wide range of media did not escape the attention of corporations operating in other entertainment industries. These firms recognized the central role of music within different forms of entertainment, and were not only attracted by the increase in music sales (see Figure 6.11 and Table 6.18), but also by music's potential to link these segments in a synergistic way (Turow, 1992). As a consequence, the record industry was hit by a wave of mergers and acquisitions during the second half of the 1980s. Ownership structures within the music industry changed radically as major record companies came under the control of multinational corporations that operated in the multi-media & publishing and consumer electronics industries.

Figure 6.11: Constant Value of Music Sales in the 1980s (in US $ Millions)



Source: See Appendix B

In 1986, media conglomerate Bertelsmann AG became a major player in the global record industry when it made a move on the American music market. During the seventies, the German corporation had already operated on a modest scale in the record business through its local label Ariola, and in 1979 the company had gained a majority interest in Arista, an American independent. But now the big step into music for Bertelsmann was made with the acquisition of publishing companies Doubleday and Dell, and the purchase of RCA Records, reorganizing all its music assets into the Bertelsmann Music Group (Hill and Weber, 1993). The $300 million purchase of RCA turned Bertelsmann into the largest media conglomerate in the world. But only three years later, the American corporations Time/Life and Warner Communications merged, overtaking Bertelsmann's leadership. At the time, the rationale underlying this big

multi-media merger was stated in terms of synergies to be achieved from the simultaneous ownership of different media (Burnett, 1996).

In an effort to cope with its poor financial situation at the time, PolyGram had in 1984 planned a full merger with Warner to create what would have been the largest record company in the world. At the time, PolyGram faced heavy losses in the United States, and would have greatly benefited from a union with Warner. However, the US Federal Trade Commission ruled against the PolyGram-Warner combination because its position would be too dominant on the American market (Sanjek, 1991). Still, electronics manufacturer Philips regarded its stake in PolyGram as highly essential to keep abreast of developments in software, and purchased Siemens' 50% ownership of PolyGram through a series of stock transfers in 1985 and 1987. Like Philips, its former partner Sony was convinced that a successful launch of new consumer electronics in the future would only succeed if supported by the availability of software. The Japanese electronics company thus acquired CBS Records in 1988 for $2 billion, while another $3.4 billion was spent in the purchase of film company Columbia Pictures in 1989 (Malnight and Yoshino, 1990).

Matsushita, which had won the VCR but lost the CD standardization struggle, shared Sony's feelings on the significance of owning a strategic software package. As the world's largest consumer electronics corporation, Matsushita could afford to spend $6 billion on the 1990 acquisition of the MCA entertainment company. This gave the Japanese giant control of a significant software package of US-based film and music, as it not only retrieved access to MCA's film division Universal Pictures, but also got hold of MCA Records. Although one could hardly call MCA's record division a major company at the international level, it held a fair share of the American market for prerecorded music and, moreover, owned a large catalogue of titles. MCA's healthy progress over the second half of the 1980s had culminated in the 1990 purchase of Geffen Records, home to successful acts like Nirvana and Guns'n'Roses, for $550 million (Rayport and Peralta, 1995).

Within a period of five years, the record industry's formal ownership structure had changed dramatically. Whereas the music business had traditionally been an affair dominated by American companies and (more recently) a few European firms, these changes in formal control turned the industry into a more international one. At the start of the 1990s, six major companies dominated almost 80% of the worldwide record industry. Only Warner Music was still American-owned, while CBS and MCA had been

incorporated by Japanese conglomerates. As for Europe, EMI, PolyGram and RCA were owned by Thorn (UK), Philips (the Netherlands) and Bertelsmann (Germany) respectively. Furthermore, the record industry became firmly integrated in two related industries. While Warner and RCA were part of publishing and media conglomerates (Time-Warner and Bertelsmann), the consumer electronics companies Thorn, Philips, Matsushita and Sony were in control of EMI, PolyGram, MCA and Columbia.

Foundation and Proliferation of Capabilities

Table 6.19 shows the collection of capabilities, categorized in four types, which were founded when the industry's rules of competition shifted once again during the mid-1980s. Managerial-based capabilities referred to the strategic knowledge that the cultivation of musical property rights could well be even more important than the generation of revenues via sales of physical recordings. Consumers became multiple-time buyers of the same piece of music over time, and this made it crucial for record companies to be in command of its property rights. Input-based capabilities covered physical assets such as distribution networks and CD manufacturing plants that supported the widespread cultivation of record catalogues (the record company's organizational capital). Transformation-based capabilities embodied the innovative process through which majors and independents cooperated in a symbiotic way to unite different parts of the value chain, and to disperse both established and unproven acts or music styles.

Table 6.19: New Capabilities in the Mid-1980s

Managerial	Input-Based	Transformation	Output-Based
Cultivation of musical property rights	Multinational distribution networks	Cooperative combination of value chain parts	Expansion of record catalogues
Multiple-time buyers of piece of music	Scale-based CD manufacturing plants	Specialized popular and alternative artist building	Network of deals with independents

As a result, record companies' output-based capabilities covered the rights that were created in the processes of alternative and popular artist development, as well as the (majors' networks of) licensing agreements, manufacturing & distribution deals, and video production contracts. Although the data does not reveal whether one firm in particular introduced these new competitive rules and capabilities, it does show how capabilities were proliferated in three activity areas. Artist development became more and more directed towards the creation of global superstars that were involved in other forms of entertainment besides music. Relatedly, marketing and promotion of artists turned into a multi-media exercise to exploit musical property rights via an increasing variety of outlets. Furthermore, record companies transformed into music companies as they became heavily involved in publishing, the trade of which had traditionally been separated from the recording business.

SUMMARY

The history of the music industry demonstrates how record companies' search for new capabilities at the industry level was embedded in the dynamics of competition. In the early years of this century, the struggle for technological superiority between the disc and cylinder systems dominated rival behavior. Not long after the disc technology was accepted as the standard, the essence of competition shifted towards selling recordings instead of gramophone cabinets in the mid-1910s. After the depression, competition was based on the idea of mass consumerism, where the star system allowed for bigger margins and culminated into a dominant market position of four major companies just after WWII. But this spell was broken during the mid-1950s as the principle of rivalry shifted from mass marketing established stars to discovering and developing new acts and music styles. From the late 1960s on, the competitive rules were based upon the organizational method of the multi-label federation, while the market was invaded by foreign rivals. After the second depression of the early eighties, the focus on musical property rights in a multi-media world underlined the next competitive doctrine.

Table 6.20 displays these various competitive regimes that mark the industry's evolution, along with their particulars in terms of products, markets, technologies and primary organizational processes. The table thus shows how shifts in the competitive rules embodied changes in the character of core products and consumer markets, and reflected different

points of value creation within rival firms' organizations. The table also lists the various industry-specific technologies developed and employed during each competitive regime. Other technologies originating from outside the boundaries of the record industry appear to also have played a role in the competitive process. As TV replaced radio in the early fifties, the rejuvenation of local radio stations presented an opportunity to independent labels. At a later stage, television became an important channel of promotion to the industry for the creation of artist images. Radio was also important in the development of newly-created stars during the late thirties, but at the same time had been a threat to the industry when the Great Depression induced music consumers to look for alternative forms of entertainment.

Table 6.20: Competitive Regimes in the Music Industry

	Basic Product	Target Market	Company Value Point	Carrier Technology
Technology logic (early 1900s)	Gramophone cabinets	Market for home entertainment	Separate recording and manufacturing	Disc system
Software shift (mid 1910s)	Gramophone records	Market for musical variety	Batch-based capacity production	–
Star system (mid 1930s)	Music recorded by celebrity artists	Market for mass entertainment	Scale-based marketing and distribution	–
Alternative music (mid 1950s)	Music recorded by alternative artists	Youth market segments	A&R integrated with flexible distribution	Vinyl record Tape recording
Federal system (late 1960s)	Music as social awareness	Multi-market segments	Label autonomy and HQ control	Tape cassette
Rights shift (mid 1980s)	Music as property right	Global multimedia markets	Chain cooperation and publishing	Compact disc

Obviously, both economic depressions had a negative impact on the industry's performance, like the Second World War had a positive impact

on the position of US-based music on international markets. While it was theorized in Chapter 3 that industry evolution is endogenous in nature because of competitive dynamics, it is clear that the evolution of the music industry has also been affected by some exogenous developments. Still, the data strongly support the notion that competition and capabilities coevolve as competitive interactions shaped the foundation and proliferation of capabilities during competitive regimes. The various tables shown at the end of each regime throughout this chapter displayed the foundation of capabilities in terms of the general distinction between managerial, input-, transformation- and output-based capabilities. They made it clear that a change in the rules of competition was based on a radically new bundle of capabilities founded at the industry level.

Table 6.21: Proliferation of Capabilities

	Input-Market Activities	Output-Market Activities	Organizational Design
Technology logic	–	–	–
Software shift	From theater artists to anonymous performers	From standard cabinets to target models	From technology start-up to record company
Star system	From contracting artists to developing stars	From billboard to radio and movie promotion	From small company to corporate bureaucracy
Alternative music	From artist discovery to image building	From local to network radio & TV promotion	From A&R individuals to A&R departments
Federal system	From artist variety to overproduction	From sales promotion to elaborated marketing	From multiple labels to foreign subsidiaries
Rights shift	From music artists to entertainment stars	From local to global multi-media networks	From record company to music company

While in two out of six competitive regimes the data did not enable a positive identification of the strategic innovator – the company responsible for the introduction of the new capabilities to the industry – it was clear that capabilities were proliferated at the industry level in at least five

regimes.[1] Table 6.21 summarizes the proliferation of capabilities as happened in each of the competitive regimes of the record industry's evolution. It shows how this process took place in terms of distinct activities that link a record company to (1) the creative community from which it extracts artists, and (2) the consumer market where music is actually sold. In essence, these input- and output-based activities further exploited record companies' capabilities in artist strategies and marketing & promotion policies respectively, and were framed within a competitive regime's existing doctrine. Further changes in the organizational context supported or facilitated the proliferation of capabilities in distinct input- and output-market activities.

This chapter has narrated how, at the industry level, capabilities were founded and proliferated during the dynamics of competition which, to a large degree, shaped the music industry's evolution. Still, this first part of the empirical study into the record business has primarily stressed arising similarities between record companies as the competitive process unfolded, rather than the more fine-grained differences between them. The force of imitation made individual firms more uniform as to the capabilities required to compete effectively in the industry, but potential differences in the way by which record companies managed this process of replication were not discovered. The next chapter, in contrast, aims to deal with the latter issue, and narrates how individual firms created and refined capabilities during one particular competitive regime in the nineties. In other words, it studies (differences in) firm behavior in a context in which the rather abstract notion of competition becomes explicit in terms of manipulation and adaptation.

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[1] As mentioned in the course of this chapter, Victor, Decca, Atlantic and Warner were the strategic innovators in the early 1900s, mid 1930s, mid 1950s and late 1960s respectively.

CHAPTER 7

Coevolution at the Firm Level:
A Multiple-Case Study of Record Companies

IFPI figures display how worldwide music sales almost doubled from $12.25 billion in 1985 to $24.10 billion in 1990. As said, the sustained price setting of the compact disc and the increasing returns on musical property rights had made giant multi-media and consumer-electronics corporations aware of music's value to other entertainment products. They had expanded or seized ownership control of the six dominant players in the music industry, which were increasingly relying on back catalogue sales. They had cut into their artist rosters during the recession of the early eighties, but the rise in revenues had reduced the need for a move back to strong A&R policies like some of the more prominent independents had done. To make up for this detriment and, moreover, to gain control over the rights attached to rich catalogues, the majors turned their attention to these successful independent labels. Appendix C lists some of these acquisitions, such as the purchase of the American labels Geffen and Motown by MCA and PolyGram respectively. Yet, the most dramatic of these acquisitions took place in the UK.

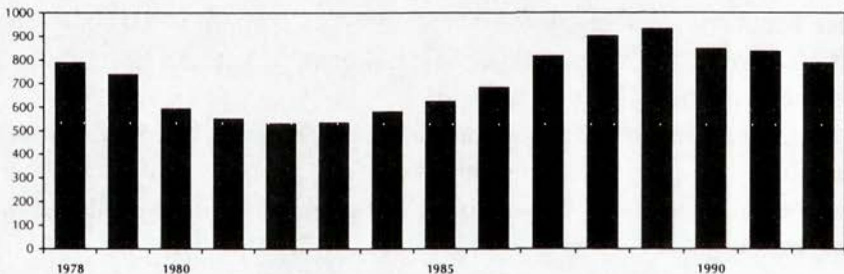
It is this specific part of the music industry that is the focus of investigation in this second empirical chapter. Here, a longitudinal study is presented that covers an eight-year period of coevolution of capabilities and competition in the British music industry. It describes and analyzes coevolution from a firm level perspective, in that it stresses differences in how record companies created and refined capabilities during a particular competitive regime in which the rules of the game were again redefined. In line with the methodological guidelines discussed in Chapter 5, a 'three-dimensional' analysis of the context, content and process tied to organizational change at seven record companies is performed. This inquiry into how individual firms search for capabilities as they adapt to (or even manipulate) their competitive environment is embedded in a pano-

ramic account of the competitive dynamics that shaped the UK industry during the period 1990-1997. To put things into perspective, this chapter commences with a brisk retrospect of the UK industry's development.

TOWARDS A NEW COMPETITIVE REGIME

During the second half of the sixties, the British record industry emerged as one of the major sources of repertoire in the worldwide music market when UK artists achieved international success. Starting with the Beatles, and followed by acts like the Rolling Stones and Led Zeppelin, British artists sold substantial amounts of records in the United States and on the European continent. This not only established Anglo-Saxon repertoire as the prominent source of music for the Western world in those years, but also made major record companies aware of the value of developing British talent and music. The positions of PolyGram and British EMI, based on a strong presence in British classical music, were eroded by the entrance of American majors CBS and Warner in 1965 and 1970 respectively. Although sales increased during the seventies, the UK industry's growth was halted by the same recession of the early eighties that had also affected the American record business.

Figure 7.1: Constant Value of UK Music Sales at 1997 Prices (in UK £ millions)



Source: BPI Statistical Handbook 1998

Figure 7.1 shows the (constant) sales values experienced by the British record industry from 1978 to 1992. A similar pattern is noticeable when compared to that of the US industry (as discussed in the previous chapter on how developments in the music business became more global in character during the 1980s). Indeed, prominent independents such as

Island and Virgin had engaged in manufacturing and distribution deals with BMG and PolyGram, and the average combined major distribution market share (representing BMG, EMI, PolyGram, Warner and Sony) over the period 1984-1990 was 82.8% (see Table 7.1). Like its American counterpart, most of the new music introduced to the UK market sprang from the musically innovative behavior of independent labels, whereas the major record companies focused on the cultivation of superstars and existing catalogues. This was reflected in a relatively modest combined market share that averaged 62% during those same years.

Table 7.1: Market Shares of Majors and Independents

Year	Majors: Record Company	Majors: Distribution	Indies: Record Company	Indies: Distribution
1984	60.4	84.3	39.6	15.7
1985	60.5	83.1	39.5	16.9
1986	62.3	85.5	37.7	14.5
1987	62.8	86.2	37.2	13.8
1988	60.9	83.1	39.1	16.9
1989	61.0	83.1	39.0	16.9
1990	66.3	84.6	33.7	15.4
1991	66.4	85.5	33.6	14.5
1992	72.8	83.6	27.2	16.4

Source: Compiled from data displayed in BPI Statistical Handbook 1995

Note: Both record company and distribution shares involve the market for albums.

Table 7.2 displays some of the record labels that were founded in this period of musical innovation, which indicates the independent sector's health during those years. On the surface, the division of labor between A&R-oriented independent labels and majors specialized in manufacturing and distribution proved fruitful to the industry. Figure 7.2 presents how British music sales more than doubled between 1985 and 1988 to almost $2 billion. In addition, the UK industry experienced an average growth rate of over 31% during the same period. This expansion made it the best performing national music market of the Top Four major world markets, surpassing that of the United States, Japan and Germany (see Table 7.3). But the data also show a sudden halt to the UK industry's suc-

cessful path of development, and Figure 7.1 visualizes how sales actually declined during the start of the nineties.[1]

Table 7.2: Prominent Independent Labels Founded in the Eighties

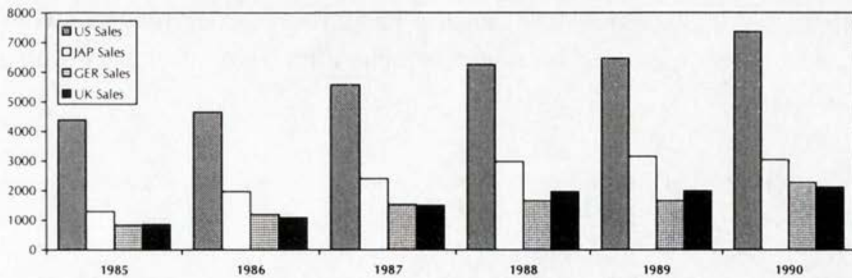
Record Company	Date Founded	Prominent Artists
Creation Records	1983	Jesus and Mary Chain Primal Scream
Go! Discs	1983	Beautiful South Paul Weller
Mute Records	1983	Depeche Mode Erasure
China Records	1984	Art of Noise The Levellers
Food	1984	Blur Jesus Jones
Big Life Records	1986	Yazz De La Soul
Cooking Vinyl	1986	Bhundu Boys Oyster Band
FFRR Records	1986	Salt 'N' Pepa Utah Saints
One Little Indian	1987	The Shamen The Sugarcubes
ZTT Records	1988	Seal 808 State

Source: Adapted from Monopolies and Mergers Commission (1994), The Supply of Recorded Music, *London: HMSO*

At the same time, the joint market share of British independent labels began to erode (see Table 7.1) when the most celebrated of these companies were attacked by major record corporations. In their search for record catalogues and publishing rights, EMI and PolyGram purchased the four biggest independent record companies that in 1987 had a market share of 16.5%. At a total cost of £682 million, EMI acquired Chrysalis Records and Virgin Music Group between 1989 and 1992, increasing its market share from 12.7% to 22.2%. In the same way, PolyGram purchased Island Records and A&M Records for a figure of $822 million in 1989 and 1990, raising its share from 16.1% in 1989 to 23.3% in 1992.

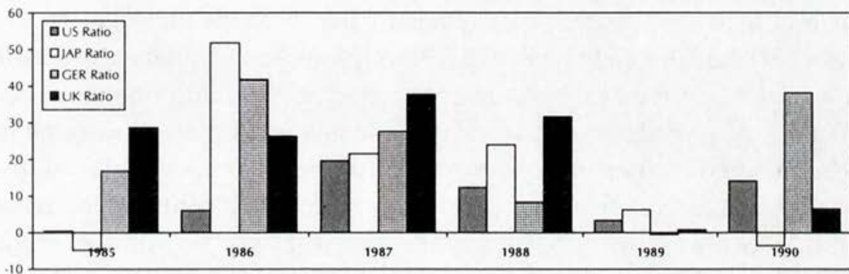
[1] The fact that 1990 sales have a higher value than 1989 sales in Figure 7.2 (in $), while Figure 7.1 (in £) shows exactly the opposite, is due to fluctuations in exchange rates.

Figure 7.2a: Sales Values in Top Four Music Markets (in US $ Millions)



Source: Compiled from IFPI Data

Figure 7.2b: Sales Growth Rates in Top Four Music Markets (in %)



Source: Compiled from IFPI Data

Table 7.3: Sales Growth in the World's Major Music Markets (in US $ Millions)

Year	US Sales	Gr. %	JAP Sales	Gr. %	GER Sales	Gr. %	UK Sales	Gr. %
1985	4388.8	0.4	1299.6	-4.9	845.8	16.8	862.4	28.7
1986	4651.1	6.0	1972.9	51.8	1199.6	41.8	1089.1	26.3
1987	5567.5	19.7	2396.9	21.5	1530.0	27.5	1500.0	37.7
1988	6254.8	12.3	2969.3	23.9	1657.0	8.3	1973.4	31.6
1989	6464.1	3.3	3152.0	6.2	1646.3	-0.6	1989.9	0.8
1990	7368.8	14.0	3039.8	-3.6	2273.9	38.1	2117.5	6.4

Source: Compiled from IFPI Data

At the time, the doubts of industry participants about the impact of these developments on the health of the record business increased. Especially after the Virgin acquisition, both independent and (rival) major companies commented on the industry becoming 'too corporate.'[2] However, an unexpected and constructive side effect would emerge out of these take-overs.

THE CASE OF ISLAND RECORDS

Because independent record companies were traditionally regarded as the engine of musical innovation, this merging of majors and indies was not favorably received. It was believed that it would obstruct the symbiotic process between both groups and therefore block a renewal of artists and music which the industry so badly needed now that it was perceived to be in a state of depression during the early nineties.[3] But it was the 1989 acquisition of Island Records by PolyGram that brought the industry to a new level of rivalry and helped the UK music industry to regain its health. Case Box 7.1 describes the process of change at Island after the take-over in detail, and provides the basic input for an analysis of Island's search for capabilities as it manipulated its competitive environment. Table 7.4, presented thereafter, summarizes both the context and the content for change, that is, why the change happened in the first place and what the exact nature of the transformation came to be.

CASE BOX 7.1: ISLAND RECORDS

Within a six month period, from July 1989 to January 1990, PolyGram purchased two of the industry's most eminent independent record labels, Island Records and A&M Records, for a combined figure of $822 million. This set the stage for a new era in the life of PolyGram, the global music industry's third largest player. During the eighties, the record corporation had expanded primarily through internal growth, but with these acquisitions the firm's portfolio of labels almost doubled. Alain Lévy, the man who had negotiated both deals and would become PolyGram's new CEO within one year, had thus created the opportunity for strengthening the company's market position and corporate organization. But he also knew that his new labels needed to be restructured to integrate them into the firm's existing label group, formed by Phonogram-Mercury, Polydor and London. The following case study describes the strategic

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[2] See, for example, the commentary articles "Virgin Rivals Eye Deal with Caution" and "A Sad Day for Independents" in *Music Week*, 14 March 1992, p. 3.

[3] Laing, D., "Industry Faces Difficult Time after Record-Breaking 80s," *Music Business International*, February 1991, p. 22.

change process at Island Records and analyzes how the company was able to improve its competitive position in the market.

Island's Hollow Success of the 1980s

In 1962, Chris Blackwell was on his way from Jamaica, the island where he had spent his youth, to Britain, when he stopped over in New York to have lunch with Atlantic Records' Ahmet Ertegun. Inspired by this conversation, Blackwell started what would be one of Britain's most celebrated independent record companies: Island Records. Originally focused on selling Jamaican records, by the seventies Island had built an impressive roster with acts like Traffic, Cat Stevens and Bob Marley, while striking various label deals which gained access to the talents of King Crimson and Roxy Music. During the eighties, Island enjoyed worldwide success when it sold millions of records through its international distribution deals with Warner and BMG. This was the time when Robert Palmer, Steve Winwood and Grace Jones all scored their biggest hits, Frankie Goes to Hollywood broke through, and U2 established itself as a global superact.

So when Chris Blackwell and PolyGram's Lévy agreed to appoint thirty-year-old Marc Marot in May 1990 to be the label's new Managing Director responsible for spearheading Island's restructuring program, it seemed his task would be a relatively easy one (especially given the fact that Marot was a six-year Island 'veteran' having run three of Island's other businesses including its music publishing division). However, behind this facade of success, Island was not in very good health as one of the most fundamental problems of the eighties had been the uncertain inflow of new recording talent. Basically, new artists came to the company through its A&R activities and its label deals – Frankie Goes to Hollywood, for example, was a license deal with ZTT Records. But worryingly, Island's A&R had virtually been a one-man show as Blackwell had positioned himself as the sole creative force within the record company. When during the second half of the 1980s most of the label deals ended and Blackwell turned his interest – as well as the company's funds – to other areas of entertainment such as movies, Island Records was left empty-handed in terms of its A&R capability.

Furthermore, Island's dependence on its four superstars Robert Palmer, Steve Winwood, Grace Jones and U2 in reality meant that incomes were relatively modest due to their demands of higher advances and royalty payments. The company's diversion of profits to its film business not only obstructed the development of a next generation of recording artists, but also hampered Island's ability to preserve three out of four of its superstar contracts. When these contracts expired, the company lacked the necessary capital to match the more lucrative offers made by rival record companies, leaving Island with only U2 as a 'superstar' act. A further source of deception was Island's high-cost infrastructure: large numbers of employees were tied to a swelling roster of artists, of which but a few were commercially viable. Reflecting on that situation, Marot commented how "at the time we were twice as big in terms of personnel as Mercury Records which was twice as big [as Island] in terms of turnover, while in terms of roster we were four times as big as Mercury Records."[i]

Creating a New Island Philosophy

Being a fat company in terms of its infrastructure but a hollow one regarding its A&R and marketing capabilities, Island managed to survive the late 1980s by exploiting its

catalogue through the release of numerous 'best-of' albums and occasional hits from the likes of the Christians and Mica Paris. Faced with these gloomy facts, Marot realized that major changes were inevitable if Island was to be among the top record companies of the industry again. He thus embarked on his role as a change agent by evaluating the company's key resources and developing a new vision for the company. Although in need of serious polishing, Island's artistic logo and culturally innovative reputation were among the most prominent assets that could be used for future purposes. Equally important was the presence of company chairman Blackwell, whose reputation, industry expertise and connections were invaluable. The label's third core asset was its U2 contract; since its signing in 1980, the band had sold more than 50 million albums, which showed Island's commercial ability to the creative community.

Another property base was the firm's respectable catalogue which, although it had already been exploited to a considerable degree, reflected Island's values towards a diversity of musical streams. Finally, the new bonds of ownership not only provided vital access to PolyGram's deep pockets, but also reflected the music corporation's commitment to the successful execution of Island's turnaround program. Based upon this analysis of the company's pivotal assets, Marot set out to create a vision in which the label's successful past could be merged with the demands of the future. Island's history provided a rich context out of which a revived direction for new, cutting-edge music could be distilled that, at the same time, had to be in line with the commercial reality of the record business. The new philosophy thus challenged accepted industry knowledge that innovation in music and its effective commercial exploitation could not be combined in a single record company.

In his campaign to differentiate Island from the competition, which at the time had "retreated into bankable catalogue exploitation and mainstream pop,"[ii] Marot thus defined his company as a commercially alternative label. "Commercially alternative meant to us that we were always going to be looking for alternative forms of underground music, but we were going to be very, very keen to sell bucket loads of them if we could."[iii] With a background in Island's music publishing division, an area which enables people to develop skills in both music and business, Marot knew that it wasn't enough to just restore Island's A&R capability. The company also needed to be much more commercially oriented, and the lack of sufficient marketing expertise demanded the creation of new competence in this domain. But before he could install his new vision in the organization, he secured the support of Chris Blackwell and chairman Tom Hayes so that he could restructure Island into a focused and compact group of enthusiastic individuals.

Restructuring Island's Cost Base

Part of the aspired increase in Island's organizational effectiveness and efficiency was realized as a direct consequence of the PolyGram purchase. The corporation not only took care of the manufacturing and distribution of all Island records, but also created a new and bigger sales team, called AIM, which represented the combined product of Island and sister label A&M. Apart from the removal of much of Island's financial accounts department to a centralized unit within the corporation, PolyGram was also involved in the division of Island's music and more expensive film interests. The latter were placed in a separate company, Island World Communications, so that Island Visual Arts could concentrate its efforts and resources on the production of sell-

through videos (to be distributed by PolyGram). Finally, the royalty and copyright functions of Island's publishing branch were transferred to the corporation's growing publishing company PolyGram Music.

Although synergistic benefits flowed both ways, Island still faced a cost base disproportionate to its value-adding activities. While most of the functions involved in the various arrangements with PolyGram carried limited amounts of personnel, the number of staff within the remaining departments in no way related to their respective performance levels. The only way to get a grip on such an "expensively built company" for Marot was to identify "pockets of cynicism and absolute entrenched acceptance of failure" within some corners of the company.[iv] He thus reviewed and evaluated each person in every single department, not only on the basis of their past performance, but also in terms of their future potential. Quite a few people in key positions appeared to be anchored in Island's past practice, obstructing Marot's intent to instill new blood into the organization. Over the next 18 months, he removed 40% of the original 119 people within the various layers of Island's organization.

A second source of Island's excessive cost base was rooted in its voluminous artist roster of a total of 64 UK-signed acts, all in need of advances, recording costs, promotional material, management and tour support. The problem was that, apart from U2, only five of these acts broke even in terms of the costs ascribed to them. In a drastic move, Marot dropped more than 50% of this highly unprofitable roster during those first 18 months. The limited value of Island's roster at the time was underlined by the virtual absence of competition for these acts: only two of them were able to get a record deal again on another label. For PolyGram these actions meant that the need to invest did not stop after it had acquired Island. During the following two years the corporation sustained heavy losses as Island disbanded half of its artist and employee contracts. But even more money was involved when Marot started his quest for rebuilding the label's capability base.

Constructing Island's Capability Base

The execution of downsizing policies represented but one of two parallel tracks that made up the change program. The other trajectory involved the restoration of Island's A&R competence and the development of new marketing capabilities. Marot realized that the key to a resurgence of company profits and turnover lay in developing a high-quality repertoire; his principal objective in this respect was to bring the right A&R people into the organization. Although he had a basic sense of the musical direction Island would have to take to be successful again, Marot acknowledged that, coming from a music publishing background, he didn't have the expertise to actually make records. In need of a vigorous A&R team with "a backbone of experience in how to turn the vision into a practical physical reality of making records," the Island MD hired Nick Angel as head of A&R and promoted Julian Palmer as head of the 4th and B'way label.[v] Coming from Mercury and CBS respectively, their assignment was to pursue Island's musical history while at the same time start looking for music in places that no other record company would look.

While the A&R team could build on Island's musical philosophy of the past, there was a lack of existing marketing skills and infrastructure within the company. Before the acquisition, there had been only one marketing executive for the 211 acts signed worldwide. This was born out of Blackwell's traditional distaste for marketing people, believing them to obstruct the creative process of delivering music of a high

caliber. But Marot believed that marketing staff can play a vital and creative role and, moreover, recognized the significance of strong marketing capabilities if he wanted to realize his vision of Island's pioneering role as a commercially alternative label. He therefore created a marketing team from scratch to establish a new competence bundle that could actually sell records, while at the same time emphasize their artistic value. Paul McGarvey was hired from RCA as head of marketing, while the arrival of Phonogram's marketing director Nick Rowe as general manager further boosted the accumulation of marketing knowledge within the company.

Apart from the creation and development of marketing and A&R capabilities, Island's commercial focus was reinforced by the incorporation of a legal and business affairs department headed by Ian Moss. In line with Island's new business philosophy, the label was restructured according to how labels were design at major records firms. At Island, top positions within this structure were assigned to managers coming from major record companies, while the front-line positions were staffed by people with a background of working for independents companies. Reacting upon this observation, Marot explained that at "the key positions within the company in terms of making the business tick, I needed to have real core competences; while in terms of making the company exciting, I needed people that had challenging ideas and a kind of different excitement."[vi]

Energizing the Island Organization

Marot realized that in addition to this renewed 'lean and mean' Island, he needed to make his people hungry for success and to instill in them a sense of purpose. He thus created three basic vehicles through which he could raise employee moral and trigger enthusiasm among his staff. Foremost, there was Island's reason for existence: "there was nothing better than giving them good music; I gave them something to feed on."[vii] Furthermore, he composed a select group of people who would communicate his new vision further down the organization, designing a context in which employees could freely apply their creativity. Finally, Marot hired management consultants who set up action learning groups, risk-taking courses and implemented alternative team-building exercises throughout the company. But there was another event during the summer of 1991 that united the Island organization, be it that the incident was not engineered by Marot himself.

On the day of release of the rap group NWA's album Efil4Zaggin, a police squad from Scotland Yard confiscated more than 12,000 copies, claiming it violated the British obscenity law. Although Island had released the album, its parent was also involved as the albums were seized from a PolyGram distribution plant. Unless both companies would decide to fight the move, the police would destroy the copies of the controversial album. When Marot turned to the record industry's trade organization for financial and legal support, the BPI denied his request, as it didn't approve of the notorious record. His claim that this was not a matter of aesthetics but a "wider, more compelling issue in this case is censorship and freedom of speech,"[viii] earned him the full support of PolyGram's board and, moreover, a court victory. Again, Island had displayed its role as an industry pioneer, and winning the first and last legal obscenity test against a recording created a sense of pride and loyalty within the company.

PolyGram's added value to Island was certainly not limited to legal back up in the NWA case or cost reductions through attending the label's back office functions.

Without being aware of it, Marot enjoyed personal protection from PolyGram's CEO Alain Lévy during the label's turnaround. Although perhaps doubtful about the commercial viability of Island's new signings, he still backed him against Blackwell when required, who feared that Marot was turning Island into a major.[ix] This political support enabled the Island MD to pursue his vision and change program in a constant dialogue with PolyGram's corporate management. Another source of protection was embodied in his personal mentor, chairman of PolyGram UK Roger Ames, whose experiences through good and bad times taught him valuable lessons. Finally, the PolyGram structure provided Marot room for discussion of problems and industry issues on an informal level with colleagues at PolyGram's other labels.

Island's Marked Success of the 1990s

The label's new bundle of A&R and marketing capabilities aimed at alternative forms of music lead to Island's remarkable resurgence in the early 1990s. By the end of 1992, the company had managed to sign Nine Inch Nails, PJ Harvey, PM Dawn and Stereo MCs, followed by Cranberries, Pulp and Tricky in the next two years. As the A&R staff had indeed searched for acts in alternative areas of music where nobody else was looking, lack of competition prevented these deals from being hugely expensive. Artist development and creative marketing ensured that each of these acts was introduced successfully; a 1994 survey of 380 music industry employees indeed revealed that Island Records was considered to be the top record company in breaking and developing new acts.[x] The rejuvenated label went from a situation of "massive unprofitability to very good and very stable profitability" within the first three years, while experiencing a 250% increase in turnover over a five-year period.[xi]

Exhibit 7.1: Island's Performance in Awards and Market Shares

Year	Album Market Share	Brit Awards	Mercury Prize
1990	1.4	1 win, 2 nom	n/a
1991	2.0	-	n/a
1992	2.0	2 win, 1 nom	1 nom
1993	2.4	1 nom	3 nom
1994	2.4	2 win, 7 nom	1 nom
1995	2.6	1 nom	2 nom
1996	1.7	8 nom	1 win

Source: BPI Statistical Handbook 1997, The UK Record Industry Annual Surveys

Exhibit 7.1 shows Island's market share figures and the various awards won or nominations gained for in a seven-year interval. UK industry figures demonstrate that Island was the only registered label in the business that consistently maintained or increased its market share throughout the period 1990-1995. Exhibit 7.2 reflects Island's enhanced capacity to get the best out of its artist roster, portraying the improvement in effectiveness with which the label commercialized its repertoire. The different awards and nominations express the record industry's and artistic commu-

nity's recognition of Island's achievements. Sensing that their record company was back on the right track, U2 renewed its contract in a six-album worldwide deal with Island in 1993. Various employees were promoted during the following year, not only as a reward to their efforts and commitment in building a successful and stable Island, but also with the intention to prevent them from leaving in response to attractive offers by rival firms.

Exhibit 7.2: Island's Performance in Repertoire (in Number of Signings)

Year	Super Profitable	Profitable	Commercial Viable	Unproven	Total Roster
1990	1	1	4	63	69
1996	4	4	4	24	36

Source: Island company records

The high visibility of Island Record's A&R policy's success inevitably attracted the attention of many competitors. Marot remembered how in the early nineties there was "a very small, well-stocked rock pool that we were sitting on the side of fishing, and every time we put our hook in, we pulled a fish out with nobody else fishing in the pool. I suddenly [early 1996] looked around and found there were much fewer fish left in the pool and everybody was fishing around it."[xii] In addition to this sudden increase in competition for new and alternative music, Island's management practice had become routinized, obstructing the flow of creativity within the company. In celebrating its success, Marot now believed that Island was struck with a certain amount of arrogance and even drowsiness, culminating in disappointing performance figures for 1996. Eight years older now, Island's MD Marc Marot was again confronted with the need to change. But this time, things were different as he intended to transform the label's top-level management without the supervisionary eye of Blackwell, who had decided to leave PolyGram in November 1997.

Endnotes

[i] Recorded Interview, September 24th 1997.
[ii] Marot, M., "Opinion," *Music Week*, May 11th 1991, p. 4.
[iii] Recorded Interview, September 24th 1997.
[iv] Recorded Interview, January 27th 1998.
[v] Ibid.
[vi] Ibid.
[vii] Ibid.
[viii] Marot, M., "Opinion," *Music Week*, August 31st 1991, p. 4.
[ix] In his comments upon this text, Marc Marot stressed that "I was not always at odds with Chris Blackwell; we could not have made the changes without his support. I believe though that he thought that sometimes I went too far."
[x] Editorial, "Survey Reveals the Industry's Winners," *Music Week*, October 1st 1994, p. 11.
[xi] Recorded Interview, September 24th 1997.
[xii] Ibid.

(See Appendix D for secondary sources)

The prime trigger for Island's organizational change trajectory was the label's new ownership relation with PolyGram. The Dutch major saw opportunities to create synergy benefits by incorporating activities like manufacturing and distribution, sales, accounting and publishing into its own operating structure, and to increase efficiency at the label itself. Still, the actual change process only got going after Marc Marot was appointed as Island's new Managing Director. Although the company had experienced an average 3.6% market share between 1984 and 1988, Island's market performance had suddenly declined: in the year of its take-over, the label had a 0.8% market share, mainly due to the departure of three of its superstars and its reliance on label deals for A&R. Still, Marot had noticed a new opportunity for his company as he saw how competition in the record industry evolved around the exploitation of existing catalogues and the development of acts into mainstream pop music.

Table 7.4: Context and Content of Organizational Change at Island Records

Change Context	
New executives	Appointment of Marc Marot as new Managing Director
New ownership	PolyGram's £272 million acquisition of Island
Threat/opportunity	Competition focused on catalogue and mainstream pop
Performance decline	Rapid decrease of company market share over 1989
Change Content	
Vision	Merge Island's musical past with future commercial demands
Scope	Introduce new music/artists to a wide audience
Positioning	Island as a commercially alternative record label
Capabilities	Rebirth/formation of A&R and marketing capabilities

The MD's knowledge of this industry opportunity came to shape the content of change at Island. Marot developed a new vision in which the label's successful music history could be merged with the commercial demands of the future. His primary aim was to lift Island to a situation in which it introduced new alternative artists as well as new musical genres to the market, but to a much larger audience than was previously thought possible. Common sense in the record industry held that innovation in music and the commercial market were mutually exclusive opposites. But Marot based his change program on a different perception of the business, and positioned Island as a commercially alternative record label among its

rivals. Still, Island needed to create new capabilities to realize its novel strategy. Its dormant A&R capabilities had to be awoken, while capabilities in marketing had to be bred considering the near absence of marketing skills within the company.

Table 7.5: Main Events at Island Records

Event	Date
PolyGram acquires Island Records for $320 million	July 1989
Publishing department to PolyGram	March 1990
Combined sales team for Island and A&M	April 1990
Marc Marot becomes new MD	May 1990
Removal of staff at key A&R positions	July 1990
Nick Angel becomes new head of A&R	August 1990
Account department integrated in PolyGram; Closure of art department; More staff removal	September 1990
Paul McGarvey becomes new head of marketing; Ian Moss 'brings in' business affairs department; Joanne Turner becomes new A&R coordinator	January 1991
Island Visual Arts streamlined	February 1991
Julian Palmer becomes new head of 4th&B'way; Marc Marot publicly claims record companies have to take risks and break new genres instead of just artists	May 1991
Start of NWA obscenity case	June 1991
Island wins NWA case	November 1991
Nick Rowe becomes new general manager	March 1992
U2 renews its contract for six more albums	June 1993
Promotion of department heads as reward for success	April 1994
Island wins 1995 MW A&R award	March 1996
Nick Rowe leaves Island	October 1997
Chris Blackwell leaves Island	November 1997

Island's search for such new capabilities embodied a process of organizational change, which started with the appointment of Marc Marot and ended near the end of 1992 when it had signed the first four acts that would be part of its successful artist roster – Nine Inch Nails, PJ Harvey, PM Dawn and the Stereo MCs. Table 7.5 lists the major events during these 2½ years of transformation (as well as the specific dates of their occurrence) covered in the Case Box of Island Records. Furthermore, Table

7.6 displays an outline of the core features of the strategic change process at Island. The label's new business philosophy was to extract high-quality repertoire from the creative community that had a higher than average commercial potential to a broad consumer music market. As a prelude to the mandatory restructuring of Island's organizational processes, the video division was streamlined, while the art department was terminated.

Table 7.6: Process of Organizational Change at Island Records

New philosophy	Discover high-quality repertoire with commercial potential
Reorganization	Structure with new A&R and marketing staff at top and front-line positions
Internal ventures	Launch of internal legal and business affairs department
Novel acquisitions	-
New alliances	-
Status reevaluation	Declining influence of founder Blackwell on label strategy
Learning new skills	Marketing new and alternative music (genres)
Resolving dilemmas	Innovation in and commercialization of music

In addition, 40% of the company's staff was discharged to make room for new people from outside the firm with experience and skills in both A&R and marketing. Marot structured Island's organizational processes conform to the designs he had observed at individual labels of major record companies. This enabled him to place managers with a 'corporate' history at top positions and put staff with working experience at indies in front-line positions. The heightened awareness of commercial aspects also required the launch of a new legal and business affairs department that would keep track of the label's property rights and contractual relationships. Founder Chris Blackwell's influence on the label's direction was eroded. Finally, new skills were learned as new acts and music styles were marketed on a broad consumer market. In the end, Island Records managed to resolve the dilemma between innovation in, and commercialization of, music.

As for the effects of Island's transformation on its financial performance, Table 7.7 shows the label's resurrection in terms of turnover and gross profits. From 1990 onwards, these figures display a steady growth pattern over the first half of the nineties, which was slightly interrupted only in 1993.

Table 7.7: Island Records' Financial Performance (in £1000)

	1990	1991	1992	1993	1994	1995	1996
Turn-over	20140	25159	37718	37375	40949	45823	37390
Gross Profit	4877	4230	8441	8188	8548	10693	8658
Operat. Profit	(4606)	(2062)	1270	880	234	361	(2963)

Source: Compiled from the UK Record Industry Annual Surveys 1993-1998

THE CASE OF VIRGIN RECORDS

At about the same time that Island's Marc Marot hired a new general manager as one of his final moves in the label's transformation process, a major event took place in the UK music industry. In March 1992, major record corporation EMI purchased the Virgin Music Group from founder Richard Branson for £560 million. This take-over induced a process of organizational change at London-based Virgin Records, which in the end would make an important contribution to the revival of British acts and music on an international level. Case Box 7.2 narrates the change process at Virgin after the 1992 purchase in more detail. This text supports a subsequent analysis of the label's search for capabilities in a changing competitive environment. This discussion starts with Table 7.8 that displays the primary features of the change context (why did the change happen), as well as the main attributes that made up the change content (what was its exact character).

CASE BOX 7.1: VIRGIN RECORDS

When Colin Southgate took over as Thorn EMI's new CEO in 1987, the corporation's music company entered a new era in its long history. Rooted in its contract with The Beatles and its fair share of the classical market, EMI Music had established itself as a major world player during the '60s and '70s. But after its incorporation into the Thorn conglomerate in 1980, the firm became what many in the record industry regarded as a 'sleeping giant.'[i] Lacking a winning culture and governed by people who lived on memories of past success, EMI had turned into a company that was poorly managed and organized. Southgate designed a new strategy to cope with EMI's need for both a different approach to the market and a stronger presence within the worldwide music

industry. Regarding the latter component of his strategy, Southgate had initially been outbid by MCA and PolyGram, when respectively Geffen and Island were up for sale. But he definitely managed to rock the industry in 1992 when EMI acquired the most prominent of all independents: Virgin Records.

How the Maiden Lost Her Virtue

After two years of operating as a record retailer, Richard Branson launched the Virgin record label in 1973. Modeled after Chris Blackwell's Island label, Branson wanted his company to be involved in music outside the commercial mainstream. Branson's entrepreneurial touch was complemented by the creative talents of co-founder Simon Draper, who became responsible for the label's artistic direction. This combination of skills lead to the signing of Mike Oldfield and The Sex Pistols during the seventies. Although the new record company enjoyed staggering sales and even more publicity in those years, Virgin's success really gained momentum during the eighties with acts like Phil Collins, Human League and Simple Minds. In the mean time, Ken Berry had joined the company to govern the label's business affairs and firm management. This enabled Branson to reduce his personal involvement in Virgin Records to negotiating multi-million dollar deals with big acts such as Janet Jackson and The Rolling Stones.

In the late 1980s, Virgin expanded into 25 countries, and in the United States immediate success followed as deals were struck with artists like Paula Abdul, Lenny Kravitz and Meat Loaf. However, as the label's size surged, new staff and acts were contracted without much regard to their commercial viability, and the corporation's entrepreneurial culture even seemed to encourage such unlimited growth. Moreover, Virgin's prosperity had pulled the company into the area of mainstream pop music, a competitive environment in which it was surrounded by commercially focused major record corporations. Despite this shift away from the label's original positioning and his virtual non-interference with operational matters, Branson remained emotionally attached to his record label. In January 1992, when asked about a possible sale of his music company, he insisted that "as Virgins we've enjoyed our virginity for 20 years and don't really want to lose it."[ii]

Yet, during the second half of the 1980s the unpredictable Branson had moved into the airlines business, where he perceived unexploited new market opportunities. Here, he quickly saw his business costs rise in a capital-intensive and cyclical industry where competition was dominated by large national airline operators. In his hunt for more cash, Branson made an unsuccessful attempt to raise external capital through the London Stock Exchange between 1986 and 1988. In the next year, he sold 25% of his music assets to the Japanese media corporation Fujisankei for £115 million. Although he raised another £40 million through Sega's purchase of Virgin Mastertronic in 1991, the British entrepreneur was still in need of substantial capital to compete effectively with the likes of British Airways and Pan Am. Two months after his statement that the Virgin Music Group was not for sale, Branson abandoned his flag ship for the £560 million offered by Thorn EMI.

Putting the Lady on a Diet

Thorn EMI's CEO Southgate realized that his acquisition of Virgin offered immense opportunities to create the world's biggest record corporation, but at the same time he knew that their amalgamation could leave both companies worse off. Virgin Records' unique entrepreneurial style had accounted for much of its success, and a full

merger with the prudent EMI institution would undoubtedly destroy much of the company's future value. Still, Southgate intended to implant part of EMI's business philosophy into the Virgin organization to avoid extravagant expenditures and to get the company focused again. He thus called upon the services of his number one man, Jim Fifield, to implement the changes necessary to rationalize Virgin's cost structure. Southgate had appointed Fifield in 1988 to shake EMI out of its doze, and under his leadership profit figures had increased sharply.[iii]

Commenting upon his latest assignment, in which he had to team up with the Virgin Music Group's new CEO Ken Berry, Fifield said that "we are obviously going to look for efficiencies and the right synergies, but we are not going to take away the spark and entrepreneurial spirit which Virgin has shown over the years."[iv] Most of the synergy benefits, a reported £47 million, were realized through Virgin's product flow in EMI's worldwide manufacturing sites and distribution channels. Significant cost reductions were also achieved through the absorption of Virgin Music Publishing into EMI's publishing arm, raising the latter's catalogue with 25,000 titles. But the larger part of the actual downsizing took place at Virgin Records, where more than 30% of the total staff was laid off within one year. Most employees were forced to resign, but some left the label voluntarily claiming that "Virgin is a different company from what it was and without saying it with any recrimination or bitterness, sometimes you know when it's time to leave."[v]

Apart from removing its classical music label to EMI's Classics division, a fair number of Virgin's sub-labels were disbanded in that same year. Imprints such as Ten Records that were related to contracts with specific A&R people, and labels that were tied to particular artists such as Boy George's More Protein imprint were the first to go. These policies were initiated against the background of curtailing Virgin Record's voluminous artist roster that had grown to more than 150 acts in the UK alone. With the exception of the company's superstar deals, all artists were evaluated on the basis of their artistic and commercial value in the near future. Within 18 months after the acquisition, Virgin had cut its roster to 70 acts, generating turnover almost exclusively via releases of its superstars during 1993 and 1994. Additional revenues in this period were derived from Virgin's domination of the compilations market segment with its 'Best Album in the World' and 'Now!' series – the latter via a long-standing alliance with EMI and PolyGram.

How the Lady Got Back in Shape Again

Virgin thus managed to remain profitable during the shake-up, but it was self-evident that the company needed new repertoire to be successful in the future and to lower its dependence on past A&R achievements. Having been involved in the full process of restructuring for 18 months, Virgin's Managing Director Paul Conroy now set out to re-build the company's musical and commercial capabilities. Although Conroy had not been appointed by Southgate himself, the EMI CEO knew he was the right man for the job; three months before Virgin's acquisition, Southgate had offered him the job of turning daughter-label Chrysalis around, but in the end Branson came up with a better offer. Having developed industry expertise at Warner and Chrysalis in areas as diverse as marketing, international affairs and general management, Conroy started to develop a new vision for Virgin Records. The key of that vision lay in building new, cutting-edge repertoire: "this is the year for focusing on new talent; when our A&R strategy comes of age."[vi]

Conroy's philosophy of how to develop new Virgin repertoire was structured around three core themes. First, artists had to be created for the world, in that each and every act would be contracted with a global audience in mind. As a UK-based record company, Virgin had the British advantage of the English language and a historically determined international outlook. Although it would be virtually impossible to break all of its acts on a global basis, Virgin had much to gain by an explicit international business perspective. Furthermore, new repertoire had to be built in alternative music spheres; during the eighties, Virgin had drifted towards mainstream pop music, but it needed to focus on areas where new styles continued to pop up. Finally, the label had to maintain Virgin's original entrepreneurial culture, but in a much more focused way. In this respect, EMI's performance standards, which had guided the label's management during the restructuring phase, would be useful in creating a proper context.

According to Conroy, the heart of the matter was not simply to build Virgin's marketing and A&R capabilities but, moreover, to blend them in a way that business and musical objectives would become one. Whereas in most record firms marketing and A&R departments often clash because of different viewpoints, the Virgin MD was blessed by the presence of his two deputies, Ray Cooper and Ashley Newton. These men had worked together at Island Records before teaming up and launching the Circa label within Virgin in 1987. Responsible for signing and breaking acts like Massive Attack and Neneh Cherry, Newton's A&R talents and Cooper's marketing skills had already earned them the supervision of Virgin's associate labels in 1991. Recognizing the unique value of their partnership, Conroy appointed Cooper and Newton to be his deputy managing directors in 1992 when Thorn EMI obtained ownership. After some 18 months of downsizing, Virgin's new management team started to direct their full attention to what they could do best: developing and commercializing new repertoire.

The Development of Virgin's New Capability Base

At the same time, the new Virgin management team had to be careful not to repeat the record company's historical folly of unlimited and unstructured growth. For without a clear sense of direction, the label could easily drift away as it had done during the late eighties. Recognizing the strategic value of Virgin's original ethos, the management team set out to create a structured organizational setting in which creativity could flow without disturbing the various creative processes themselves. Core to this idea was to structure the Virgin organization as a network of satellite labels, divisionalized along three broad musical categories: pop, alternative and dance. Whereas established artists and mainstream pop acts continued to be signed directly to the Virgin front-line label, two distinct departments were founded to deal with the company's exploration into the areas of alternative and dance music.

Installed to deal with the discovery and development of new talent and music, both divisions were headed by experienced A&R men who would be responsible for an organic growth process of their departments through a number of sub-labels. The alternative music division came to be managed by David Boyd, who had founded his Hut label – home to acts such as Smashing Pumpkins and Urban Dance Squad – under the Virgin umbrella in 1991. Accordingly, the new dance department came under the supervision of Andy Thompson, who had successfully managed London Record's ffrr dance label. Virgin Record's full ownership of its alternative and dance imprints

thus reflected a long-term commitment to the cultivation of what Ray Cooper regarded as "a core competence in the discovery, development and marketing of artists on a global level."[vii] Although the absence of third-party interests made the company's label policy an expensive matter, it effectively expressed the credibility of Virgin's commitment to its artists.

In line with the ambition of Virgin's management team to establish a focused but creative company, both departmental managers had to be highly selective in their signing policy. The idea of housing a limited amount of high-quality acts within each imprint was to establish a creative environment where, according to Cooper, "a team-based atmosphere enhances communication with the artist and activities continue to be comprehensive for those involved."[viii] As a consequence, marketing and promotion capabilities and A&R competences were cultivated at an operational level within the company where creativity could emerge instantaneously. In contrast, Virgin's general A&R direction and marketing course were shaped by top management along distinct planning stages. Coordination among various layers of responsibility was achieved via open channels of communication within the company and, more formally, by means of common management systems and performance criteria.

A New Virgin, A New Success

Within two years, Virgin Records had become a very different company from what it used to be before the EMI purchase, be it that Branson's original Virgin philosophy was still alive within the label. With a trimmed record company and no worries about manufacturing and distribution, Virgin's management had managed to install a sense of discipline within the organization while at the same time encouraging an interactive flow of creativity throughout the company. Referring to the benefits of Virgin's new network of in-house imprints, Cooper stressed how "the relationships of people within a record company are crucial to its success, and that's why communication channels must be open at all times."[ix] In the end, Virgin's A&R and marketing capabilities were enhanced and exploited on a company-wide level. Moreover, they were integrated in a way that business objectives would not undermine the search for high-quality music.

Exhibit 7.3: Virgin's Performance in Awards and Market Shares

Year	Album Market Share	Brit Awards	Mercury Prize
1991	6.4	n/a	n/a
1992	7.3	n/a	-
1993	9.0	2 nom	1 nom
1994	8.6	2 win, 2 nom	-
1995	8.3	2 nom	-
1996	10.7	1 win, 3 nom	-
1997	10.3	3 win, 8 nom	2 nom

Source: BPI Statistical Handbook 1997, The UK Record Industry Annual Surveys

Exhibits 7.3 and 7.4 show the impact of Virgin's strategic change program on its performance for the period 1991-1997 in terms of industry awards, record company market share, and repertoire. The company's steady growth of sales and operating profits since the EMI take-over reflect the success of Virgin's rehabilitation efforts, while the same can be argued if one observes the increase in album market share: official BPI figures show that no other record company could match Virgin's 4.3% growth in market share over these six years. The transformation in Virgin's repertoire composition expresses the label's effectiveness with which it built and marketed its artist roster. Leaving aside a few smart signings (like George Michael after he broke up with Sony Music), incomes were derived from the label's capabilities in re-searched-based marketing and style-searching A&R. This is clearly mirrored in the commercial success of artists like Janet Jackson and Spice Girls, and the breakthrough of acts such as Verve and the Chemical Brothers.

Exhibit 7.4: Virgin's Performance in Repertoire (in %)

Year	Super Profitable	Profitable	Commer-cial Viable	Unproven	Total Ros-ter
1992	5	10	20	65	100
1997	15	20	35	30	100

Source: Estimated on the basis of artist rosters

In 1996, Virgin's UK artist roster accounted for sales of more than 4.3 million albums, which made Virgin "the most successful in the UK at signing and developing British talent" according to research performed into the performance of British record labels.[x] However, Virgin's management team has recognized the dangers inherent to that unique performance, described by Cooper as "the toughest thing we're confronted with again and again is to keep the boundaries of the company within clearly defined limits, and to prevent staff growing out of its corporate jacket."[xi] Another challenge for Virgin presented itself when deputies Newton and Cooper crossed the Atlantic at the end of 1997 to run Virgin Records America. Although their presence in the US company created an opportunity for Conroy to break his acts in America, the Virgin MD would now have to adapt his organization in order to keep the balance between A&R and marketing alive.

Endnotes

[i] Scott, A., Southgate: "The Salesman Who Says His Selling Days Are Over," *Music Business International*, April 1996, pp. 15-17.
[ii] Editorial, "Sell Virgin? No One Can Afford It, Says Branson," *Music Business International*, January 1992, p. 5.
[iii] Between 1988 and 1995, EMI's profits would raise from £30 million to £300 million, increasing its return on sales ratio from 5.6% to 14.8% during the same period.
[iv] Editorial, "EMI Buys Virgin," *Music Week*, March 14th 1992, p. 1.
[v] Editorial, "Lascelles Set to Quit Virgin," *Music Week*, October 31st 1992, p. 5.
[vi] Editorial, "Future Sounds of Virgin Records," *Music Week*, June 18th 1994, p. 27.
[vii] Recorded Interview, September 17th 1997.
[viii] Ibid.
[ix] Ibid.

* Editorial, "Virgin Tops A&R Rankings," *Music Week*, April 12th 1997, p. 1.
** Recorded Interview, September 17th 1997.

(See Appendix D for secondary sources)

From an outsider perspective, the most observable cause of Virgin's trajectory of transformation was the transfer of the firm's formal ownership to Thorn-EMI. EMI's CEO Southgate publicly stated how synergy benefits could be achieved as distribution and manufacturing of Virgin products (formerly taken care of by rival PolyGram) would be dealt with by the major. Additional economies were to be gained by incorporating Virgin's publishing division and its classical label into the equivalent operations of EMI. A second drive for change was the formation of Virgin Record's new top management team, consisting of three individuals with complementary skills. Whereas Virgin's average market share during the period 1985-1990 had been 7.6%, the label had experienced a drop in performance as its market share had declined to 6.4% in 1991. But Managing Director Paul Conroy had noticed an opportunity in that there was no competition in the industry for alternative music at an international level.

Table 7.8: Context and Content of Organizational Change at Virgin Records

Change Context	
New executives	Formation of new three-headed management team
New ownership	Thorn-EMI's £560 million acquisition of Virgin
Threat/opportunity	No competition for new music on a global level
Performance decline	Sudden decrease of company market share in 1991
Change Content	
Vision	Merge Virgin's entrepreneurial past with future global demands
Scope	Deliver new music/artists to a worldwide audience
Positioning	Virgin as a globally focused record company
Capabilities	Convergence of new A&R and marketing capabilities

Conroy therefore developed a vision in which Virgin's original entrepreneurial culture could be blended with a global approach to new music. His principal goal was to turn Virgin into a focused record company that would have a superior competence in delivering alternative forms of mu-

sic and new acts to a worldwide audience. This meant that artists would not necessarily have to be UK-based, but could also originate from other parts of the world. From a competitive point of view, Virgin was therefore positioned in the industry as a globally oriented record company in the discovery and development of new acts. But to realize these ambitions, Virgin had to shake off some of the more negative effects of its entrepreneurial culture, which had culminated in its unrestrained and inefficient growth. Moreover, the company needed to construct new capabilities in A&R and marketing and, furthermore, to converge these capabilities in an international frame of mind.

Table 7.9: Main Events at Virgin Records

Event	Date
Paul Conroy becomes new Virgin MD	February 1992
EMI acquires Virgin for £560 million	March 1992
Removal of 80 staff; Termination of 80 artist contracts; Publishing department and Classics label to EMI; Ray Cooper and Ashley Newton become deputy MDs	June 1992
Offside label MD Lascelles leaves Virgin	October 1992
Ten label MD Clark leaves Virgin; Termination of More Protein label	November 1992
Removal of staff at international department	May 1993
Fifield claims Virgin to be more focused and profitable	December 1993
David Boyd becomes head of new alternative music Division	January 1994
Conroy publicly states Virgin's reorganization is over and that Virgin has spent the past 18 months into new music areas	June 1994
Andy Thompson becomes head of new dance department	March 1995
Virgin signs Chemical Brothers; Promotion of marketing and A&R staff to management team	April 1995
Conroy publicly states four years of hard work pay off	October 1995
Virgin moves into pop with Spice Girls	September 1996
Virgin wins eight 1996 MW awards	March 1997
Research confirms Virgin's A&R department as the most successful at signing and developing British talent	April 1997
Ray Cooper and Ashley Newton move to Virgin America	October 1997

Virgin's search for such new capabilities embodied a process of organizational change, which started with the acquisition of the company by Thorn-EMI in March '93 and formally ended in June '94 when Conroy publicly proclaimed the end of Virgin's reorganization process.[4] Table 7.9 lists the major events and their corresponding dates during these years of transformation as described in the Virgin Records Case Box. In addition, Table 7.10 presents a structured overview of the most prominent features that made up Virgin's change process. The company's new philosophy was directed at the discovery and development of creative and alternative artists for a worldwide music audience. A head count reduction of more than 30%, the termination of more than half of its original artist roster to 70 acts, and the divestment of particular sub-labels tied to individual artists or A&R people preceded the necessary restructuring of the label's organizational processes.

Table 7.10: Process of Organizational Change at Virgin Records

New philosophy	Discover alternative repertoire with global potential
Reorganization	Internal network of divisionalized sub-labels
Internal ventures	Launch of alternative and dance departments
Novel acquisitions	-
New alliances	-
Status reevaluation	Increasing attention to research-based marketing
Learning new skills	Coordinating creative and planning functions
Resolving dilemmas	Diversity in A&R and targeted marketing

Virgin's internal organization was structured as a company-owned network of small satellite labels which were categorized into three broader music divisions (pop, alternative and dance). These departments were headed by managers like David Boyd and Andy Thompson, who had significant A&R experience in their respective musical areas. To create such an organization, two new departments were launched that would manage Virgin's operations in alternative and dance music. This new organizational setup facilitated the development of specific A&R and marketing capabilities at the front-line level where creativity was key, while the company's more general A&R and marketing course was planned at top

[4] However, the analysis presented here suggests that the process of reorganization could have continued until at least March 1995 when Virgin launched its new dance division.

level. Marketing policies came to be much more founded on marketing research techniques. All this cumulated in Virgin's ability to resolve the dilemma between diversity in artist development and targeted marketing at the global level.

Table 7.11: Virgin Records' Financial Performance (in £1000)

	1991	1992	1993	1994	1995	1996	1997
Turn-over	80130	73685	93545	132968	142767	164168	219562
Gross Profit	41743	39255	43964	63111	66012	76242	87632
Operat. Profit	19110	3129	27408	27079	31693	34650	42621

Source: Compiled from the UK Record Industry Annual Surveys 1993-1998

From a financial point of view, Virgin's turnaround came to be a success (see Table 7.11). In the five years after the label had been acquired by Thorn-EMI, Virgin managed to triple its turnover and saw its gross as well as its operating profits increase in a significant way.

MAJORS' RESPONSE TO THE NEW REGIME

Apart from acquisitions like those of Island and Virgin, majors and independents were also moving closer to one another through more complicated relationships other than formal ownership structure. Cooperation via production and distribution deals that had linked both types of companies during the eighties became more complex in character at the start of the nineties. On the one hand, major companies recognized the value of independents in terms of their ability to discover new acts: an industry survey of 380 industry employees revealed that 83% of the respondents considered the independent sector to be more important than ever.[5] On the other hand, independents themselves acknowledged the fact that majors had superior skills in distribution and marketing.[6] More often than not, indies

[5] Editorial, "Survey Reveals Industry's Winners," *Music Week*, 1 October 1994, p. 11.
[6] Editorial, "Indies and Majors: Happy to Fraternise with the Enemy," *Music Week*, 15 December 1990, p. 15.

faced cash shortages, tortuous distribution operations and a lack of marketing knowledge, which endangered the label's survival (Lee, 1995).

During the early nineties, major corporations and independents thus began to combine their complementary strengths through cooperative ventures. This resulted in the formation of webs of complex relationships between majors and minors, breaking down the conventional distinctions between both genres (Negus, 1992). Apart from the mode of an outright acquisition, three principal types of partnerships between the major record companies and independent labels emerged in the UK industry in the late eighties, all of which were increasingly adopted during the first half of the nineties (Hesmondhalgh, 1996). First of all, the major could acquire a minority stake from the owner-manager of an independent label with an option to purchase the remainder at some later point in time. The label's management retained full creative control and operated in a relatively autonomous manner. In the meantime, the major took care of local and/or international distribution of the label's products, backed up its financial position, and provided legal and administrative expertise.

The earliest reported example of this type of partnership goes back to 1987 and regards PolyGram's purchase of a 49% stake in Go! Discs. The main advantage to the major company in such a setting was that it could track and evaluate the independent's (lack of) success over time, which made the investment decision to buy the remaining shares less risky. However, the termination of the Go! Discs label in 1996 shows how these cooperative ventures could lead to conflicts between label management and the major at a later stage (as will be discussed in the Independiente case presented later on in this chapter). This cooperative mode could also take the shape of a joint venture in which both the label managers and the major took a 50% ownership stake, and worked together more closely. For example, in their joint venture with BMG, the managers of the Deconstruction label were responsible for the major's overall dance strategy, while they accessed BMG's operational structure.

A second type of partnership is the so-called funding and distribution deal, in which the major did not purchase an ownership share of the label but still provided it some financial resources. Here, collaboration was on a fixed-term basis and evolved around complete label autonomy and major distribution. Chronicled as the prototype of this kind of alliance is EMI's 1988 deal with Food, home to acts as Blur and Jesus Jones. In 1994, this agreement turned into a 25%-75% stakeholder partnership, with EMI gaining formal control of the label. Still, Food continued its A&R policy

outside EMI, although the major was now involved in both the marketing and distribution of its products.[7] Another example of the funding and distribution deal is the relationship between indie label Blanco Y Negro and Warner Music, managed by founder Geoff Travis in close collaboration with Warner's front-line label WEA. Again, this agreement evolved into an elaborated shareholder relationship.

Finally, there is the license agreement in which the independent label licenses individual acts or recordings to the major that takes care of everything else apart from the initial discovery of the particular artist. The license deal was, to a minor extent, in use in the late 1980s, and has been extended to an international level in the early 1990s. In this way, independent companies were relieved from the time-consuming, expensive and complicated activity of negotiating licensing and export agreements with a number of foreign independent labels. The major partner, in turn, collected international revenues and paid its minor counterpart a licensing fee, usually in terms of a certain percentage of the wholesale price. Over time, even more sophisticated agreements came to life, as deals were constructed that combined elements of these three basic types of strategic alliances. A prime example is the cooperative venture between Creation Records and Sony Music UK's Licensed Repertoire Division.

Sony had already launched this division in 1992 to coordinate its international licensing activities with regard to its affiliated independent companies. It established partnership deals with labels like Creation, Nude and Network in which it acquired up to 50% of their shares. In this way, these independent labels could piggyback on Sony Music's international marketing and distribution, gain financial stability, and absorb administrative and legal expertise. Creation, for instance, was offered £3.5 million in 1992 to sell 49% of the label to Sony's LRD. Apart from the fact that acts like Oasis were professionally marketed on a world-wide level by Sony, Creation also benefited from this deal as it learned how to set up a focused and efficient record company. As a consequence, Creation changed into a company where both music and business were considered to be crucial to its success. The deal was extended in 1996, when Creation was reported to have generated a pre-tax profit of £7.0 million.[8]

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7 Editorial, "Food Men Sell to EMI," *Music Week*, 23 April 1994, p. 1.

8 Sources: Editorial, "Creation's £3.5 Million Deal Sees Sony Go 'Indie'," *Music Week*, 22 August 1992, p. 1; Gorman, P. "Indie Pioneer's Ambitions Go Beyond Hitting Number One," *Music Week*, 26 August 1995, p. 8; Editorial, "Creation Finds the Perfect Partner," *Music Week*, 15 June 1996, p. 3; Editorial, "Dane Report Names Creation as Top Indie," *Music Week*, 23 August 1997, p. 1.

THE CASE OF BMG INTERNATIONAL UK

The increase in cooperative ventures was a general phenomenon in the UK industry in that all majors were creating ties with independent labels. However, some major firms were more involved in these practices than others: apart from Sony Music's Licensed Repertoire Division, the other major record corporation that came to build its strategy on a comprehensive approach to collaboration was BMG International UK. Because the firm had its roots in RCA, the American record company that once had been one of the 'big four' companies until the mid-1950s, its repertoire had been primarily US-based. But as British music was important to the company's International group, the UK company had to create a sound base of local repertoire. Case Box 7.3 narrates the process of change involved in this assignment, and supports the analysis of BMG's search for capabilities in a changing competitive environment. Subsequently, Table 7.12 displays the characteristics of both the context and content of change.

CASE BOX 7.3: BMG INTERNATIONAL UK

When the German media conglomerate Bertelsmann AG acquired RCA Records from General Electric in 1986, it entered an international arena in which five major players – CBS, EMI, MCA, PolyGram and Warner – were competing for global dominance. Driven by its ambition to be one of the world's Top 3 record companies, the German corporation created the Bertelsmann Music Group as an organizing framework for its various labels and publishing houses. BMG International, responsible for the group's worldwide music activities outside North America, responded to these aspirations by boosting its overall market share from 11% to 15% in just five years. With an average annual growth ratio of 22%, gross revenues increased from $665 million to $1749 million between 1986 and 1991, while the total number of countries in which BMG International had a presence expanded from 17 to 34. However, the British operating company was not able to follow this successful growth pattern. Even worse, the UK subsidiary's market share declined from 9% to 4.7% during these same years, making it BMG International's worst performer.[i]

BMG UK as Repertoire Source

From its inception in 1986, BMG International has been headed by Rudi Gassner, who had previously worked as Executive Vice-President of PolyGram's International division in London. Most record companies traditionally regarded such international departments as simple operational divisions, responsible for licensing records to overseas partner companies. His new job presented Gassner with a tremendous opportunity to build a genuine international organization. His vision of how this could be done effectively consisted of three principal elements: (1) incorporating Bertelsmann's philosophy of entrepreneurial management at autonomous operating companies, (2) stimulating the development of domestic repertoire at these units, and (3) leveraging

local artists to an international level. To realize his dreams, Gassner developed a two-stage international management structure in which managing directors at national operating companies were given a high level of autonomy. At the same time, cross-border coordination was achieved through frequent meetings among regional directors that headed one of five territories.[ii]

In this way, Gassner built an infrastructure in which all operating units could concentrate on local repertoire development in their national markets, and still have the possibility to break acts on a regional or even global basis. This would reduce his "fear of being too dependent on English-speaking repertoire," and install a cooperative and border-crossing attitude among the members of the BMG International group.[iii] At the same time, Gassner accepted the reality that no global record corporation could do without Anglo-American repertoire, simply because this can be more easily exploited on a global scale than its non-English-speaking counterparts. With the US (together with Canada) having its own division within BMG, the crucial operating company in this respect within the International group was therefore BMG UK. Using Gassner's own words, "The United Kingdom, despite its relatively small profits, was our largest source of repertoire, a major supplier."[iv]

The UK company's declining performance therefore not only affected BMG's competitive position on the British playing field, but also obstructed a potential increase in revenues at other units within the International group. Acting as licensees, foreign sister companies could earn substantial amounts of money via the release of English-speaking acts without the costs of signing and developing this repertoire themselves. Gassner understood the significance of the British company to BMG International as a whole, and saw the United Kingdom as an "area where our market share is below the expected standard."[v] He also claimed that in the UK far too much money was spent with the primary objective of immediate chart success and that the British industry "has almost lost its focus and certainly overlooked long-term [artist] development."[vi] To John Preston, regional director and chairman of BMG UK, the message was clear: he had to streamline his company and create a sound base of new repertoire.

Organizational Restructuring at BMG UK

In the spring of 1991, Preston started a process of organizational change by removing eight percent of his staff, mostly at a managerial level within the company. Apart from eliminating one layer of middle management, he dismissed both managing directors at RCA and Arista, handing him direct control of operational affairs at the BMG UK company's main pop labels. Building upon his experiences as MD of Polydor Records and the old RCA Records, Preston aimed at refocusing established practice within the bottom of the organization. But when Preston "began to realize there were aspects of my role as chairman that were not being given as much time as I would have liked," he appointed new MDs to these labels in 1992.[vii] Their assignment was to be engaged in structural artist development and to create new repertoire that would reduce the UK company's dependency on American superstars such as Whitney Houston.

RCA's new managing director Jeremy Marsh, like Virgin's MD Paul Conroy a former protégé of Warner Music chairman Rob Dickins, recognized the rapid rise of dance music, and accordingly redesigned the label's modest dance department. In this process, he took on Pete Hadfield and Keith Blackhurst of RCA's licensing imprint Deconstruction as dance A&R consultants responsible for the label's dance

strategy. At the same time, Marsh ended a licensing deal with Perfecto, RCA's second dance imprint led by Paul Oakenfold, as "Perfecto had a very different agenda that did not line up with what we wanted," enabling Blackhurst and Hadfield to create a coherent dance policy within RCA.[viii] The label's new focus indeed delivered success: its album market share rose from 2.3% in 1992 to 3.7% in 1995, RCA's best achievement in the UK ever under BMG's umbrella. In contrast, Arista could not live up to expectations during this period and experienced its worst performance ever since 1986.

To address this enduring problem, chairman Preston promoted his successful change agent Jeremy Marsh to president of a newly created BMG UK Music Division. This division comprised the company's main labels RCA, Arista, BMG Classics and Deconstruction, which by then almost operated as an autonomous label. Marsh's task was to deal with strategic priorities of these labels concerning their organizational and environmental contexts, as well as to deal with complexities in possible relationships between them. Marsh expressed his intention to leverage capabilities across BMG's autonomous front-line labels as "a chance to harmonize the skills we have across the labels while maintaining their identities."[ix] In addition, he formed a new department that would be responsible for marketing the Music Division's four-legged repertoire internationally, while strengthening the Classics label through the acquisition of the classical independent Conifer Records.

Developing BMG's Label Infrastructure

Meanwhile, RCA underwent further changes under the new supervision of its former marketing director Hugh Goldsmith after being promoted to the vacant chair of MD. In pursuit of his goal to broaden the label's musical domain from mainstream pop acts such as Take That, Goldsmith had divided RCA's marketing and promotion activities into three separate departments. Whereas each of them was targeted at different styles of music, the label's A&R function continued to operate as an integrating platform. At Arista, the new MD Martin Heath had created the so-called 'hub-system,' in which a project management organization acted as an interface between the Arista label and its various imprints. Being designed to encourage internal competition in the Arista label, this system aimed at integrating its A&R and marketing capabilities into project teams. Each team was headed by a project manager and covered a portfolio of projects linked to sub-labels like Rhythm King, Boilerhouse and Urgent.

The apparent complexity within BMG UK's organizational set-up was closely related to the company's continuous need for creative expertise in music circles. As a major record firm, BMG had strong capabilities in the areas of sales, manufacturing and distribution, all embedded in an organizational context which was dominated by tight financial guidelines and, to a lesser degree, technological considerations. But top management was well aware that the company could only employ its core capabilities if it could attract the attention of the artists providing the actual content of recordings. Managerial efforts were thus directed at the gradual development of an infrastructure that would enable BMG's front-line record labels to manage the required interface with recording acts. In this sense, the launch of several fully-owned satellite labels by RCA and Arista was aimed at the creation of compact and artist-friendly operating structures on a project basis within the company.

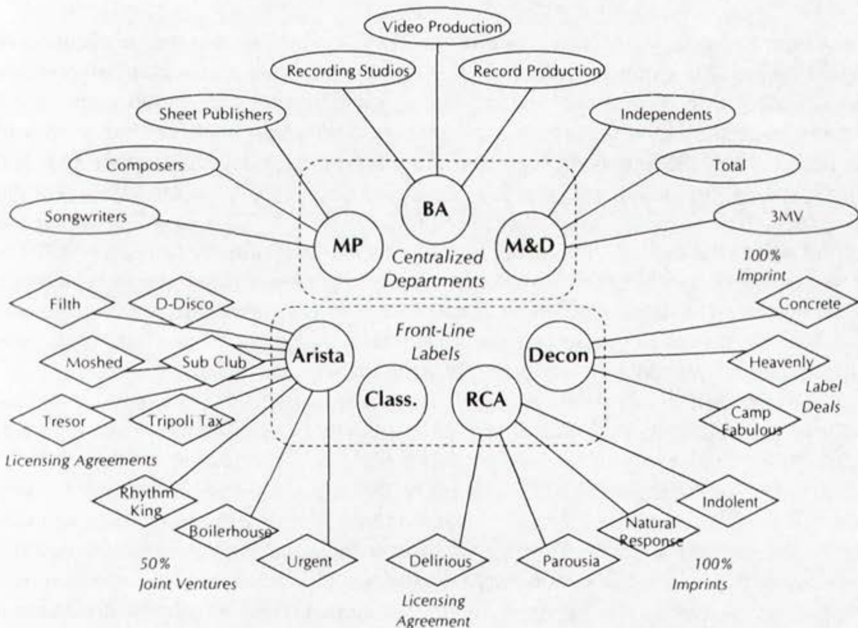
BMG's evolving label infrastructure also allowed for a closer cooperation with independent record companies via licensing agreements and joint ventures. Referring

to the intensity of competition for creative talent among independents, Music Division president Jeremy Marsh argued that "there's a lot of new talent being nurtured there, so one of our strategies is to continue to build strategic alliances with the indies."[x] While satellite labels were launched with the intention to actually internalize creative resources from the artistic community, joint ventures and licensing deals were closed with a different purpose in mind, according to director of business affairs Clive Rich: "the rationale for such agreements is that you manage to access creative partners, who in turn give you access to the bands that you wouldn't be able to have access to if you were just BMG."[xi]

BMG's Network of Relationships

Not hampered by organizational procedures and formal structures, independent labels had a clear advantage over their major counterparts; not only were these small record companies able to operate at street level where they were quick to move and do deals, but a lack of formality also made them much more attractive to young artists. Another reason mentioned by Rich for linking up with independent labels was that "it's very, very difficult for record companies to have a 360 degree beam, and covering all the different niches and trends that are going on at one time."[xii] Together with the firm's sub-labels, BMG's joint ventures and licensing deals increased the company's market outlook, in the process creating an infrastructure for managing the internalization and access of creative resources and capabilities. Exhibit 7.5 shows how this infrastructure made up a significant part of BMG UK's elaborate network of relationships with its surrounding music community.

Exhibit 7.5: The BMG Network as of Early 1997



The company's key centralized departments embodied a second route through which the company nurtured these linkages. Whereas the Music Publishing division maintained its relationships with songwriters and composers, BMG's business affairs department intermediated between the firm's front-line labels and record producers, recording studios, and video production companies, generating services through which more long-lasting relationships were also forged ocassionally. BMG UK's manufacturing and distribution division was linked to some 25 small record labels, and offered its services to another 30 independents through its alliance with Total and 3MV, intermediates specialized in distribution, marketing and sales activities. Crucial in managing these interfaces was that "BMG is at the heart of it, and there are lots of different operating structures to accommodate these different activities."[xiii] This web allowed the company to develop along a process in which both organic growth and acquisitions played a role.

A perfect example of the strategic value of BMG's cooperation-based network to the firm's evolution has been the gradually rising prominence of the Deconstruction label within the overall company. Its relationship with BMG UK started in 1988 with a distribution deal and evolved about two years later into a licensing agreement with RCA. Another two years later, Deconstruction's owners Blackhurst and Hadfield were promoted to internal consultants responsible for RCA's overall dance strategy when Jeremy Marsh restructured this struggling label. In 1994, Deconstruction changed into a joint venture company in which its owners and BMG UK shared a 50% stake, at that moment demonstrating its gift for success with M People's Mercury Prize victory. By 1996, Deconstruction had evolved into a self-contained front-line label within BMG's Music Division, even signing up its own label deals. Although it took 8 years and millions of pounds, BMG had managed to develop a new UK-based label.

The Return of a Major Player

Apart from the recovery of RCA, the birth of a new lead label, and the fortification of BMG Classics with Conifer Records, BMG had also launched a new business venture called Global to enter the fast-growing market segment of TV-marketed compilation albums. Backed up by a steadfast annual average distribution market share of 15% in the period 1991-1996 (making BMG the UK's third largest distributor after EMI and PolyGram) the firm's album market share steadily recovered from the 1990 extreme low. Recalling that BMG's market share had dropped from 9.0% to 4.7% during the second half of the eighties, the company had showed its vitality by re-capturing 8.3% of the market by 1996 (see Exhibit 7.6). With a stronger repertoire base, in which US-based acts like Puff Daddy and Toni Braxton were complemented by established and new UK artists such as Annie Lennox, Lisa Stansfield, Posh and Sleeper, BMG was back in the race with Warner and Sony for the third spot on the list.

Despite the successful recovery of the company in terms of market share and local artist development, BMG found itself faced with further challenges near the end of 1997. Apart from some immediate setbacks such as the unexpected departure of RCA's MD Goldsmith and the termination of the firm's eight-year relationship with Total, a more strategic management issue involved BMG's expanding organization. The increasing number of cooperative ventures with various creative sources had not only boosted the company's A&R activities, but had also amplified the organization's complexity. As each of these projects embodied individual profit centers, it became a more of a challenge to maintain appropriate cost controls and keep track of margins

throughout BMG's network structure. It was up to the company's management to think of ways in which both A&R and best business practice could be further integrated.

Exhibit 7.6: BMG's Performance in Market Shares

Year	BMG	RCA	Arista	Decon.	Classics
1990	4.7	1.5	1.6	0.2	n/a
1991	5.2	2.5	1.2	-	1.7
1992	5.1	2.3	1.9	-	2.6
1993	7.0	2.9	2.2	-	5.3
1994	4.8	1.7	0.7	0.8	3.8
1995	8.1	3.7	n/a	0.9	3.1
1996	8.3	3.2	n/a	1.1	4.9

Source: BPI Statistical Handbook 1997

Note: Figures in BMG and Classics columns are record company markets shares; figures in RCA, Arista and Decon(struction) columns are label market shares.

Endnotes

[i] In August 1996, BMG International changed its name into BMG Entertainment International. For matters of convenience, the original company name will be used in this case.
[ii] These territories or regions were: the German-speaking countries, Central Europe, Spain & Latin America, Asia-Pacific and the United Kingdom.
[iii] Hill, L.A. and K.S. Weber, *Rudi Gassner and the Executive Committee of BMG International*, Harvard Business School Case, 1993.
[iv] Ibid.
[v] Editorial, "BMG's Five-Year Man," *Music Business International*, January 1993, pp. 18-21.
[vi] Ibid.
[vii] Editorial, "Marsh Coup Gives BMG Shot in Arm," *Music Week*, March 14th 1992, p. 5.
[viii] Editorial, "Perfecto is Pushed Out," *Record Mirror*, November 14th 1992, p. 1.
[ix] Editorial, "Marsh to Work Magic on BMG," *Music Week*, July 15th 1995, p. 1.
[x] Editorial, "Preston Predicts Bright Future," *Music Week*, September 16th 1995, pp. 8-9.
[xi] Recorded Interview, October 16th 1997.
[xii] Ibid.
[xiii] Ibid.

(See Appendix D for secondary sources)

In contrast to the cases of Island and Virgin, there was no change of ownership to trigger the change process. Although RCA had been acquired by multi-media conglomerate Bertelsmann AG, this had already happened in 1986. While RCA's US-based musical focus was indirectly responsible for the changes that were about to take place, a time lag of some six years makes it difficult to assume the presence of a direct causality. Whereas no executive replacements occurred at the highest mana-

gerial level within BMG UK, the appointment of Jeremy Marsh as new Managing Director at the RCA label level was an important catalyst for the firm's transformation. Furthermore, the company had experienced a significant performance decline. Whereas its average share of the market during the period 1986-1988 had been 8.2%, this figure tumbled to 5.2% over the next three years. But the increasing emphasis on local content in the world's music markets provided an opportunity for BMG to recover.

Table 7.12 Context and Content of Organizational Change at BMG Intern. UK

Change Context	
New executives	Appointment of Jeremy Marsh as RCA Managing Director
New ownership	-
Threat/opportunity	Increase in consumer attention for local content
Performance decline	Significant decrease of company market share 1989-1991
Change Content	
Vision	Merge Bertelsmann's management ethos with local market demands
Scope	Deliver commercial artists to international audience
Positioning	BMG UK as internationally-oriented local record corporation
Capabilities	Incorporation of local A&R capabilities

This was reflected in the content of change at the company of which the vision was to combine Bertelsmann's traditional strength in autonomous and entrepreneurial management with the market demands for UK music. A fundamental objective was to make BMG UK the International group's main source of repertoire. This meant that it had to deliver commercially attractive British music not only to the local market, but also to other parts of the world covered by the International group. The company was therefore positioned among its rivals – that is, the other major record companies – as an internationally-oriented local record corporation. But with almost no experience in local A&R, BMG had to create new capabilities to meet such a deficit in British artist development. However, building local A&R capabilities from scratch would be a time-consuming matter, and the company therefore needed a fast route to incorporate capabilities and expertise in local artist development.

Table 7.13 Main Events at BMG International UK

Event	Date
Removal of staff, including RCA and Arista MDs, and a layer of middle management	April 1991
Jeremy Marsh becomes new RCA MD	March 1992
Pete Hadfield and Keith Blackhurst head RCA's new dance strategy	July 1992
Perfecto label leaves RCA	November 1992
John Preston publicly states 12 months of restructuring are over	December 1992
Deconstruction becomes 50% joint venture	August 1994
Deconstruction wins Mercury Prize	September 1994
Launch of Global TV	October 1994
Hugh Goldsmith regroups RCA's marketing in line with A&R	December 1994
Heavenly Records signs label deal with Deconstruction	April 1995
Jeremy Marsh becomes president of new Music Division; Hugh Goldsmith becomes new RCA MD	July 1995
Jeremy Marsh publicly states objective to link up with indies	September 1995
New International Marketing department in Music Division; BMG acquires classical label Conifer Records	November 1995
Martin Heath becomes new MD at Arista to create 'hub' system	April 1996
Urgent and Boilerhouse become 50% joint ventures with Arista	September 1996
Delirious Records signs label deal with RCA	November 1996
Hugh Goldsmith leaves RCA	July 1997
Total ends eight-year deal	September 1997

BMG UK's search for these capabilities embodied a process of organizational change, which seems to have started with company chairman John Preston's decision to remove his label MDs in early 1991 and ended near the end of 1996 with two joint venture deals.[9] Table 7.13 lists the major events, tied to specific dates, which occurred in these years of transformation as described in the Case Box of BMG International UK. Furthermore, Table 7.14 displays an outline of the essential elements that comprised BMG's change process. The corporation's new business phi-

[9] It has to be noted that the removal of a layer of middle management was an act of downsizing; the actual building of new capabilities seems to have started a year later with the arrival of Jeremy Marsh.

losophy was to build local repertoire at label level that could be leveraged to other BMG companies and music markets in the world. The reorganization of BMG's internal processes essentially happened at two different levels within the company. On the one hand, the creation of separate departments and project-based structures enabled a focused approach to A&R and marketing at BMG's front-line labels.

Table 7.14: Process of Organizational Change at BMG International UK

New philosophy	Build local repertoire to be leveraged internationally
Reorganization	Music Division at corporate level; projects and departments at label level
Internal ventures	Launch of satellite labels and Global TV
Novel acquisitions	Purchase of classical Conifer Records
New alliances	Various license deals and joint ventures
Status reevaluation	Increasing attention to cross-label coordination
Learning new skills	Managing a network of interfaces with the creative community
Resolving dilemmas	Access to and internalization of creative resources

On the other hand, more strategic concerns that surpassed individual labels and other cross-label issues were made manageable through the formation of BMG's new Music Division at the corporate level. Whereas the labels used to operate autonomously from each other, more emphasis was given to the coordination and leveraging of skills across the company's front-line labels. Still, the creation of a network of license deals, joint ventures and satellite labels took place at both the label and corporate levels within the company. In addition, the BMG Classics label was strengthened via the purchase of independent Conifer Records, while a new business venture was launched to enter the TV compilation albums market. In the process of developing such an elaborated organizational structure, BMG created distinct skills in managing its interface with the creative community. Moreover, its evolving label infrastructure enabled BMG UK to both access and internalize creative resources.

In the end, the company's performance in terms of turnover and gross profits increased rapidly from 1992 onwards, while operating losses were turned into substantial profits, as the following table of BMG International UK's financial figures shows.

Table 7.15: BMG International UK's Financial Performance (in £1000)

	1990	1991	1992	1993	1994	1995	1996
Turn-over	42899	48850	42420	48963	63945	84736	100243
Gross Profit	18736	19163	15277	20798	27859	40160	43799
Operat. Profit	(738)	(140)	(2423)	871	6034	11432	13674

Source: Compiled from the UK Record Industry Annual Surveys 1993-1998

THE CASE OF WARNER MUSIC UK

BMG had not been the only major record company that had noted a shift in consumer preferences from US-based music to local artists. Warner Music had also experienced this trend at the cost of declining worldwide sales of its American superstars. With its roots going back to Ahmet Ertegun's Atlantic Records and Steve Ross's federation of autonomous labels, Warner had always been the most American-oriented major of all. It had established itself in London in the sixties when British pop came to a rise, and had expanded internationally during the seventies and the first half of the eighties. In those years, its principal aim had always been to distribute and market US-based acts instead of being involved in local artist development. But now that local content came to be more valued by the market, Warner's operating companies were in need of local repertoire. Case Box 7.4 describes how this issue was dealt with by its UK company, after which an analysis of Warner UK's search for new capabilities is presented.

CASE BOX 7.4: WARNER MUSIC UK

In 1989 the largest media conglomerate in the world was created when Time acquired Warner Communications Inc. for $14 billion. Although the formation of the Time-Warner combination did have an impact on Warner's music business outside America, the effect was more a matter of speeding up a change in the company's course that had already been set in progress. During the late eighties, WEA International had decided to modify its traditional strategy of developing and marketing American superstars on a global level. Although the worldwide successes of artists like Madonna and Prince demonstrated WEA's strength in this area, the International

division's management was well aware of a shift in consumer preferences towards local music products. In 1990 Ramon Lopez, CEO of the newly named Warner Music International, started his search for national talent by purchasing local independents such as Carrère in France and Alfa Moon in Japan, and by reshaping his operating companies in key markets.

The Split of Warner Music UK into WEA and East West

In the most prominent of these key territories, Warner Music companies were divided into two separate units to bring more balance between US-based and local repertoire. In the United Kingdom, the first of these principal label groups, WEA Records, would focus on marketing American acts from the Elektra, Reprise and Warner Bros. labels. It would also access local artists through licensing deals with independents Blanco Y Negro and ZTT. The launch of Warner Music UK's second front-line label, East West Records, was primarily aimed at building a strong base of local repertoire, backed up by the solid roster of its US-based Atlantic sister label. The complementarity of these two label pillars created a double-edged organizational context which enabled the UK company to be involved in the costly process of local repertoire building. At the same time, financial growth and stability were secured, as both label groupings were active in marketing and developing American acts.

During the period 1991-1995, both WEA and East West steadily restructured their A&R ranks to meet chairman Rob Dickins' objective of boosting Warner Music UK's share of domestic repertoire. Yet, despite the employment of A&R consultants by both front-line labels, results failed to meet expectations regarding the balance of the company's repertoire base during the first two years. WEA MD Moira Bellas, who had replaced Jeremy Marsh after his departure to RCA in 1992, and her counterpart at East West, Max Hole, thus complied to the more drastic measures proposed by their chairman. Commenting upon the initiated radical employee turnover at the company's A&R departments in 1993, Rob Dickins argued that "A&R is the beating heart of any record company which takes itself seriously and that heart has to beat strong. Marginal changes are pointless and I have to go in for some deep surgery and heart surgery is a fairly major business."[1]

Exhibit 7.7: Warner's Market Share Performance

Year	Warner Music	WEA Records	East West
1991	12.6	3.5	3.6
1992	11.7	3.4	3.5
1993	10.3	3.0	2.4
1994	9.8	2.9	2.6
1995	9.9	2.8	3.0
1996	9.6	2.5	2.6

Source: BPI Statistical handbook 1998

Note: WEA includes Warner Bros.; East West includes Atlantic.

Apart from appointing new A&R managers and directors, WEA also extended its licensing deals with independents Blanco Y Negro and ZTT into shared ownership joint ventures, while East West created an alliance with Dave Stewart's Anxious label. Furthermore, both front-line labels contracted individuals who worked in the industry as DJs or record producers to manage newly launched imprints, like Paul Oakenfold's Perfecto label at East West and WEA's Eternal venture with Steve Allen. Not only did Warner Music UK's A&R rejuvenation increase the share of domestic repertoire from 15% to 32% between 1991 and 1995, but it also brought the company into new music segments such as dance and underground. Although at first sight the change program had been effective as it brought more balance into the company's repertoire, Exhibit 7.7 shows how Warner Music UK's album market share declined by 2.7% over the same period.

Warner Music's Move into Compilation Albums

Confronted with this drop in performance, Dickins refused to believe that his business philosophy nor the people in the revived Warner organization were to blame, and thus dismissed the idea that another major restructuring would be helpful. Instead, Dickins sought an alternative way to improve Warner Music's competitive position in the UK market by stepping into the unknown territory of multi-artist compilation albums. For years Dickins had refused such a move, believing that an involvement in compilations would distract his company from focusing on long-term development of strong acts. Yet faced with the reality that all the other major record companies were competing in a market segment that had captured 26.9% of overall album sales by 1995, he changed his mind, recognizing this major segment as "an interesting profit and loss area."[ii] At the end of 1995, Dickins launched a new division, warner.esp (**e**nterprises and **s**pecial **p**rojects), and appointed Martin Craig as general manager with a brief to expand the company into compilations.

Until the early nineties, the compilation area had been dominated by specialist companies such as Telstar and Dino, that composed multi-artist albums by licensing songs from other record firms' catalogues. Not bothered by any investments in A&R, these specialists committed substantial resources to market their compilation albums, more than 80% of which was directed at TV advertising to reach an audience as large as possible. Apart from the successful 'Now!' series by the EMI/Virgin/PolyGram joint venture, major record companies in those years limited their involvement in this segment to the release of compilations during the Christmas season. But with the rise of dance music (primarily released on the singles format), the majors could no longer ignore an area which had grown over a five-year period from 15.1% to 22.6% of the total market in 1993. After all, they were the companies that owned large catalogues and the copyrights attached to them.

Most majors simply reviewed the number of tracks they licensed to specialists and realized that revenues would be higher if they took control of their catalogue and entered the compilations segment themselves. The growing number of competitors in this market niche made TV advertising budgets rise rapidly: in 1990 an estimated £6.2 million was spent by the industry on TV advertising over six months, while only four years later the same amount was spent in one quarter. Furthermore, as the supply of multi-artist compilations grew, competition started to evolve around exclusivity deals and tactics such as doubling the number of tracks on an album. But without access to strong catalogues and large promotional budgets, the specialist compilation

companies quickly saw their market prominence eroded by the majors. When BMG launched its Global TV compilations venture, Telstar's access to BMG's catalogue came to a halt, forcing Telstar to establish a joint venture TV compilations company with Universal Music, the smallest of the majors.

Warner.esp's Collaborative Capability

When in late 1995 national sales manager Martin Craig and chairman Rob Dickins got together, it turned out that both shared the opinion that Warner Music's catalogue was largely being left unexploited, despite the presence of a growing compilations market. Recalling those meetings, Craig observed how "in conversations with the chairman it became clear the time was right; his views and mine met and there was an opportunity to create something new."[iii] The outcome of their discussion materialized in the brand-new warner.esp division. Although Warner Music was the last of the majors to move into compilations, the timing seemed just about perfect: the company's restored A&R capabilities started to deliver in fresh local products, and its dance labels Eternal and Perfecto were performing well in the singles market. Exploiting this proven repertoire, warner.esp immediately released six compilation albums within six months after its conception, two of which scored a number one position in the charts, selling over half a million copies.

But the department's immediate success could not be completely attributed to Warner Music's hit repertoire. Another critical factor was Craig's deliberate choice to cooperate with other record companies in the process of creating compilation albums. After observing the success of the 'Now!' series and various failures by other record companies to set up TV compilation divisions, .esp's general manager concluded that "the way forward is the sharing of expertise, repertoire and risk. We have to share in the profit, but that's acceptable because of the other elements."[iv] During the two years after warner.esp's launch, the number of releases was increased via different projects with other majors, of which the self-initiated 'Hits' alliance with BMG's Global TV and Sony TV came to be highly successful. Apart from .esp's unproven position as a late entrant, various other reasons backed Craig's philosophy of cooperation, the most obvious being the reduction of risk through mutual investment and the reduction of competition by taking a rival out of the marketplace.

A crucial motive for warner.esp to be engaged in multi-company compilation projects was the creation of stronger albums as partners contributed tracks from their prime repertoire. Moreover, the combination of expertise and creativity in compiling, branding and marketing the compilation further strengthened its quality, improving its position at retailers. Despite this cross-company sharing of resources and capabilities, Craig stressed that "nobody forgets that we are all in competition with each other, so we are careful in how we deal with each other, sharing and discussing as much information relevant to the joint project as we can without compromising ourselves."[v] While intelligence on chart analyses and costs of TV campaigns was publicly available and could therefore be exchanged to a virtually unlimited extent, more firm-specific data like TV supplier contracts were treated as confidential towards partners.

Warner.esp's Coordinative Capability

In addition to its responsibility of developing Warner Music UK into a key player in the compilations business, warner.esp's second primary task was to take care of those issues and activities that concerned the company as a whole. Although the presence

of competition between the WEA and East West labels created an organizational climate in which both could thrive, such internal rivalry could at the same time endanger the interests of the overall Warner Music corporation. Projects turned down by the label groupings but critical to the company as a whole created a "hole in the middle of the company," according to Craig, who continued that "if you create an identity for East West and an identity for WEA, there has to be something also taking care of the interest of Warner Music."[vi] Warner.esp was thus set up as a separate division to deal with company-wide and cross-label issues and opportunities, embodying a central unit of coordination that recognized the labels' distinct identities.

One of the department's new core activities in this respect was the exploitation of Warner's overall back catalogue, an area that had until that moment been uncharted extensively by WEA and East West. The general feeling at the individual label groupings was that their artists could well be unhappy about what was traditionally regarded as an inferior or musically irreverent activity. Applying a somewhat more contemporary perspective, Craig felt that "perhaps we erred too much on the side of caution; I think we can work our catalogue a little bit more effectively and the changes in the marketplace have allowed us to do that."[vii] Closely related to its coordinative task of catalogue marketing was warner.esp's functioning as a central marketing body without interfering with the respective marketing capabilities of WEA and East West. The idea of installing such an intelligence agency was to offer the labels access to data that had been gathered via a systematic and scientific approach to market analysis and research.

Comparing warner.esp's marketing recipe to the music industry's traditional instinctive practices, its general manager argued how "we can help become a bit more scientific to be able to prove things, understand things better. We can still then follow our instincts and ignore the analyses if we choose to. But it's far better to choose to ignore that rather than to ignore that in complete ignorance."[viii] Craig's views clearly corresponded with those of chairman Rob Dickins who expressed his "want to release fewer records, better records [...] as it gets more and more competitive, I want to see more focus on how we market them."[ix] Installing this focus implied a pivotal role for warner.esp within the overall Warner Music organization; not simply because it was the core supplier of supporting market data, but above all because it aimed to provide an environment where strategic thought and debate would take place among various people throughout the company.

Ready for the Digital Age

Exhibit 7.8 displays warner.esp's success over the past few years in terms of its rapidly growing market share of the compilations segment, also expressed in the increase of releases and number of copies sold. Warner.esp's prosperity also seems to have had a positive contribution to Warner Music UK's halt to its declining overall market share. The growing prominence of warner.esp's role within the Warner Music organization was underlined by the integration of the company's licensing division and its classical label into warner.esp at the end of 1997. The move seemed to be a legitimate one as a major part of Warner Classics' revenues were obtained through themed compilations created from a growing classical catalogue. Furthermore, incorporating the licensing department's responsibility for clearance of catalogue material to third parties for use in compilations, soundtracks and commercials concentrated all catalogue operations within the .esp division.

Exhibit 7.8: Warner.esp's Performance in Figures

Year	Market Share	No. of Releases	Unit Sales (x1000)	Certified Awards Silver	Gold	Plat.
1995	2.0	3	470	0	1	2
1996	4.4	12	760	1	3	4
1997	5.1	17	1300	2	9	4
1998	7.3	31	1700	5	12	5

Source: Warner.esp company records

Note: The number of compilations released via joint ventures was 3, 10, 14 and 21 for each of the above years. Qualifying levels in the UK for silver, gold and platinum awards are sales of 60.000, 100.000 and 300.000 per album respectively.

Recognizing new opportunities in the near future with respect to on-line music delivery via the digital mode of the Internet, another part of Craig's assignment had been to keep track of new technological developments. One prominent scenario living in the minds of many industry executives is that in such a digital future, record firms' will only be able to distinguish themselves by focusing on a few core activities. While A&R will be crucial to the effective filtering of the enormous supply of music, clear and well-targeted marketing programs will be indispensable to corporate and product branding. As consumers are undoubtedly going to compile their own favorite albums via the Internet, catalogue building will be essential to capture increasing copyright revenues. With warner.esp in between the WEA and East West front-line labels, the Warner Music company covers all three bases and seems to be prepared for the music industry's jump into the digital age.

Endnotes

[i] Editorial, "Dickins Plans A&R Surgery," *Music Week*, May 15th 1993, p. 3.
[ii] Editorial, "Rob Dickins," *Music Business International*, December 1995, pp. 22-23.
[iii] Recorded Interview, November 17th 1997.
[iv] Ibid.
[v] Ibid.
[vi] Ibid.
[vii] Ibid.
[viii] Ibid.
[ix] Editorial, "Warner: Aiming for a Leaner and Fitter Future," *Music Week*, September 21st 1996, pp. 6-7.

(See Appendix D for secondary sources)

Again, Table 7.16 presents the core features of the change content and context at Warner Music UK (why did it happen and what was its nature). To some extent, the $14 billion acquisition of Warner Communications Inc. by media firm Time in 1989 seems to have induced the proc-

ess of transformation. Although plans were underway at Warner Music to become more involved in local artist development over the second half of the eighties, this alteration in ownership speeded up that process. Although no executive replacements took place at the top, the appointment of WEA's MD Moira Bellas and warner.esp's Martin Craig both induced organizational change. But in contrast to the other cases so far, the company had not experienced a decline in performance; during the period 1985-1990, Warner had enjoyed an average market share of 13.0%. Still, Warner saw a move towards more intensive local artist development in the UK as an opportunity to improve its market position.

Table 7.15: Context and Content of Organizational Change at Warner Music UK

Change Context	
New executives	Appointment of WEA MD Bellas and warner.esp GM Craig
New ownership	Time's $14 billion acquisition of WCI
Threat/opportunity	Increase in consumer attention for local content
Performance decline	-
Change Content	
Vision	Merge Warner's traditional marketing approach with local market demands
Scope	Deliver commercial artists to UK audience
Positioning	Warner UK as locally-oriented American record corporation
Capabilities	Coordination and development of A&R capabilities

This perceived opportunity came to shape Chairman Rob Dickins's vision in which the company's historical strength in marketing major American artists could be merged with local market demands in the UK. His main objective was to turn Warner into a record company with a balanced and commercially successful repertoire of both US- and UK-based acts. In other words, the company had to introduce British acts in a distinct but American style to the consumer market. In terms of positioning among its competitors, Warner came to be a locally-oriented American record company. Although it had moved into local artist development to some extent during the second half of the eighties, A&R capabilities in this respect were far from what they needed to be to realize this strategy. Moreover, Warner was split up in two parts, which meant that the development of capabilities at the label level had to be coordinated somehow.

Table 7.17: Main Events at Warner Music UK

Event	Date
WEA International divisionalizes into WEA Records and East West Records	January 1990
WEA International is renamed Warner Music International	September 1990
East West signs deals with A&R consultants	August 1991
Moira Bellas becomes new WEA MD	March 1992
East West forms joint venture with Anxious label	April 1992
Rob Dickins replaces key A&R staff, claiming it to be the most dramatic change in ten years	May 1993
Steve Allen becomes WEA's A&R manager	June 1993
Clive Black becomes WEA's A&R coordinator	January 1994
East West signs deal with Perfecto dance label	April 1994
WEA launches Eternal dance label, headed by Steve Allen	January 1995
Rob Dickins publicly states how music in non-traditional Warner areas start to pay off	September 1995
Launch of new compilations division, warner.esp, headed by Martin Craig	October 1995
Warner.esp reports start(l)ing success	June 1996
Ian Dewhirst becomes catalogue manager at warner.esp	August 1996
Warner.esp reports enduring success	September 1996
Warner's licensing division and Classics label are integrated into warner.esp	November 1997

Warner UK's search for such capabilities embodied a process of organizational change, which formally started with the division of Warner into its two principal label groupings, WEA Records and East West Records. However, since this move was done in all the prominent territories, the actual process of change at the UK company can be assumed to have started only after Moira Bellas was appointed as WEA MD. The end of Warner's transformation, as far as can be determined at this stage, was shaped by a last move of restructuring at the end of 1997, when the company's licensing division and its Classics label were integrated into warner.esp. Table 7.17 lists the core events and their dates during these five years of change as narrated in the Warner Music Case Box, and shows how the change process comprised two distinct phases.[10] In addition, Ta-

[10] Between March 1992 and September 1995 (when Dickens stated how the development of music in non-traditional Warner areas started to pay off), local A&R capabilities were

ble 7.18 presents a structured overview of the main features that constituted this two-staged change process at Warner.

Table 7.18: Process of Organizational Change at Warner Music UK

New philosophy	Build local repertoire to be leveraged via catalogue exploitation
Reorganization	Separate label groupings (WEA and East West) and warner.esp
Internal ventures	Launch of TV compilations division
Novel acquisitions	-
New alliances	Various license deals and JVs at labels; compilation alliances
Status reevaluation	Increasing attention to systematic market analysis
Learning new skills	Sharing of company knowledge across label groupings
Resolving dilemmas	Competition and cooperation at intra- and inter-firm levels

Over time, the firm's new business philosophy was aimed at the discovery and development of UK artists to build an exploitable catalogue. Warner's reorganization was largely a corporate issue; first in terms of the creation of separate label groupings, and later through the launch of warner.esp that acted as an integrative body for cross-label issues as well as a central intelligence unit. During this second stage, new skills were developed to share knowledge across label groupings, which enhanced both label groupings' appreciation for a more scientific approach to market research. Furthermore, the move into compilations introduced Warner to cooperative venturing with other major record companies.

Table 7.19: Warner Music UK's Financial Performance (in £1000)

	1991	1992	1993	1994	1995	1996	1997
Turnover	86261	106710	111388	112217	132134	150814	n/a
Gross Profit	23003	39027	43340	44847	59570	77003	n/a
Operat. Profit	2605	8966	11535	10638	20948	31452	n/a

Source: Compiled from the UK Record Industry Annual Surveys 1993-1998

built at the level of the individual label groupings. During the two subsequent years, the launch and expansion of warner.esp created a more integrated company at corporate level.

During the first stage, various licensing deals, joint ventures and satellite imprints were created, which expanded the company's interface with the creative community. In the end, Warner Music UK managed to resolve the dilemma between competition and cooperation, both within the firm and across its boundaries. Although the company's market share decreased gradually during the nineties, Warner's new capabilities have had a positive impact on its financial performance in these years, as Table 7.19 shows. From 1994 onwards, both turnover and profits increased at a rapid pace.

INDEPENDENTS' RESPONSE TO THE NEW REGIME

Both Rudi Gassner and Ramon Lopes, CEOs of the International groups of BMG and Warner respectively, were not unique in their ambition to install a higher awareness of the significance of local content into their operating companies. In fact, all the major record corporations had started to increase their emphasis on local artist development during the late '80s and early '90s, be it that the European majors had a lead advantage over their American rivals due to their heritage (Laing, 1992). Apart from intensifying local A&R activities, majors purchased national independents in their quest for local repertoire and expertise. Table 7.20 displays some of these acquisitions in Western Europe during the period 1990-1994.

Table 7.20: Prominent Acquisitions of European Independent Labels

Year	Independent Label	Major Purchaser	Country
1990	Polar	PolyGram	Sweden
1990	Carrère	Warner	France
1991	Minos	EMI	Greece
1991	Sonet	PolyGram	Sweden
1992	Vogue	BMG	France
1992	Medley	EMI	Denmark
1993	DRO	Warner	Spain
1993	Trema	Sony	France
1994	Dino	BMG	Netherlands
1994	Intercord	EMI	Germany

Source: Adapted from Hardy, P. and D. Laing (1995), The European Music Business: Markets and Players, *London: Financial Times Management Report*

Clearly, the dominance of American music in the world, born out of the prominent position of the United States following the Second World War, was being eroded. This process was further intensified by the rising importance of Asia as a collection of local-oriented music markets.

Table 7.21: Continental Shares of Worldwide Music Sales

	US	Europe	Japan	Asia	L. America
1985	35.8	32.6	10.6	2.9	5.1
1990	30.6	42.8	12.6	5.5	2.6
1995	30.5	33.8	19.0	5.2	5.2

Source: Compiled from IFPI data

The declining importance of America's traditional superiority in music can be illustrated in two basic ways. First of all, whereas the European and Japanese markets showed higher growth rates, the share of US music sales of total world sales declined significantly during the second half of the eighties (Rutten, 1991). Table 7.21 shows this development, and illustrates how in subsequent years American sales remained at some 30% of total worldwide value. The table also indicates how Latin-American. Asian and Japanese markets have grown in importance during the nineties, primarily at the cost of Europe's share of overall music sales. The second way in which the decline of American hegemony in music can be underlined is by observing national markets' international repertoire as percentage of market value over time. Although this ratio also includes domestic sales of foreign music other than from American origin, it is still dominated by US (and to a lesser extent British) artists, at least with respect to the European continent (Laing, 1992).

On the next page, Table 7.22 displays these ratios for the largest national markets, as categorized along continents between 1992 and 1997.[11] Although there is a lack of data regarding Latin America, it appears that Brazil and Mexico follow an opposite trend, which could be due to Mexico's close location to the United States. In Asia, all the largest markets are involved in a movement towards more, instead of less, international repertoire. This can be related to the majors' entrance into this part of the

[11] Obviously, domestic repertoire as a % of market value displays a reversed pattern.

world during the early '90s, and the subsequent expansion of operations and investment in activities over recent years. In Europe, however, there is a general trend in which individual markets are moving towards more local music at the cost of international (primarily American) repertoire. The decline of American superiority becomes even more pronounced if one realizes that there actually has been an increase in artist recordings and music publishing that cross national borders within Europe in the first half of the nineties.[12]

Table 7.22: International Repertoire as Percentage of Market Value

	1992	1993	1994	1995	1996	1997
Europe:						
Germany	60.0	60.0	57.0	56.0	50.5	50.0
UK	–	46.8	41.8	42.7	42.0	39.0
France	49.8	48.2	46.5	45.1	42.7	44.3
Netherl.	77.0	68.0	64.7	65.0	68.0	65.0
Asia:						
Japan	19.9	19.4	27.6	23.7	26.9	24.3
Taiwan	20.0	25.0	26.0	28.4	23.3	25.9
Sth Korea	20.0	26.0	30.0	31.0	35.7	30.6
Thailand	5.9	5.9	21.4	28.5	19.1	21.6
L. Amer.:						
Brazil	40.0	40.0	39.2	35.0	32.8	28.0
Mexico	–	30.0	30.0	30.0	40.0	42.0
Argentina	–	–	–	32.6	24.8	30.0
Colombia	–	–	–	40.0	30.0	20.0

Source: Adapted from IFPI, The Recording Industry in Numbers 98, *London: IFPI*

The growing attention to local music demands can also be observed in the rise of local and regional music television channels across Europe. Launched in August 1987, MTV Europe had enjoyed a virtual monopoly for half a decade in its supply of music television to European viewers. But from 1992 onwards, a host of new stations entered the market for music television, most of them targeted at local and/or regional viewers.

12 De Whalley, C., "Europe's Songwriters Cash in on International Success," *Music Business International*, August 1995, pp. 53-55; Editorial, "US Looks On as Europe Goes Live and Kicking," *Music Business International*, August 1996, p. 13.

Table 7.23: Increasing Competition in the European Music TV Business

Channel	Countries Covered	Launch Date	Penetration rate
MTV	UK and Ireland		6.4 million
	Italy		15 million
	Germany, Austria and Switzerland		19 million
	Scandinavia, France, Belgium and Netherlands	August 1987	13.7 million
VH-1	UK and Ireland	September 1994	6 million
	Germany, Austria and Switzerland	March 1995	8 million
VIVA	Germany, Austria and Switzerland	December 1993	25.9 million
TV Zwei	Germany, Austria and Switzerland	December 1993	18.4 million
The Box	UK and Ireland	March 1992	1.9 million
	Belgium, Netherlands and Luxembourg	November 1995	2 million
	Italy	April 1997	7.5 million
Fun TV	France	February 1997	0.2 million
CMT	Europe	November 1992	4.5 million
MCM	France	July 1989	2 million
TMF	Netherlands	May 1995	5.3 million
ZTV	Sweden	May 1992	1.8 million
Mad TV	Greece	November 1996	0.6 million
+Musica	Spain	July 1997	n/a

Source: Adapted from Talbot, M., "More May Equal Less as Music TV Growth Dissipates Audience," Music Business International, *December 1997, pp. 29-31.*

These channels, displayed in Table 7.23, were welcomed by record companies as they focused on national markets and domestic repertoire. Even MTV could no longer deny the growing market demand for local music in Europe, and in 1996 divided its signal over three general European re-

gions to cope with this increase in competition for the continent's 150 million households. Moreover, it launched a separate channel for the UK in July 1997, stressing the significance of the British music industry, and its move towards more local content.[13]

While the major companies intensified operations in national markets to meet increasing local consumer demands, independent labels began to pay more attention to international market opportunities. Traditionally, independent companies had focused on their immediate or national market environment as they lacked resources, skills and a global outlook. But as cooperative ventures between majors and independents increased in number, indie labels accessed the international marketing and distribution channels of the majors while adopting a broader market perspective. Creation Records and Nude Records are examples of UK labels that achieved worldwide success after they had teamed up with Sony Music's Licensed Repertoire Division. In a similar vein did British independent labels XL Recordings and Mute Records score in America when they closed licensing deals with Warner-backed Maverick Records.[14]

THE CASE OF ROADRUNNER RECORDS

An independent company that had already developed an international perspective in the second half of the eighties was Roadrunner Records, a small label specialized in metal music with its home base in the Netherlands. In those years, the Dutch company had expanded its international scope towards its major surrounding countries (France, Germany and the UK), after which it set up overseas units during the nineties (Brazil, Japan and Australia). However, these foreign affiliates were primarily responsible for marketing Roadrunner's largely US-based repertoire, which the label extracted from its office in New York. But now that British acts became increasingly successful on an international level, Roadrunner aimed

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13 Sources: Eade, C., "Labels Give Backing to MTV's Regional Revamp," *Music Week*, 24 August 1996, p. 5; Talbot, M. " 'Clutter-Free' MTV UK Promises More Music," *Music Week*, 21 June 1997, p. 3. According to BPI figures, the share of UK artists in total British album sales rose from 49.3% in 1991 to 58.3% in 1997, whereas the American share declined from 35.4% to 28.4% over the same period (as listed in *BPI Statistical Handbook 1998*). Furthermore, it is reported in *The UK Industry Annual Survey 1998* that the number of UK acts in the annual album Top 20 rose from 9 to 16 in the period 1993-1997.

14 Gorman, P. "Reaching Their Domestic Limits, Local Players Look Further Afield," *Music Business International*, December 1997, pp. vii-ix; Gorman, P. "Flexibility Is Key to Indie Success," *Music Business International*, December 1997, pp. xiv-xv.

to develop its UK company into a international repertoire source. Case Box 7.5 narrates the change process that was involved in more detail, and provides the input for an analysis of Roadrunner's search for capabilities as it adapted to a changing competitive environment.

CASE BOX 7.5: ROADRUNNER RECORDS

During the first half of the nineties, independent Roadrunner Records experienced an unmatched degree of success in the heavy and alternative metal segment of the music industry. With a string of top-selling albums by its prime acts Sepultura, Type O Negative, Life of Agony, Machine Head and Fear Factory, the company managed to establish itself among the world's leading metal labels. Suddenly, in 1995, Roadrunner had a big hit in Europe with Technohead's 'I Want to Be a Hippy' song, which brought the company into the dance music arena. This chart success expressed Roadrunner's diversification move into other musical areas, a strategy which had been designed by Chairman Cees Wessels only a year before. Considering the fact that the United Kingdom represented the European center for dance music at the time, his aim was to increase the UK share of Roadrunner's repertoire that had traditionally been primarily American-based. To implement his idea, new capabilities had to be built at Roadrunner's London office.

Roadrunner's International Growth

Incorporated in 1981 by Cees Wessels and Jan van der Linden, Roadrunner Records entered the record business with an initial product-market strategy that was, although sharply defined, rather narrow in scope. In early those days, the label operated as a licensee for record companies like Metal Blade and Music for Nations, releasing the catalogues of these overseas independents exclusively in the Benelux markets. Still, Wessels had always intended Roadrunner as a record company involved in the development of its own artists instead of merely marketing external repertoire. Four years after the label's founding, he ended his partnership with Van der Linden to become full owner, leaving him free to decide over the company's future. Backed by a steady growth in turnover derived from Roadrunner's license-based activities, Wessels hired a small A&R staff and opened a New York office in the early eighties. His personal involvement in A&R turned him into the all-round entrepreneur traditionally associated with independents.

As a specialized record company, Roadrunner operated in the niche market for heavy metal music. At the time, Wessels had realized that the virtual absence of major record corporations in this segment and the relatively small number of European metal labels were key to Roadrunner's successful entrance into the business. Even during its starting years, Roadrunner licensed repertoire from metal labels only, through which it released acts such as Anthrax, Metallica and Slayer. The label's focus on metal music was sustained when Roadrunner's strategy became more oriented towards developing its own roster of metal acts. In this sense, the launch of the New York office had been a logical step as the larger part of the successful metal bands were US-based, and most of the innovation in this particular type of music happened in America. Roadrunner's American A&R capability was built by Monte Conner, who

joined the US company in its early years and would be responsible for signing up the label's biggest acts.

As its artist roster flourished, the company gradually expanded its international presence from its home base in the Netherlands to other territories. During the second half of the 1980s, new subsidiaries were established in the UK, Germany and France, while the first half of the nineties witnessed the launch of affiliates in Australia, Brazil and Japan. Roadrunner's international growth trajectory was guided by two principal criteria, the first of which was the respective market's size in terms of sales potential. In addition to being a major music market, territories had to be substantial sources of music from which high-quality artists could be mined. In other words, countries were considered to be suitable entry candidates when they offered the opportunity to both sell many records and sign great acts. Within less than fifteen years, Roadrunner had evolved from a small and licensed-based label to a multinational record company with an increasingly successful artist base and expanding catalogue.

Roadrunner's Multinational Set Up

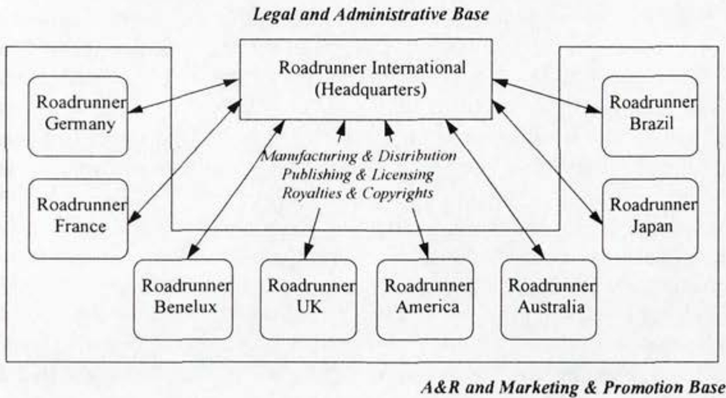
In line with the dual nature of Roadrunner's international intent, each of the operating companies was divided into an A&R department and a marketing & promotion unit. Long-term artist development, key to Roadrunner's business philosophy, was built on a mutual understanding between a particular act and the label. Marcus Turner, director of business affairs at the company's International headquarters, mentioned that "Roadrunner has survived on the strengths of its artists and we have a lot to thank them for." It was therefore simply natural, he continued, that "any artist we have on the label can pick up the phone and speak to the owner of the label."[i] When asked about his motive for signing up with Roadrunner, the drummer of Machine Head explained that "one of the reasons we went with Roadrunner is because it's very small; we wanted that kind of family, gut-level record label."[ii] Acts were therefore signed and nurtured at a local level, where personal communication was most effective in maintaining relationships.

Still, the operating companies depended upon the International head office for legal and administrative expertise; it was in this nucleus of the organization that the actual artist contracts were designed and royalty incomes or payments were managed. But there was more that made this unit, using Turner's words, "the beating heart of the organization."[iii] Whereas the image-building of an act and the recording of its album were handled by the respective local office, International took care of the album's centralized manufacturing. Furthermore, headquarters made sure that all the operating companies, distributors and licensees received the components required for a record's release. Finally, the corporate office transferred knowledge on the act's image and the album's marketing approach (developed by the office where the act had been signed) to all other companies involved. With all subsidiaries on the same footing, each could market and promote the record in accordance with the specifics of the local market.

On a more administrative level, International performed its tasks as a financial control center towards the operating companies through the design of yearly budgets, which incorporated sales targets, marketing expenditures and cost of sales figures. In addition, the company's internal (inter-unit) royalty structure, as well as the protection of mechanical rights and copyrights, were administered at headquarters. Apart from closing publishing deals and licensing agreements, International was also responsible

for managing Roadrunner's network of distributors. According to Marcus Turner, this task was an unavoidable one because "it's always been a policy decision not to do our own distribution."[iv] Instead of being involved in a worldwide distribution deal with a major record company, Roadrunner pursued separate agreements in specific countries. In high-sales territories, the label's products were usually distributed by majors, while local independent firms were dealt with in regions were sales were medium or low.[v]

Exhibit 7.9: Roadrunner's Multinational Setup



Source: Roadrunner International

Creating Musical Capabilities

It was in this context of a growing multinational organization, built around the label's headquarters, that a process of change at the UK company had to take place. Wessels' aim to increase the share of UK acts in Roadrunner's global repertoire was, in essence, driven by two factors: (1) Roadrunner's diversification move into dance music on the European continent, and (2) the successful way in which British music had conquered the international market during the first half of the nineties. Although a few bands like In The Nursery and Front Line Assembly had been early UK signings, it had been the paramount responsibility of the London office to market and promote overseas metal acts until 1993. But in the summer of that year, A&R man Miles Leonard joined the company from Virgin Records where he had discovered The Verve. His presence increased the emphasis on A&R at the UK company, which didn't last for long as he went to EMI's Parlophone label somewhat more than a year later.

In January 1995, Wessels appointed Ruth Robinson as the UK company's new A&R manager. In line with Roadrunner's latest strategy, his instruction was to expand the label's roster from its traditional metal base into new musical areas, and to develop the subsidiary's straggling A&R capability. With previous working experience at both Virgin and MTV, Robinson directed the company into British indie and dance music, where she signed acts like Bennet and Babyfox. At the same time, new marketing and promotion staff, skilled in dance as well as metal, was hired to cope with

the increase in diversity in Roadrunner's products. Within 18 months, the number of employees at the UK office increased from eight to thirteen, while the UK artist roster expanded by almost 50%. Reflecting on this quite radical development, Turner mentioned how "we saw the need to step that up a level in terms of profiling the label [as it] had grown to a level where we needed the presence of a certain personality."[vi]

Chairman Wessels detected this personality in 25-year industry veteran Jimmy Devlin, who joined the UK office as Managing Director in June 1996. Having worked at RCA and EMI as promotions manager and at Polydor as MD, Devlin simply stated his ambitions as "developing Roadrunner from being the best alternative metal label in the world to the best label in the world."[vii] He recognized the need for the company to profile itself more strongly in the UK, both to the artistic community and the music media, if it wanted to succeed in signing acts for a worldwide audience. At the same time, he mentioned how "I'm Roadrunner and Roadrunner is me," when he referred to his role in the process of profiling the label. In terms of A&R, Devlin saw no limits as to the styles of music the company could diversify into. In this sense, he reasoned that "if you perceive two musical areas as being opposites, just place them on both ends of a horseshoe and you'll find that they are actually very close to one another."[viii]

Installing a Business Focus

Remote as this may seem, Devlin was also a realistic man who saw the need to install a more professional business attitude into the UK company. Already in 1993, when he was MD at Polydor, he had exclaimed that "it's vitally important that business affairs becomes a more directly-controlled function of A&R."[ix] Now, at Roadrunner, Devlin's second main task was to make clear that it takes discipline to sign and break a limited number of new acts, while simultaneously attending to the label's existing artists pool. With limited availability of financial resources, the company needed to "match artistic creativity and business rationality."[x] Devlin's decision to team up with major record corporation PolyGram after its distribution deal with independent Pinnacle expired in January 1997 underlined his philosophy. Not only did PolyGram have highly efficient and modern manufacturing plants and reporting systems; its traditional orientation to rock music also made the major relatively open to Roadrunner's extreme products.

Another example of the label's growing emphasis on commercial concerns of the business was the appointment of a full-time bookkeeper, which effectively brought the financial administration function inhouse. Still, this was more a consequence of an efficiency drive that took place in the entire Roadrunner organization at the time. In the summer of 1995, Cees Wessels nominated Koos de Vreeze to be a kind of strategic Managing Director of the whole Roadrunner group to properly monitor the company's rapid growth. The reason for this was quite simple, as Marcus Turner explained: "with increasing staff by about 20 to 30 percent in most territories and thereby increasing overhead by as much, bigger acts, and a lot more money being spent on acts, there was a need to be efficient at the same time."[xi] It turned out that the expertise of De Vreeze, who had been director of business affairs at PolyGram and Managing Director of Sony in Holland, perfectly suited the chairman's skills in A&R and entrepreneurship.

Supervised by De Vreeze, the efficiency program was largely facilitated by the installation of new information technology. Corporate-wide computer systems linked

the operating companies with Roadrunner's headquarters, while reducing complexity and increasing the speed of administrative coordination. In addition to intranet and e-mail applications, subsidiaries could tap into contract and royalty modules designed as knowledge reservoirs. The success of these IT systems confirmed the already growing status of two International departments within Roadrunner Records as a whole. Turner mentioned how the administration department was "a lot more capable, and a lot more efficient and knowledgeable these days than it was before."[xii] The increasing emphasis on rights and royalties as a source of income also enlarged the prominence of the legal affairs department. While new A&R and marketing capabilities were created and built at the operating companies, a business focus was spread throughout the company from the center.

Repertoire Implications

After more than a decade of international expansion, metal-based label Roadrunner Records had pursued a rather revolutionary period of change during the period 1995-1997. The company had diversified into alternative musical directions and, at the same time, had become explicitly budget- and target-oriented. But as 75% of Roadrunner's repertoire still consisted of metal acts, the need to augment its musical capabilities continued to press upon the company. Recognizing this pressure, Turner reasoned that "if you want to reach the next level, you cannot just focus on heavy metal music; it's going to be in decline or out of fashion at some point in time, so you have to have a huge stable of artists from different arenas."[xiii] The same could be said for the geographical nature of Roadrunner's company-wide artist roster, 80% of which was US-based. In this sense, the growing emphasis on local A&R capabilities and repertoire development would be key to the label's prospective musical diversity and its future performance.

Although the UK company's share of overall repertoire had grown to some ten percent, it remained to be seen whether the London office could sustain its slice of the roster. As a long-term artist development company, Roadrunner operated in a local industry which was increasingly characterized by record companies looking for short-term chart successes. Furthermore, an explosive increase in competition for artists had boosted expenses on artist agreements; these days, acts were signed for a minimum of £100,000. It was therefore quite logical, said Turner, that "you focus your activities on signing US bands which do really well in Europe, as opposed to signing very expensive acts which aren't doing very well with the exception of one or two territories."[xiv] Finally, another threat that could challenge the position of the UK subsidiary was the growing importance of the Australian company within the group as a source of Anglo-Saxon repertoire.

Endnotes

[i] Recorded Interview, September 3rd 1998.
[ii] Martin, A., "Machine Head: Roadrunner Brings Californian Metal Act Out of Obscurity," *Music Week*, 22nd April 1995, p. 17.
[iii] Recorded Interview, September 3rd 1998.
[iv] Ibid.
[v] Whereas distribution in most of the territories where Roadrunner had an actual presence was taken up by majors (Sony in America, Holland and Australia, BMG in Brazil and PolyGram in the UK), independent deals covered the smaller countries in which the company did not have an office. Over the years, Roadrunner had experienced that in these cases independent distributors were often more hungry for the business, and could thus achieve higher sales, than majors where the label's repertoire was only a tiny share of its overall business.

[vi] Recorded Interview, September 3rd 1998.
[vii] Transcribed Interview, November 5th 1997.
[viii] Ibid.
[ix] Editorial, "Devlin Grabs Grainge Team," *Music Week*, 31st July 1993, p. 1.
[x] Transcribed Interview, November 5th 1997.
[xi] Recorded Interview, September 3rd 1998.
[xii] Ibid.
[xiii] Ibid.
[xiv] Ibid.

(See Appendix D for secondary sources)

To start the analysis, Table 7.24 outlines the context and content of organizational change (that is, the 'why' and 'what' of change) at Roadrunner Records. Roadrunner had always been an independent company in that its shares were privately owned by its chairman Cees Wessels. As he planned to keep it that way, and because the label had, over time, developed a healthy financial position, no alterations in ownership triggered the change trajectory. The appointment of Ruth Robinson and Jimmy Devlin as A&R manager and Managing Director at the UK company, as well as the new role of Koos de Vreeze at the International office were important catalysts to change. Although Roadrunner had not experienced a drop in market performance – in contrast, the label had achieved unmatched success in the metal segment of the market – the chairman of the company spotted an opportunity to increase Roadrunner's base of international repertoire.

Table 7.24: Context and Content of Organizational Change at Roadrunner Records

Change Context	
New executives	Appointment of Robinson, De Vreeze and Devlin
New ownership	-
Threat/opportunity	Increase in consumer attention for British music
Performance decline	-
Change Content	
Vision	Merge Roadrunner's traditional A&R approach with diverse market demands
Scope	Deliver UK artists to international audience
Positioning	Roadrunner as internationally-oriented diversified record label
Capabilities	Creation of A&R and coordination capabilities

The sudden success of the label's dance act Technohead in 1995 and the rising popularity of British music made him develop a vision in which Roadrunner Record's historical strength in personal A&R could be combined with a move into other market segments. Wessels's primary aim was to convert Roadrunner into a record company that would also be active in various non-metal styles of music with a British accent to its US-dominated repertoire. In other words, Roadrunner Records had to develop new artists in Britain as a repertoire source for its international consumer markets. Roadrunner UK was therefore positioned in its competitive environment as an internationally-oriented record label. However, the company had to create novel capabilities to realize this new strategy. First, new A&R capabilities had to be developed at Roadrunner UK to step into the alternative and dance music segments. Second, new capabilities were needed to increase efficiency and coordination at the International unit.

Table 7.25: Main Events at Roadrunner Records

Event	Date
Miles Leonard becomes new UK A&R manager	August 1993
Marcus Turner becomes head of new legal affairs department at International	September 1993
Ruth Robinson becomes new UK A&R manager	January 1995
Roadrunner UK launches Malawi dance label	April 1995
Koos de Vreeze becomes strategic Managing Director at International	June 1995
Roadrunner UK incorporates financial administration	August 1995
Roadrunner UK signs dance act Babyfox	September 1995
Implementation of new IT systems at Group level	January 1996
Roadrunner UK signs indie acts Bennet	March 1996
Jimmy Devlin becomes new UK MD	June 1996
Distribution deal with PolyGram for the UK	February 1997
Jimmy Devlin leaves Roadrunner UK	December 1997

Roadrunner's search for new capabilities embodied a process of organizational change, which gained substance through the appointment of Ruth Robinson in January 1995 as A&R manager at the London office, and terminated in December 1997 when Jimmy Devlin left the UK company. In chronological order, Table 7.25 lists the main events during these two years of transformation as covered in the Roadrunner Records Case

Box. This outline suggests that the process of change simultaneously took place at two distinct but related levels within the overall company: at the UK subsidiary and within Roadrunner' International. Furthermore, Table 7.26 summarizes the process of change according to its primary features. The label's new business philosophy was to develop a diverse repertoire of acts that could be leveraged on an international level. At the UK office, a reorganization took place in which new marketing and promotion staff was hired and the administrative function was brought in-house.

Table 7.26: Process of Organizational Change at Roadrunner Records

New philosophy	Develop diverse repertoire to be leveraged internationally
Reorganization	Staff reshuffle in UK office; new IT systems at International
Internal ventures	-
Novel acquisitions	-
New alliances	UK distribution agreement with PolyGram
Status reevaluation	*Increasing status of administrative and legal affairs departments*
Learning new skills	Intra-company knowledge sharing; property rights protection
Resolving dilemmas	Local A&R and international coordination

However, the main part of the reorganization (in terms of a business approach in which a move towards enhanced efficicncy was stressed) happened at Roadrunner's International office in the Netherlands. Here, new information systems enhanced the flow of intra-company information, and increased speed in administrative procedures. This improved the status of both administration and legal affairs departments in the company as a whole. In addition, these departments were primarily responsible for the development of skills that involved intellectual property rights protection and cross-subsidiary coordination. The distribution deal with PolyGram in the UK also showed an increasing commitment towards a more rational business approach at the London office. Although high signing costs in the UK limited the company's move into non-metal music areas, Roadrunner Records appears to have made a promising start in resolving the dilemma of local artist development and cross-market coordination.

Whereas turnover increased with 25% per annum at the International Group level over the period 1994-1997, Table 7.27 displays how this figure at Roadrunner's UK company grew at a significantly more rapid pace. At the same time, however, profits decreased or turned into losses in op-

erating terms because considerable investments in A&R and repertoire development had been made.

Table 7.27: Roadrunner UK's Financial Performance (in £1000)

	1991	1992	1993	1994	1995	1996	1997
Turn-over	286	314	372	415	1424	2928	n/a
Gross Profit	n/a	n/a	n/a	299	288	70	n/a
Operat. Profit	n/a	7	4	2	(69)	(481)	n/a

Source: Compiled from the UK Record Industry Annual Surveys 1993-1998

THE CASE OF INDEPENDIENTE

Although its new strategy gave the label a truly international character only in the 1990s, Roadrunner had been one of the few independent record companies that had already operated across its national borders in earlier years. Apart from prominent labels such as Island and Virgin, most independents established during the eighties in the UK (as presented earlier in Table 7.2) did not have an explicit international approach to their business. That is, they signed artists to be released successfully in the UK, and if an act would happen to enjoy success in overseas countries, this was regarded as a coincidental and lucky side effect. But during the nineties, independents began to develop an explicit international approach to artist development, and Case Box 7.6 describes this change at one of them: Independiente. The text supports a subsequent analysis of the company formerly known as Go! Discs, and is focused on its search for new capabilities in a changing competitive environment.

CASE BOX 7.6: INDEPENDIENTE

During the second half of the 1980s, the UK music industry had witnessed the rise of a number of successful independent record companies, the most prominent of which came to be Andy Macdonald's Go! Discs. The 27-year old entrepreneur had launched his record label in 1983 with an initial investment of only £1,500, turning the venture into a financially stable and profitable company with a turnover of £6.7 million over

the next seven years. Between 1990 and 1995, Go! Discs doubled its UK market share to 1.5%, making it the second most successful British independent non-compilations record label of that year. But in 1996, the label's prosperity abruptly came to an end when PolyGram acquired full ownership of Go! Discs, closing down the company in the process. Without his artist roster – which was redistributed over PolyGram's front-line labels – but with a cheque of an estimated £20 million in his pocket, Macdonald rebutted by launching a new and ambitious record company during the fall of 1996: Independiente.

From Go! Discs to Independiente

The early growth of Macdonald's Go! Discs record company was largely based upon his distinct A&R talents, not only in artist discovery but also in managing the label's artist roster. Keeping his stable within clearly defined limits, Macdonald was able to focus his personal attention on a relatively small number of serious acts without being distracted by the demands of a busy release schedule. The independent label's success during the late eighties with The Housemartins and The Beautiful South was extended in the first half of the '90s with quality acts as Gabrielle, Paul Weller and Portishead. Through these years, Go! Discs' market share increased rapidly. This coincided with the introduction of a new management team, including the appointment of Mike Heneghan as general manager in 1992. Having founded marketing & promotion specialist companies Platinum and 3MV, Heneghan appeared to be the perfect complement of the musically oriented Macdonald, claiming that "you get good at marketing when you accept it as a supplementary function to the music."[i]

Things started to go seriously wrong when renegotiations between Go! Discs and PolyGram UK over a prolongation of their existing ownership and licensing deal came to a stalemate in August 1996. The old agreement, in place since 1987, had not only tied Go! Discs to the Dutch major through a worldwide licensing deal, but had also seen PolyGram taking a 49% stake in the label for a reported £0.75 million. Now, after eighteen months of discussions, the partners could not reach an agreement over what to do with the remaining 51% of the ownership shares. Although John Kennedy, chairman of PolyGram UK, claimed that Go! Discs was offered a similar kind of deal as the one between Sony and Creation Records, Macdonald replied that "PolyGram is not interested in negotiating the kind of deal which would have preserved the label's independence." A disappointed man, the entrepreneur therefore continued that "under such circumstances, and with the greatest reluctance, I felt I had no option other than to resign."[ii]

Although PolyGram proposed Mike Heneghan to be Go! Discs' new Managing Director, assuring that the company would continue to operate as an autonomous label under PolyGram's umbrella, the former general manager declined this offer. Instead, he joined Andy Macdonald as Managing Director in his new Independiente venture, where he would manage the creation and development of a new record label together with chairman Macdonald. Right from the start, the choice between "going up the corporate ladder or continuing with my friend and business partner" proved to be an easy one, especially since this enabled him to keep control of his own destiny within the label.[iii] In the end, most of the former Go! Discs staff expressed the same attitude and enthousiasm: eleven out of nineteen people working for Independiente had been part of the Go! Discs team before PolyGram's purchase,

among which were creative director Tony Crean and director of business affairs John Kellett.

Independiente's Philosophy and Aspirations

Both shareholders Macdonald and Heneghan shared the feeling that Independiente had to embrace the key principle which had made Go! Discs flourish. In other words, their task was to develop an artist-friendly record company that would be known for putting out cutting-edge music and, in the future, alternative entertainment products. Crucial to this objective would be the label's capability in artist development, and the creation of an environment where acts were given the freedom to apply their musical creativity to a maximum degree. In that sense, Independiente's role was primarily one of support without interfering in the actual artistic process. Or, as Mike Heneghan put it, "artist development is like gardening in that you prepare the ground, make the soil fertile, remove obstacles, sow seeds, and then allow time for the seeds to grow."[iv]

Whereas most record companies, in search of immediate commercial success, are inclined to interfere in their artists' creative process, Independiente's management team realized that this could be detrimental to, or even stall, an eventual breakthrough. While this focus on artistic values was clearly part of the Go! Discs heritage, a broader geographic outlook distinguished Independiente from its predecessor. At Go!, all acts had been primarily developed with the British market in mind, but now the idea was to build a repertoire base that would lift Independiente to the global stage. According to Heneghan, the objective was "to have success beyond what's predictable in the UK, but then also to be playing in a bigger playing field, so our artists have a great opportunity for success in other territories."[v] In addition to developing British artists at the international level, Independiente's future growth would also be coming from foreign signings.

To realize its global ambitions, Independiente linked up with Sony Music in a worldwide licensing deal, which also included a sales and distribution agreement for the UK. Apart from Sony's marketing muscle and a track record at breaking British acts internationally, the corporation's successful cooperative ventures with labels such as Creation and Nude through its Licensed Repertoire Division made it the most suitable partner for Independiente. At the time of the deal, Andy Macdonald underlined Sony's reputation as an indie-friendly major by telling how "Sony proved fully responsive to our needs and aspirations as an independent company," referring to Sony's capability in creative collaboration.[vi] This was manifested in the launch of an Independiente office in New York alongside Sony Music's Epic label. This affiliate served as an interface between Independiente and Sony in the US, and as an A&R base for American acts.

Synthesizing Music and Business at Independiente

The company's international outlook was a direct consequence of management's aim to install a vision in which Independiente's musical orientation was integrated with a professional business attitude. Crucial to Heneghan in communicating such a vision throughout the organization was "to dispel the myth that it was one thing or the other, to dispel the myth that it's either suits and finances or magic and music all the time."[vii] But although the philosophy stressed that music and business were two sides of the same coin, the music flowing out of the acts' creativity would under no circumstance be adapted to the commercial demands of the record industry. In this

sense, the future growth and development of the company would not depend on album sales, but on the size of Independiente's artist roster. Although balanced between music and business, the course taken by the label thus depended upon the musical direction incorporated in Independiente's signing policy.

Independiente's attitude that a compromise between art and commerce was out of the question was fueled by the belief that the company could create a future of its choosing. Heneghan argued that in conjunction with signing up great bands, "part of our job is the molding of the industry machinery to squeeze out every sale and have commercial success."[viii] The firm's confidence in its own abilities was reflected in an aspired success ratio of 70%, which means that at least seven out of ten acts signed to Independiente would have some or considerable success in the marketplace. If realized, this ratio would bring the label a significant competitive advantage in an industry where the average percentage of acts becoming successful is about 10%.

Independiente's desire to "be prepared to do things in a different way than they are normally done and to be quite investigative about them" made it very careful in its signing policy, according to Mike Heneghan.[ix] Keeping the artist roster within clearly defined boundaries enabled the label to establish long-term relationships with acts and nurture them in a way that a high proportion of them would break through. Also, the compactness of its artist stable provided the company a unique opportunity to tailor a distinct and individual marketing approach to each of its acts. Here, the company was involved in creative thinking to come up with marketing ideas that had a high impact without them being very costly. Instead of simply buying high-cost advertising space at numerous media outlets, marketing efforts were closely tied to the innovativeness of the music being released, and in this respect Independiente had developed a capability for 'art terrorism' marketing practices.

Integrating Functional Capabilities at Independiente

In order to let this bridge between commercial creativity and musical artwork flourish within the company, Independiente's management had created an environment "where people could be freed up from their self-imposed limitations to create activities and to generate results beyond their own expectations." MD Heneghan continued that this creative dreaming took place in an organizational context of "effectively-run meetings out of which action plans are created, with a very high, down-to-earth, solid efficiency about how the information then gets communicated."[x] Interaction patterns among the label's staff ran through a large number of small and informal dialogues, and through regular formal sessions such as communication, artist and project meetings. After each meeting, its minutes were imported into a computer system and transcribed into action plans, which specified the assignments to those involved and, furthermore, served as a tool for feedback after implementation.

Although Independiente's organization was formally divided into a number of distinct departments, the multitude of meetings encouraged people to cross functional boundaries, especially with respect to marketing and A&R. Here, cross-fertilization of knowledge and creativity was achieved as discussions opened up the attitudes of A&R and marketing staff, and formal communication patterns made them involved in each other's line of work. Moreover, management installed a project organization in which employees were no longer regarded as departmentally driven labor input, but instead as creative resources available to specific projects. Organizational members were thus involved in several projects simultaneously, while the integration of such

marketing, A&R and financial resources was the main responsibility of their project leaders. As a result, Independiente's employees were continuously being reconfigured into different project teams, thus increasing the company's cohesiveness in the process.

Such a project-based structuring of work processes created an organization in which creativity could circulate openly and, at the same time, could be channeled into desired directions. The resulting virtual absence of hierarchy did not turn the label into an uncontrolled and chaotic company, however. Project leaders and top management provided the strong leadership needed to keep employees focused and to stay on top of all developments which could impact Independiente's organizational performance. Instead of perceiving its functioning in terms of coordination and control, Heneghan argued for "a balance between leadership and democracy."[xi] To him, intense patterns of communication among organizational members, through personal conversations or even by means of Independiente's newly developed digital intranet, were crucial in maintaining that balance and "to keep the conversation alive."

Ready for the Future

After 12 turbulent months during which the groundwork for the company's hoped-for success had been laid, Independiente's compact roster included acts like Travis, Vitro, Sunhouse and American-signed Deejay Punk-Roc. As the construction of its premises 'The Drill Hall' neared completion at the end of 1997, Independiente was set for a promising start in the music business. Depending upon the speed with which its artist roster would expand, Independiente's management aimed at a double-digit company growth over the next five years. The deal with Sony allowed for a gradual expansion of the label over the globe; close cooperation with the Japanese multinational would allow Independiente to profit from its expertise in starting new subsidiaries in major territories. Also, the success and downfall of Go! Discs had provided Independiente's management with a wealth of experience of owning and managing a new, ambitious record label.

Endnotes

[i] Eade, C., "Profile: Go! Discs," *Music Week*, December 10th 1994, p. 8.
[ii] Editorial, "Macdonald: 'I Had to Go'," *Music Week*, August 31st 1996, p. 1.
[iii] Recorded Interview, January 28th 1998.
[iv] Ibid.
[v] Ibid.
[vi] Editorial, "Independiente Going Global with Sony Licensing Contract," *Music Week*, February 22nd 1997, p. 3.
[vii] Recorded Interview, January 28th 1998.
[viii] Ibid.
[ix] Ibid.
[x] Ibid.
[xi] Ibid.

(See Appendix D for secondary sources)

Table 7.28: Context and Content of Organizational Change at Independiente

Change Context	
New executives	-
New ownership	PolyGram's estimated £20 million purchase of 51% of Go! Discs
Threat/opportunity	Less competition for innovative music on an international level
Performance decline	-
Change Content	
Vision	Merge Go! Discs's A&R history with international alternative market demands
Scope	Deliver creative artists to international audience
Positioning	Independiente as internationally alternative record label
Capabilities	Incorporation of international and commercial capabilities

Again, Table 7.28 presents the core features of the change content and context at Independiente (in other words, why did the change happen and what was its specific nature). The most observable cause of the company's transformation from Go! Discs to Independiente was PolyGram's acquisition of the remaining 51% ownership shares of Go! Discs in August 1996. Claiming that the major was no longer interested in the label's independent status, Andy Macdonald sold his stake and started a new record company that would have complete independent ownership. Although their positions officially altered from MD and General Manager to Chairman and MD respectively, the label's shareholders Macdonald and Heneghan continued to embody its management team.

Table 7.29: Go! Discs' Financial Performance

	1989	1990	1991	1992	1993	1994	1995
Turn-over	587	1192	4254	4977	4954	5966	10790
Gross Profit	n/a	n/a	974	1285	1325	1555	2517
Operat. Profit	n/a	(204)	203	106	57	4	(21)

Source: Compiled from the UK Record Industry Annual Surveys 1993-1997

In terms of market performance, there appeared to be no need for change as Go! Discs's market share had grown from 0.2% to 1.4% between 1991 and 1996, while turnover and operating profits had increased steadily during the first half of the nineties (see Table 7.29). Still, the firm's management had spotted an opportunity to expand its scope internationally.

Compared to its predecessor Go! Discs, a new Independiente vision was thus developed in which the company's strong A&R history could be blended with a more international business approach. Top management's principal objective was to create a new label responsible for the development of an alternative and high-quality repertoire base for an international or even worldwide audience. This meant that acts would not necessarily have to be rooted in the UK, but could also be signed in foreign territories. Independiente was therefore positioned as an internationally alternative record label in the industry from a competitive point of view. But in its Go! Discs years the company had primarily focused its activities on the UK without much regard to foreign policies. As a consequence, Independiente had to create new capabilities that would allow it to deal with its international operating context. As a prerequisite, the record label needed capabilities to manage its activities with a more professional business attitude.

Table 7.30: Main Events at Independiente

Event	Date
Acquisition of 49% ownership by PolyGram	June 1987
Mike Heneghan joins as general manager	November 1992
Go! Discs wins 1994 MW A&R award	March 1995
Andy Macdonald sells his 51% stake to PolyGram	August 1996
PolyGram offers Mike Heneghan MD position at Go! Discs	September 1996
Macdonald incorporates Independiente	October 1996
Independiente signs its first act (Travis)	December 1996
PolyGram terminates Go! Discs	January 1997
Mike Heneghan becomes Independiente MD; Tony Crean becomes creative director; John Kellet becomes director of business affairs	January 1997
Independiente closes deal with Sony Music	February 1997
Launch of New York office	March 1997
Implementation of IT system	Course of 1997
Dave Gilmour becomes senior director of A&R	September 1997
Completion of the 'Drill Hall'	December 1997

Independiente's search for new capabilities essentially embodied a process of organizational change, which started with the sell out of the remaining 51% ownership shares of Go! Discs to PolyGram in August 1996 and ended when the construction of its London quarters was finished in December 1997. Table 7.30 presents a chronology of the major events involved in this period of transformation as narrated in the Case Box of Independiente. Furthermore, table 7.31 outlines the core features of Independiente's change process. The company's new business philosophy was to develop a compact roster of highly creative artists through which an international consumer base could be attracted. This meant that Independiente's future growth and success would be shaped by its ability to discover creative resources and to introduce these acts to the market. Such an increase in market awareness had already started to penetrate the label in its Go! Discs years after Mike Heneghan had joined up. But the philosophy had now been widened towards an international understanding of Independiente's market.

Table 7.31: Process of Organizational Change at Independiente

New philosophy	Discover high-quality repertoire with international potential
Reorganization	Temporary and cross-functional project teams
Internal ventures	Launch of New York office
Novel acquisitions	-
New alliances	UK distribution and International licensing deal with Sony
Status reevaluation	Increasing appreciation for creative action within a business setting
Learning new skills	Effective and efficient communication via meetings
Resolving dilemmas	Creativity in music and creativity in business

Important in this respect was the label's international licensing deal with Sony Music: not only did it provide Independiente access to the major's global distribution and marketing capability, but it also enabled the independent to learn from its partner. This would be of value to Independiente's ambition to set up an international structure, which started with the launch of the American office. At the same time, organizational processes were structured along a project-based company texture where expertise and skills crossed functional boundaries. Increasingly, formal and informal meetings were valued as effective vehicles for communication which, through a balanced form of managerial leadership, increased

the organization's operational efficiency. Creative action could thus take place within the company without obstructing a more rational business approach. In the end, all this enabled Independiente to resolve a dilemma of managing creativity in music and creativity in business at the very same time.

TOWARDS THE COMPETITIVE REGIME'S END

The above collection of case studies represents only a sample of UK record companies that were involved in a process of organizational change to search for new capabilities. Many other companies have been reported to be engaged in organizational change between 1992 and 1996. Like BMG and Warner, the other majors restructured their A&R departments and stepped into alternative music areas, which was guided by the replacement of many top managers. When Paul Burger became chairman of Sony in early 1993, he appointed new managing directors at both front-line labels Columbia and Epic with a brief to bring the company into new and British music during the next two years.[15] Driven by the success of its new sister-label Island Records, PolyGram's front-line label Polydor renewed its A&R policy during 1994 and 1995. Its move into the unknown territories of dance and R&B paid off with a market share increase from 2.3% in 1995 to 3.6% in 1996.[16]

At EMI, both managing directors of the firm's front-line labels EMI and Parlophone were replaced in early 1993. Being previously centralized, both labels were split up into separate operating units with distinct A&R and marketing departments. (At the corporate level, another radical development took place when music corporation EMI demerged from electronics company Thorn in the summer of 1996.)[17] In a similar vein, American Decca's direct descendant MCA was reorganized after Nick Phillips joined the UK company. Its new focus on breaking artists in non-traditional genres was even reinforced by the investments of its new

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[15] Editorial, "Stringer Gets Epic," *Music Week*, 10 April 1993, p. 1; Editorial, "Outsider Gets Columbia," *Music Week*, 10 July 1993, p. 1; Editorial, "Burger Urges Sony to Break UK Talent," *Music Week*, 24 September 1994, p. 10.

[16] Webb, S., "Developing New Talent Takes Priority as Polydor Revives its A&R Traditions," *Music Week*, 25 November 1995, p. 6.

[17] McGinlay, P., "Blur Triumph Underlines Resolve to Keep Parlophone Riding High," *Music Week*, 16 September 1995, p. 10; Ashton, R., "EMI Enters New Era after Split with Thorn," *Music Week*, 24 August 1996, p. 1.

owner Seagram, which had acquired 80% of MCA's shares of Matsushita for $5.7 billion in April 1995. To facilitate integration of its newly acquired label Interscope, Phillips renamed MCA into Universal Music and restructured the company into two separate label groupings, MCA/Geffen and Universal/Interscope.[18] Between 1990 and 1997, Universal's album market share almost quadrupled from 1.2 to 4.6%.

Table 7.32: Market Shares of Majors versus Independents

Year	Majors: Record Company	Majors: Distribution	Indies: Record Company	Indies: Distribution
1990	67.5	84.6	32.5	15.4
1991	70.2	85.5	29.8	14.5
1992	76.9	83.6	23.1	16.4
1993	74.9	81.9	25.1	18.1
1994	74.9	81.0	25.1	19.0
1995	75.3	79.2	24.7	20.8
1996	76.3	78.8	23.7	21.2
1997	75.8	79.6	24.2	20.4

Source: Compiled from data displayed in BPI Statistical Handbook 1998

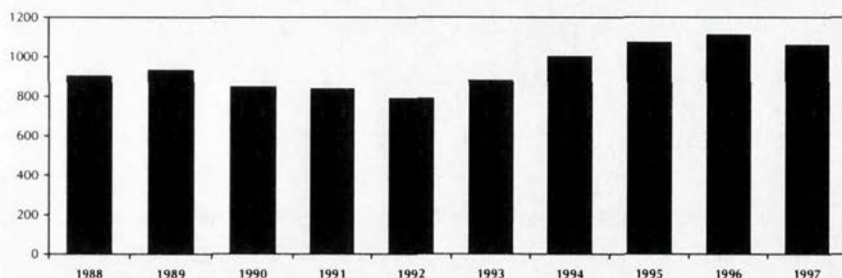
Note: Major record companies comprise PolyGram, EMI (including Virgin after its acquisition), Sony, BMG, Warner and Universal.

Table 7.32 displays how, after EMI's purchase of Virgin in 1992, major record companies continued to hold some 75% of the British market for albums. In contrast, their combined market share in distribution declined with 5.0% over the period 1990-1997. At first sight, this appears to be inconsistent with the forementioned increase in the number of manufacturing and distribution agreements between major and independent record companies. However, it has been discussed how such cooperative ventures (designed during the 1980s) were extended to more complicated deals. Apart from Roadrunner and Independiente, other independents such as Creation Records and XL Recordings became engaged in international

[18] This move mirrored the division of Warner into WEA and East West. Sources: Editorial, "MCA Buyout Hits Seagram Shares," *Music Week*, 22 April 1995, p. 5; Webb, S., "MCA's Fortunes on the Ascendant as Phillips Plans Yet More Success," *Music Week*, 13 July 1996, p. 8; "Universal Splits Labels and Sets its 10% Target," *Music Week*, 19 July 1997, p. 1.

licensing deals to expand their market scope. Part of the deal in these alliances was that the major partner took care of distribution and marketing in other countries outside the UK. At the same time, distribution in the independent's home territory continued to be taken care of by independent distributors to retain the label's independent character in the UK.[19]

Figure 7.3: Constant Value of UK Music Sales at 1997 Prices (in UK £ Millions)



Source: BPI Statistical Handbook 1998

Statistics show how the new competitive regime made the UK music industry regain its pre-1990 growth pattern. Whereas Figure 7.3 displays this recovery in terms of constant sales values, Table 7.33 reveals how unit shipments increased from 133.6 million in 1992 to 208.3 million in 1996. Furthermore, this rejuvenation of the UK record industry at the national level can also be observed at the international level.

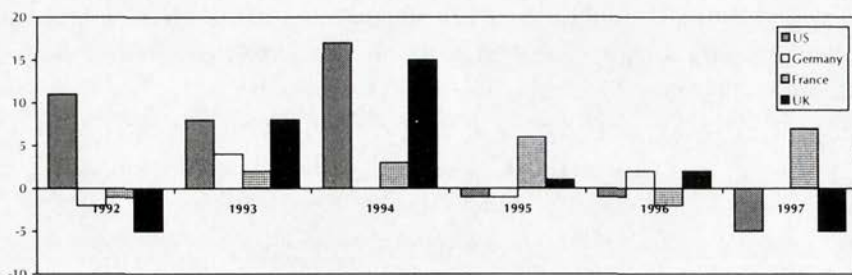
Table 7.33: Trade Deliveries of Albums (in Millions of Units)

Year	Total Albums	Year	Total Albums
1988	160.3	1993	153.5
1989	162.6	1994	176.9
1990	150.7	1995	196.2
1991	142.5	1996	208.3
1992	133.6	1997	197.9

Source: BPI Statistical Handbook 1998

19 Editorial, "MBI United Kingdom Report," *Music Business International*, December 1994, pp. 29-39.

Figure 7.4: Comparison of Sales Growth Ratios in Top Four 'Mature' Markets



Source: IFPI (1998), The Recording Industry in Numbers 98, *London: IFPI*

Note: Figures denote real growth, taking account of consumer price rises and inflation.

As Figure 7.4 illustrates, the UK was the top performer among the four largest markets for music that are considered to be in a mature stage of development. In the four-year period after 1992, the British music industry experienced an average growth ratio superior to any of the other largest mature markets for music. In addition, the UK industry's rising export figures for physical music carriers (see Table 7.34) express the heightened interest of foreign market consumers in music of British origin during the same period.

Table 7.34: Value of Physical UK Exports (in UK £ Millions)

Year	Exports	Year	Exports
1992	211.9	1995	354.2
1993	260.0	1996	359.2
1994	283.7	1997	n/a

Source: BPI Statistical Handbook 1997

During the new competitive regime of the nineties, many UK record companies managed to improve the effectiveness with which they discovered and developed new artists and music. Table 7.35 displays how the total number of album releases increased by more than 70% between 1993 and 1997, which indicates the enhanced efforts of record companies in the musical domain.

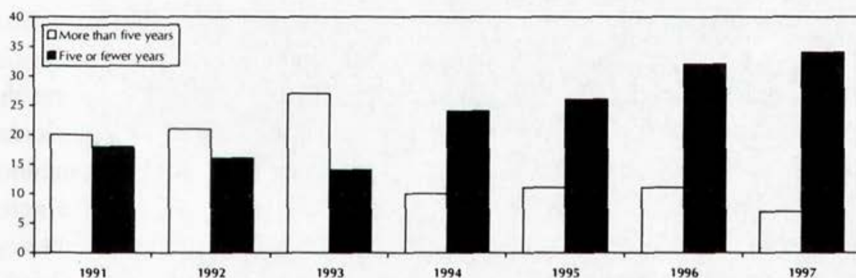
Table 7.35: UK Industry Album Releases

Year	Total Releases	Year	Total Releases
1990	11,021	1994	11,654
1991	10,141	1995	13,551
1992	11,988	1996	15,393
1993	10,716	1997	18,386

Source: BPI Statistical Handbook 1998

However, to correct for both an increase in compilation albums and new records from established artists, Figure 7.5 provides a more reliable measure of the increase in new artist development. It illustrates how, after 1993, the number of newly launched acts in the yearly Top 50 albums chart outstripped a declining amount of successful albums as recorded by 'superstars' with a chart history of more than five years. Not only did the 'Top 50 presence' percentage of this group decline from 66% in 1993 to 17% in 1997, but record sales of these established artists also did not meet expectations relative to their past performances during the eighties and early nineties.

Figure 7.5: New Artist Development in the UK Industry



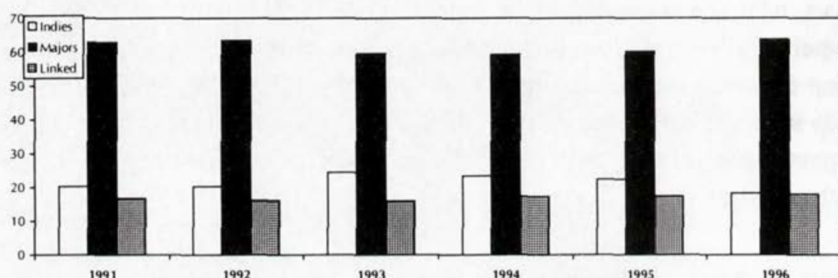
Source: The UK Record Industry Annual Survey 1998

Note: The figure displays Top 50 albums of the year, divided between artists with five or fewer years of chart history and those with more than five years of chart history. Greatest Hits albums are not included.

The increasing variety of relationships between majors and independents in the first half of the 1990s not only enhanced record companies'

abilities in artist development, but also improved their business focus.[20] In a competitive regime where firms needed to be focused on business and music simultaneously, the major companies internalized and accessed A&R capabilities and creative resources, whereas the independent labels became more professional and adopted structural capabilities and superior marketing skills. This was clearly reflected in the differential rates at which industry-wide profits and turnover increased over the period 1992-1996: whereas turnover grew from £1.35 billion to £1.92 billion at an average annual rate of 9.2%, gross profits increased from £331.6 million to £570.8 million at an average annual rate of 14.7%.[21] Indeed, such an improvement in financial performance was experienced by major record corporations as well as their independent counterparts.

Figure 7.6: Share of Turnover by Category



Source: See Appendix E

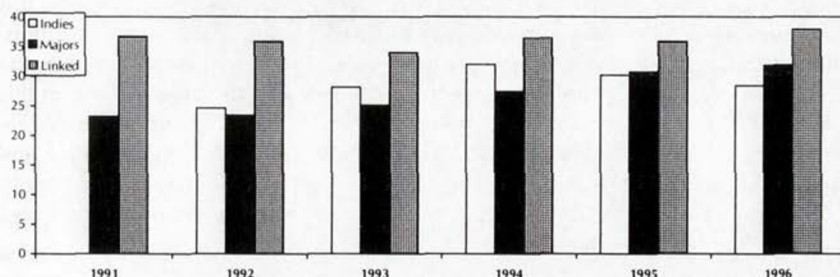
Further analysis of comprehensive data on turnover and profits (as categorized into major, linked and independent companies) supports the idea that the improvement in performance was not confined to a particular type of record company, but was indeed an industry-wide phenomenon. Whereas Figure 7.6 shows that the relative shares of turnover among these three categories are rather stable over time (with independent and major companies accountable for marginal fluctuations), Figure 7.7 indicates how they move towards one another in terms of gross profit margins during the mid-nineties. Apparently, the increasing similarity among different types of record companies as to their competitive capabilities is matched by this convergence in profit margins. Despite this performance

[20] Editorial, "MBI United Kingdom Report," *Music Business International*, December 1995, pp. 25-35.

[21] Calculated from data presented in *The UK Record Industry Annual Survey 1998*.

improvement at British record companies, industry-wide turnover, profitability, sales, and trade deliveries stagnated once more in 1997, which marked the end of the UK music industry's successful expansion.

Figure 7.7: Gross Profit Margins by Category



Source: See Appendix E

Note: Gross profit figures for independents in 1991 were not available.

THE CASE OF V2 MUSIC GROUP

According to *Music Business International*, 1996 was a year in which the majority of record companies in the UK consolidated their business.[22] One year later, company executives aimed to deal with disappointing results by stressing further cultivation of the company's licensing and publishing operations. During the mid-1990s, record companies had recognized both the importance of international licensing revenues and the significance of publishing departments as A&R sources in signing promising acts and composers. Both licensing and publishing activities were therefore integrated in a more comprehensive approach to artist development to gain additional (international and publishing) revenues as the industry's growth stagnated.[23] It was in these times of consolidation that Richard Branson made his comeback in the music industry with the launch of V2 Music Group. Case Box 7.7 narrates V2's rapid entrance in more detail, and provides the input for an analysis of the firm's search for capabilities as it aimed to manipulate its competitive environment.

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[22] Editorial, "MBI United Kingdom Report," *Music Business International*, December 1996, pp. 17-29.

[23] Editorial, "MBI United Kingdom Report," *Music Business International*, December 1997, pp. 19-27.

CASE BOX 7.7: V2 MUSIC GROUP

In December 1996, Richard Branson returned to the music industry after a pause of more than two years, a period in which the dynamic entrepreneur saw himself as "a dog without a bone."[i] After he had sold Virgin Music in 1992 to Thorn-EMI for £560 million, Branson had focused his attention on Virgin's involvement in industries as diverse as airlines, insurance and radio. Part of the EMI deal had been an agreement *in which Virgin promised not to launch a new record label for 30 months, and this* non-competition clause had frustrated Branson's desire to continue his striking presence in the record business. Almost immediately after the clause's expiration date, he set up a working party to investigate a renewed entrance into the industry, and in this respect arranged meetings with quite a number of record company executives. While nothing really came of these meetings, Sony's Jeremy Pearce took the initiative and approached the Virgin chief himself. Attracted by his unconventional ideas of how to create a new independent and international record company, Branson appointed Pearce as CEO of what would become the V2 Music Group.

V2's Business Philosophy

At Sony Music, Jeremy Pearce had managed the formation of the Licensed Repertoire Division in 1992, establishing Sony as the first 'indie-friendly' major record company in the British industry. Pearce's LRD business concept was based on his perception of the film business, where he had observed that "several large companies have gained expertise in distribution, but there are any number of production houses making films because they have the creative ability."[ii] He launched LRD as unit responsible for the coordination and administration of Sony Music UK's international licensing activities, aimed at the creation of partnership deals with independent labels like Creation, Nude and Network. The distinctive feature of these alliances was that Sony invested in its partners by acquiring up to 50% of their shares, securing mutual commitment to the deal. The partner labels therefore not only benefited from Sony Music's international marketing and distribution capabilities, but also achieved financial stability.

For Pearce, an important part of LRD's mission was to bridge the gap between cost-conscious Sony Music and the musically creative independents, gaining access to the entrepreneurial skills of these companies. Despite LRD's noticeable success over the years, Pearce could really realize his ambitions when he started out at V2, where he was not confronted by the inevitable corporate rigidities of a major record company. As over $100 million was committed to the new music venture for its first three years of operation, the new CEO was finally able to set up an artist-friendly record company that could compete with the financial muscle of the majors. Within one year of V2's official launch in December 1996, Pearce struck partnership deals with independents Big Cat, Gee Street and Junior Boy's Own (JBO). Although the V2 Group did acquire equity stakes in them, these three partner labels continued to operate alongside of the company according to their original values and culture.

However, having cooperation-based access to independent repertoire sources and entrepreneurial capabilities was not enough to challenge the global dominance of the majors. V2 needed to have an international presence in the most prominent of the world's music markets as well if it aimed to capture market share from these mighty multinationals. With its home base in the UK, the one thing the company could not do was to license its repertoire to independent or even major record com-

panies in foreign territories. Such an approach would not only lessen the incentive for small labels to link up with V2, but would also reduce its operating margins to the level of licensing fees. Furthermore, V2 would lose control over its repertoire with respect to marketing and promotion as its acts would have to compete with the licensee's repertoire. To Pearce, its was clear that only physical distribution of records could be outsourced, and that local subsidiaries had to be launched to keep control over the company's revenues and repertoire.

V2's International Set Up

Together with his director of finance Stuart Middleton, Jeremy Pearce developed V2's organizational structure, incorporating a legal, business and international perspective. Within eighteen months, affiliates were established on the Australian continent and in Germany, France, Scandinavia, Benelux, Italy and Spain. Furthermore, the New York offices of partner label Gee Street Records became V2's American headquarters, while Big Cat founder Steve Abbot became the new company's head of international artist development. Whereas the international affiliates mentioned before were wholly-owned, V2 established a joint venture in Japan and planned further joint ventures in other South East Asian record markets to better cope with the radically different cultures of these countries and their unique way of doing business. Looking back upon this global and revolutionary growth process of the company, Pearce noted how he encountered little difficulties as "we planned it quite carefully, we knew exactly where we wanted to go, and we had a clear strategy there."[iii]

Still, his concerns during those eighteen months of unlimited expansion were twofold, the first of which concerned the laborious enterprise of employing some 200 people in various parts of the world. The large majority of the qualified persons were employed at other record companies, and a lot of effort was involved in talking them out of their secure jobs and getting them excited to be part of a new venture. Another challenge for Pearce was to obtain repertoire as the V2 Music organization unfolded, simply because "it would have been completely disastrous if I had 200 people around the world and no records to sell; equally, I couldn't sell and sign artists until I had the people, because I wasn't licensing to other companies."[iv] The construction of a sound repertoire base was partly achieved through a policy of accessing other artist rosters: apart from licensing deals on given acts with labels like Blue Rose and Banana, V2's partner labels participated as primary repertoire sources here.

But the V2 CEO recognized the temporary nature of licensing agreements and knew that joint ventures could be dissolved over time. Within two months after taking up his new assignment, Pearce installed a number of people on key positions within the company to develop an in-house artist roster, thus avoiding the danger of ending up as a hollow corporation. First of all, he hired Ronnie Gurr from Sony's front-line label Columbia to be the Group's creative director with the responsibility for building V2 Music's new A&R competences. Secondly, he appointed David Steele, who had previously worked at both Island Records and Virgin, to run V2's UK record label as its general manager. Whereas accessing external repertoire via cooperation-based ventures was a matter dealt with at the Group level, the various V2 record companies in the world became home to the company's internal repertoire where contracts were being signed with acts (instead of other record labels) to build a strong artist roster.

V2's Organizational Processes

A second benefit of V2's non-traditional set up was that it provided an environment in which informal relationships with acts were allowed to flourish without disturbing the company's professional attitude towards the harsh realities of business. According to CEO Pearce, "the artists really are the stars in this company, unlike the majors where the executives treat themselves like stars, even if the public doesn't give a shit."[v] V2's artist-friendly outlook was superbly reflected in its artists contracts, which were free from the regular packaging and CD deductions (originally introduced by major record companies to cover for breakages) and recognized artists' moral rights. Furthermore, each V2 act was considered to be a company-wide asset for the world, irrespective of the original operating unit where the artist was signed. This global artist policy stood in sharp contrast to the conventional approach of the majors where each operating unit owned its acts and received international licensing fees from other units overseas.

Although V2 operating units were free to engage in local artist development, Pearce perceived the Group's international market approach as key to its competitive position: "We plan each artist's career internationally right from day one, so we have regular international meetings where a new artist is introduced even before they've made a record. The plot is for the world right away."[vi] While all the companies were involved in the development of a worldwide marketing plan, Group headquarters in London decided which of the acts had international potential and accordingly funded all international activities. Like the UK head office's decision to centralize all worldwide administrative functions, this policy relieved operating units from much of the burden of financial affairs, enabling them to concentrate more on the development of marketing and A&R capabilities. Cooperation among operating companies, and between local units and Group headquarters, was thus a prerequisite to global success.

The infusion of Branson's original Virgin ideology into the V2 Music Group created a company in which teamwork and communication were not being hampered by hierarchy. Jeremy Pearce stressed the significance of such cooperation to the new record company's international outlook, mentioning how "there's a vibe of everyone being involved in the company; there aren't any people who don't have a real job and just sit around typing letters and stuff. And that's important, the atmosphere it creates, implying that our communications are very, very good."[vii] Quite a few employees had roles that overlapped traditionally different functions; for instance, the Group's A&R managers spanned both publishing and record operations so that artists signed up for a record deal could also be contracted by V2's publishing arm. Right from the start, V2 Music Publishing had been fully integrated into the company's global set up, sharing offices with its counterpart in all the local subsidiaries.

V2's Information Highways

Narrating how Beethoven's publisher must have been the most important person in his life as he collected his income for him, Pearce defined the distinction between records and publishing as "a blip on the history of the music business." Based upon his earlier job as head of Sony Music Publishing in the UK, the V2 CEO argued that while physical carriers would undoubtedly disappear in the future, there would always be rights. In this sense, it would be foolish to separate the two, because "at that point the publishing right will be very much the same as the recording right, and the systems will be the same."[viii] V2 was also prepared for any future technological de-

velopment that spurred on-line music delivery, as a highly advanced computer system had been integrated into the Group's worldwide organization. Information technology indeed played a crucial role in V2's concept of the corporation, as was clear from the presence of two global databases that linked the London head office to its affiliates and distributors around the world.

In line with the centralization of V2's administrative functions, a database was installed for managing distribution accounts and royalty payments. An integral part of the company's agreements with its various distributors over the world was for them to supply data on sales and prices via on-line systems. This direct information, processed centrally in London, not only provided V2 with valuable feedback on the effectiveness of marketing campaigns, but also enabled the company to calculate and pay royalties to its artists on short notice. The application of this new information system implicitly demanded a high degree of proficiency at distributor partners which could not always be found at independent distribution companies. Although V2 preferred independent distributors – like PIAS in the Benelux and Rough Trade in Germany – because they better understood the company's music, it was therefore forced to deal with majors in territories like the US and France where no strong independents could be found.

The company's second information system supported V2's global artist development approach and provided access to marketing data to all of the group's affiliates around the world. This international marketing database consisted of detailed information on individual acts such as release target dates, marketing plans and pace of development in each and every territory. The coordination and sharing of this intelligence among the different parts of the company not only cut overhead costs, eliminated mistakes and increased speed of action, but also contributed to V2's capability in global artist development. Jeremy Pearce mentioned how the incorporation of these databases "sounds obvious but other companies just don't have it; it's something which takes quite a long time, particularly in an existing structure."[ix] He thus considered the information systems as crucial to the effectiveness of V2 Music's global business processes in its competitive attack on the major record corporations.

V2's Competitive Challenge

Only the future could tell whether this assault on the majors' domination of the record business would bring success to Richard Branson's new music venture. But whatever would happen, his first man and CEO Jeremy Pearce had ignored established industry practice and managed to set up a truly distinctive company. Never before had a music company been set up with affiliates in all of the world's major markets at one go, and never before had the record industry known a company constituted upon worldwide cooperation and partnership deals. Together with young and promising people at key management positions, an artist-friendly attitude and a progressive approach to IT, V2 became the first truly transnational music company in the record industry where both publishing and recording capabilities were given equal attention. All this made V2 a professional and ambitious new entrant, focused on breaking even before the turn of the century.

In the end, it would be the strength of its repertoire that would determine the company's success in the marketplace. With its boundaries determined by the size of the company, V2 Music's roster had grown to some 45 acts, half of which were direct signings such as Headrillaz and Stereophonics. The other 50% was contracted in by

its partner labels Big Cat, Gee Street and JBO, and consisted of acts like Addict, Jungle Brothers and Underworld. Whereas the V2 Record label had initially focused on signing up guitar bands, the Group's joint ventures brought V2 into a variety of musical spheres such as rap, R&B, dance and techno. Referring to his new company as "a supermarket of good taste," Pearce acknowledged the significance of developing a healthy artist roster in an industry where "the competition to sign artists is tougher than ever and the business is much more professional and sophisticated than it used to be."[x]

Endnotes

[i] Talbot, M., "The 'Dog Without a Bone' Finds a Fresh Challenge to Chew On," *Music Week*, December 7th 1996, p. 7.
[ii] Pride, D., "Sony Looks to Licensing to Fill the Talent Gaps," *Music Business International*, June 1992, p. 32.
[iii] *Recorded Interview, January 30th 1998.*
[iv] Ibid.
[v] Ibid.
[vi] Ibid.
[vii] Ibid.
[viii] Ibid.
[ix] Ibid.
[x] Ibid.

(See Appendix D for secondary sources)

Although V2's entry was not a matter of change, the attributes listed in Table 7.36 seem to be applicable to analyze the context and content of this new business venture. One trigger for entrance was the expiration of Branson's non-competition clause enforced by Thorn-EMI when he had sold the Virgin Music Group. This enabled him to incorporate V2 Music under his Virgin Group umbrella next to his other businesses such as hotels, airlines and radio. The primary catalyst to V2's launch, however, was the appointment of Jeremy Pearce as CEO responsible for the grand design of the new music company's strategy and organization. Obviously, a decline in market performance had not been experienced, as the company had not existed before. Still, Pearce had noticed a substantial opportunity to do things differently from the conventional modes of operation and the traditional approach to organization as embraced by the major record corporations. His perception of the competition, and his deviant ideas of how to organize a music company, came to shape the content of V2's entrance.

Pearce developed a vision in which the Virgin Group's financial muscle could be merged with an artist-friendly approach to music. His primary aim was to create a music company with a truly international outlook, which delivered all sorts of music to various audiences over the world. Although its ownership structure made it a UK-based company, its

organizational setup as a consequence had to cross borders to sign artists all over the globe and to cope with this international variety in demand. V2 was thus positioned among its competitors (in other words, the major record corporations) as a transnational music company in which artists were company-wide resources (instead of being owned by individual operating companies in the country were the respective act was signed). To realize such ambitions, capabilities had to be created that would facilitate the establishment of the new company. More specifically, these capabilities concerned its international organization and coordination.

Table 7.36: Context and Content of V2 Music Group's Business Venture

Change Context	
Executives	Appointment of Jeremy Pearce as CEO
Ownership	Virgin Group's capital injection of more than $100 million
Threat/opportunity	Major companies' conventional approach to organization and operations
Performance decline	-
Change Content	
Vision	Merge Virgin Group's financial strength with artist-friendly attitude
Scope	Deliver style variety in music to international variety in audience
Positioning	V2 as a transnational music company
Capabilities	Formation of (inter-)organizational capabilities

Essentially, V2's entrance into the music industry was embodied by its search for these new capabilities, which started when Pearce was appointed as V2's CEO in March 1996 and ended in December 1997 with his public announcement that the firm was on course. Table 7.37 lists the main events and their corresponding dates during this period of entry as described in the V2 Music Group Case Box. In addition, Table 7.38 presents a structured overview of the core features that constituted this process of entrance. (As the V2 case essentially concerns a new business venture, the original attribute 'internal ventures' has been omitted from this table.) The company's business philosophy was characterized by an international but artist-friendly approach to artist development shaped by intracorporate knowledge sharing. This demanded a specific organizational setup, which started with the incorporation of local V2 record companies in each of the world's main music markets.

Table 7.37: Main Events at V2 Music Group

Event	Date
Richard Branson sets up a working party to investigate his return to the music industry	December 1995
Branson publicly announces an attack on the majors; Jeremy Pearce becomes V2's CEO	March 1996
Ronnie Gurr becomes creative director	May 1996
David Steele becomes MD of V2 Records; Stuart Middleton becomes finance director; Richard Polding becomes manager of business affairs; Launch of V2's music publishing division	July 1996
V2 signs its first act (Stereophonics)	August 1996
V2 closes partnership deal with Big Cat label; Steve Abbott becomes head of international A&R	October 1996
V2 closes partnership deal with Gee Street label; Opening of American office	December 1996
Implementation of global databases	Course of 1997
Licensing deal with the JDJ compilations label; V2 signs distribution deal with BMG for North America	March 1997
Branson sells 33% stake of V2 Music to the McCarthy Corporation for £45 million	June 1997
V2 closes partnership deal with dance label JBO; Pearce publicly states V2's funding was in excess of $100 million	December 1997

Two global databases, one for planning international marketing campaigns and the other for managing distribution accounts and royalty payments, turned this worldwide collection of operating companies into a transnational network. At each of V2's local subsidiaries, communication and teamwork was stressed, while publishing and recording operations were integrated at a managerial level. This underlined V2's focus on the significance of various musical property rights. At the corporate or group level, partnership deals and international licensing agreements were closed to access creative resources. In addition, V2's London headquarters created skills in global planning and cross-company coordination across its network of local units as part of its responsibility for the dissemination of information and knowledge. As the music industry's first major yet independent transnational music company, V2 aimed to resolve the dilemma between managing local and global market demands.

Table 7.38: Process of V2 Music Group's Business Venture

Philosophy	Transnational artist development approach
Organization	Network of database-linked and project-based local companies
Acquisitions	-
Alliances	Network of partnerships, licensing agreements and joint ventures
Status evaluation	Emphasis on musical rights through integration of recording and publishing
Learning skills	Global planning and cross-unit coordination
Resolving dilemmas	Differences in local and global market demands

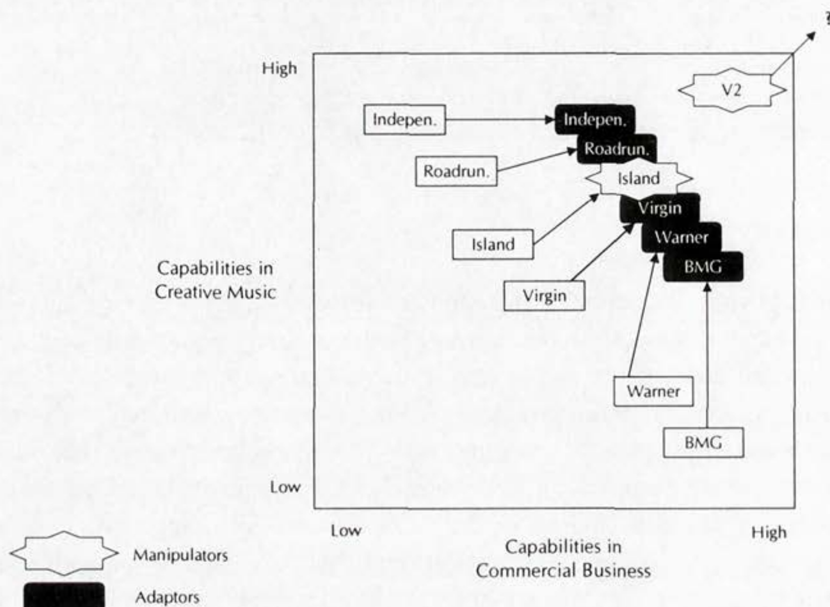
SUMMARY

As it is beyond the scope of this study to forecast future developments in the industry, it remains to be seen whether V2 Music Group's innovative and deviant approach to organizing a music company will spearhead the industry's next competitive regime. All the same, V2's offensive posture towards the major record companies reflects its intention to manipulate its competitive environment. Like Island Records, it analyzed established competitive practices and positioned itself in a unique competitive space, in the process searching for revolutionary and distinctive capabilities. However, it is not yet clear whether V2 will force its rivals to adapt to a new competitive context in the way Island managed to do. Indeed, the various case descriptions displayed between those of the two innovators showed how rival firms adapted to changes in their competitive environment. Thus, the current study of the British music industry demonstrates that record companies' search for new capabilities at the firm level was embedded in a dynamic of manipulation and adaptation.

This process is illustrated in Figure 7.8, where the institutionalization of the competitive regime of the nineties is depicted in the competitive moves of the various case-study companies. As discussed, the manufacturing and distribution deals between major record corporations and independent labels during the eighties had resulted in a further specialization of record company value chain activities in commercial business and creative music respectively. The new competitive concept of the nineties, initiated by Island, evolved around the convergence of an innovative orientation towards music and a focused business perspective. The figure shows how BMG and Warner created new capabilities in A&R to adapt to the new demands of musical innovation, moving upwards on the 'creative

music' capability dimension. Warner's move to the right on the 'commercial business' capability dimension expresses its novel dedication to the exploitation of property rights through the launch of warner.esp.

Figure 7.8: The Dynamic of Manipulation and Adaptation in the UK, 1990-1997



Independent record labels Roadrunner and Independiente, originally positioned in the opposite corner of Figure 7.8, created new capabilities in organizational coordination and financial administration, moving further on the 'commercial business' capability dimension. Roadrunner's move upward on the 'creative music' capability dimension illustrates its diversification move into new musical arenas. Island and Virgin moved along both dimensions simultaneously as they rebuilt their dormant A&R capabilities and created focused marketing capabilities. Whereas Island had historically been more orientated towards the introduction of new acts and new music, Virgin had traditionally been more involved in commercial artist development while expanding on an international level. At V2, these dimensions were already integrated as a basic 'platform of departure.' Its progressive capabilities in organization, not present at any other company in the music industry at the time of incorporation, can therefore possibly initiate a subsequent competitive regime.

Although Figure 7.8 shows how the case companies moved towards one another as followers adapted to changes in their competitive environment, *the way* in which new capabilities were actually created differed significantly among individual firms. Indeed, each of the case companies developed a unique strategy as an input for organizational change that embodied its search for new capabilities. The cases show this diversity in strategy in terms of both competitive positioning and developed strategic capabilities. They also illustrate how the nature of reorganization differed across companies and how each firm learned new but distinctive skills. In other words, the study of the UK music industry demonstrates how all companies were involved in a process of organizational change as they searched for new capabilities. Whereas this search brought them closer to each other from a competitive point of view, a basic level of variety was present in both its process and outcomes.

The case studies indicate that the reason for this observed diversity is rooted in the companies' past. At each of the case companies, the vision for change comprised a future and an historical component, the merger of which came to guide the company's search for capabilities. Island's musically innovative history, Virgin's entrepreneurial heritage, BMG's decentralized management ethos, Warner's traditional US marketing approach, Roadrunner's past of 'family-based' A&R, and Independiente's legacy of introducing new musical styles all influenced the future direction of these companies. On the other hand, these past strengths had at an earlier point in time obstructed the companies' ability to change in a more voluntarily setting (and not induced by outside forces). Further refinement of capabilities that underlay these strengths had apparently resulted in a competence trap, as can be observed in four of the case studies presented in this chapter. Although this study, in line with earlier expectations stated in the methodology chapter, unavoidably paid more attention to explorative search, these core rigidities deserve some attention at this point.

At Island, Blackwell's expertise had been fundamental to the label's successful artist roster over time, but had at the same time prevented the company from focusing on critical activities such as marketing and developing a company- instead of a person-specific A&R base. Virgin's entrepreneurial culture had been an important factor in its prosperity in earlier years, but had also created a company where acts were signed on the basis of A&R managers' personal tastes and where new staff was hired in an internal context of unlimited growth. BMG's emphasis on management decentralization had been key in the establishment of a multinational cor-

poration, but made the process of change difficult for the UK company: after the restructuring of A&R activities at the company's front-line labels, Jeremy Marsh needed to launch a new Music Division to centralize strategic management decisions. Warner's traditional strength in US-based repertoire and marketing had created a flourishing company over the years, but obstructed the company in its objective to increase local artist development, a process that would take almost five years.

This chapter has described how, at the firm level, capabilities were created and (to a lesser extent) refined in a dynamic of manipulation and adaptation, which shaped a process of organizational change at individual record companies. Whereas Chapter 6 focused on similarities between record companies as the competitive process at the industry level unfolded, this second part of the empirical study investigated the differences between firms in their search for new capabilities. Although it generated no clear-cut findings on the refinement of capabilities, this multiple-case study into the UK music industry showed that firms are different (and that this variety increases over time), even when they move towards each other to conform to a new set of rules of the competitive game. The next chapter concludes this thesis with a discussion of the outcomes of the empirical investigation as confronted with the theoretical framework outlined earlier.

CHAPTER 8

Discussion and Conclusion:
Principal Findings of the Research Project

The previous two chapters presented a two-layered study of the music business in which the coevolution of capabilities and competition was investigated at both firm and industry levels of analysis. This chapter closes the thesis and completes the research project by comparing evidence and theory. Spurred by new knowledge of record companies and the music industry, it returns to the original research question. As a first step, the propositions are considered in light of the evidence presented in both the historical study and the multiple-case study. The objective is to examine the validity of the integrative framework developed in Chapter 4, which leads to a more detailed discussion on the conclusions and implications of the research project. In addition, the basic flaws and advantages of the empirical research approach adopted in this thesis are reflected upon from a methodological perspective. Finally, several future research trajectories for the field of strategic management are suggested.

PROPOSITIONS AND FINDINGS

As stated at the outset of this thesis, the principal aim of the current study has been to gain new insights into the relatively unexplored phenomenon of coevolution between capabilities and competition. This goal was initially prompted by the observation that existing theories on competition and capabilities display fundamental differences as to their assumptions on firm idiosyncrasy and uniformity. Drawing upon the notion of search, a theory-induced framework of coevolution has been constructed to reconcile these conflicting perspectives. It aims to integrate firm and industry levels of analysis in accordance with two sets of propositions, each related to one of these levels (see Table 8.1). The framework was then applied in

a historical study and a multiple-case study of (record companies competing in) the music industry. The result of this exercise has been that all propositions are supported by the findings derived from this data, as will be discussed in the following paragraphs.

Table 8.1: A Recap of Propositions

Industry Level of Analysis	Firm Level of Analysis
1a: Coevolution of capabilities and competition is shaped by search behavior of rival firms in a process of innovation and imitation.	2a: Coevolution of capabilities and competition is shaped by search behavior of rival firms in a process of manipulation and adaptation.
1b: Explorative and exploitative search behavior of rival firms results in the foundation and proliferation of capabilities.	2b: Explorative and exploitative search behavior of rival firms results in the creation and refinement of capabilities.
1c: Coevolution of capabilities and competition embodies a sequence of competitive regimes.	2c: Coevolution of capabilities and competition embodies a sequence of organizational changes.

The study seems to confirm the basic premise that firms do not search in isolation; instead, the search behavior of a particular firm has implications for that of other firms operating in the same competitive environment. The historical exposition of the music industry displays how the search for capabilities at innovative record companies like Victor, Decca, Atlantic and Warner resulted in a competitive struggle at the industry level in which rivals' search behavior was directed at the imitation of these previously unknown capabilities. In addition, the case studies show how, from a firm-level point of view, Island's search behavior was essentially manipulative in character as it forced other rival firms to adapt to the resulting change in their competitive environment, and to search for new capabilities as well. These findings strongly support Proposition 1a and Proposition 2a on how the search behavior of firms shapes the coevolution of capabilities and competition.

Next, the history of the music industry demonstrates how exploration at the industry level was a matter of creative search for distinct capabilities by both innovators and imitators. But once the innovator's advantage had been eroded, and rival companies had become more identical in terms of strategies and capabilities, the founded capabilities were further proliferated. This was observable in the exploitation of distinct activities that

linked record companies to the creative community and to the consumer market. These activities consisted of bundles of the earlier founded capabilities that in this way came to be proliferated across the industry as conventional practice.[1] Although the data presented in the historical study does not reveal in-depth knowledge on the search behavior of imitators, it does indicate that the latter are also involved in explorative search behavior when trying to replicate the innovator's new capabilities base. In four out of six competitive regimes, it took rival record companies several years before they had managed to erode the innovator's competitive advantage, which reflects the strenuous nature of their search behavior.

The multiple-case study is more informative in this respect: it clearly shows how both manipulators and adaptors were engaged in explorative search as the studied record companies created new capabilities and dissociated themselves from established practice. Indeed, the contemporary case studies provide ample evidence to support the idea that exploration at the firm level was in fact the creative search for new capabilities by both manipulators and adaptors. However, it was less clear how the newly created capabilities were further refined. Yet the data shows that, in four out of six possible cases of rejuvenation, record companies found it difficult to change as they had fallen into a competency trap. In line with existing theory, this indicates that previously created capabilities are refined over time – even to the extent that core capabilities become core rigidities, and further amplify the internal differences between firms. In sum, the empirical findings support Proposition 1b and Proposition 2b on the distinction between explorative and exploitative search behavior as related to the development of capabilities.[2]

Also, the empirical studies register the necessity for rival firms to be engaged in a sequence of organizational change trajectories in order to survive. As said, the multiple-case study displays how record companies had become locked into old routines that had turned historical capabilities into barriers to change. In a similar vein, the history of the music industry exhibits how Edison's National Phonograph Company failed to survive as it sustained the production of cylinders. After the rise of the independents

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[1] This switch from explorative to exploitative search brought rival companies even closer to one another, and precluded the rise of clear competitive advantages among them.

[2] Again, it must be stressed that empirical evidence on how new capabilities were refined at the firm level was less pronounced than that on how capabilities were proliferated at the industry level of analysis.

in the mid-1950s, RCA and Decca were not able to conform to the new rules of the competitive game; it was only when both companies were acquired by major capital providers Bertelsmann and Matsushita respectively that they were able to regain their strength. However, the case studies clearly show how record companies also managed to adopt a strategic choice perspective. This enabled them to shake off old habits and routines, and to renew their search for novel capabilities through radical processes of organizational change.

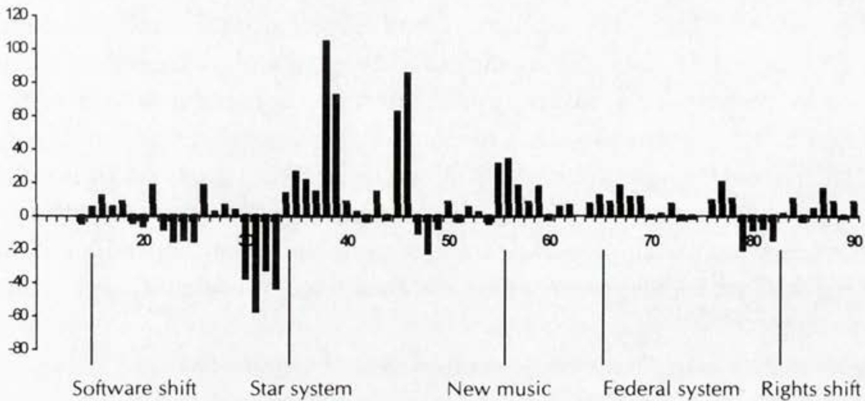
This sequential nature of the dynamic between explorative and exploitative processes of capability development can also be found at the industry level. But in contrast to the above where firms again move closer towards one another in their competitive strategies and capabilities, differences among rivals start to increase at the industry level as a new strategic innovator spearheads the next competitive regime. Both the historical and the multiple-case study indeed show how entrepreneurial record companies were radically different in their capabilities as they introduced new competitive practices that replaced the existing rules of the game. This not only induced explorative search at rival companies, but also took the industry to a next round of development or, in other words, to a new competitive regime. These empirical findings strongly support Proposition 1c and Proposition 2c, thus suggesting that capabilities and competition coevolve over multiple competitive regimes and trajectories of organizational change.

IMPLICATIONS AND CONCLUSIONS

As the individual propositions seem to stand the test of empirical evidence, the validity of the integrated framework of coevolution presented in Chapter 4 can be sustained. Firms coexist and search in a competitive ecology, in which the creation and refinement of capabilities at individual rival firms impacts the foundation and proliferation of capabilities that shapes their industry (and vice versa). As search behavior alternates between the rejuvenating properties of exploration and the maturing tendencies of exploitation, the industry and its constituent rival firms coevolve over time. This dynamic, displayed in the framework as a continual and cyclical movement at both firm and industry levels of analysis, indeed substantiates the call for more dynamic models of strategy as voiced by prominent authors in the field (e.g., Porter, 1991; D'Aveni, 1994). In this respect, two conclusions can be derived from the application of this par-

ticular dynamic framework to the music industry: (1) the coevolutionary interaction of search processes at firm and industry levels is a major and endogenous force of development, and (2) a coevolutionary perspective of the relationship between capabilities and competition allows for the inclusion of conflicting perspectives on firm idiosyncrasy and uniformity.

Figure 8.1: Competitive Regimes and Growth % of US Music Sales

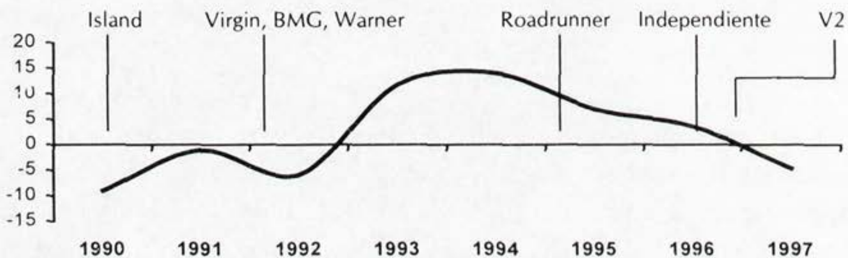


Source of Growth %: See Appendix B

First, integration of the results obtained from the historical and multiple-case studies suggests that coevolution of capabilities and competition shapes change at both firm and industry over time. In other words, the process of reciprocity between capabilities and competition represents a major endogenous force of development that moulds the evolution of the industrial system and its constituent rival firms. Figure 8.1 plots the annual growth ratio in American music sales (based on constant value) for the period 1910-1990. If one adjusts this pattern for the rather excessive ratios during the Great Depression and around the Second World War, it can be observed how the coming of new competitive regimes as described in Chapter 6 influenced the US record industry's prosperity. In each case, a significant increase of the real growth ratio followed the establishment of a new competitive regime based on explorative search behavior that rejuvenated the industry. At the same time, the figure displays how the launch of a new regime was preceded by stable or even negative values that attended the degenerative features of exploitative search behavior.

In addition, Figure 8.2 presents a more detailed view of the impact coevolution of capabilities and competition had on industry growth during a particular competitive regime in the UK. Island's innovative search for ways to converge creative music with commercial business spearheaded the organizational change programs of many record companies. In effect, this resulted in the institutionalization of the new regime during the nineties, which in turn drove the British music industry's growth ratio to higher levels. Whereas Virgin, BMG and Warner entered the process of transformation at an early stage, Roadrunner and Independiente changed their organizations only after they had experienced increased returns. Recognizing that organizational change programs place significant costs upon a company, this observation seems to be consistent with data presented earlier on. It was shown in Chapter 7 how gross profit margins for independents stagnated from 1994 onwards, whereas gross profit margins for majors and linked companies displayed exactly the opposite pattern. It seems that cooperation between majors and linked minors induced the speed with which these companies searched for new capabilities.

Figure 8.2: Organizational Change and Growth % of UK Music Sales



Source of Growth %: Calculated from Constant Sales Value as presented in the BPI Statistical Handbook 1998

Still, the slower response of the independent companies to the new rules could not prevent a downturn in the UK industry's prosperity. Representing 80% of industry profits and turnover, the other two categories made sure that the founded capabilities were further proliferated. As a consequence, the British music industry's real growth ratio dropped to 3.6% over 1996 and even turned negative during the following year. As Decca, Atlantic, Warner and Island had done in their times, V2 aimed to create a new concept of competition during these years of decline. Al-

though it remains to be seen whether V2's innovative behavior will lead to the launch of the next competitive regime, Schumpeter (1934) already noted that periods of downturn or stagnation offer fertile ground for strategic innovations to occur. Moreover, the above conforms to the theory of Schumpeter that development is an endogenous process, and contributes to his thoughts with the specific assertion that it is, to a large degree, the coevolution of capabilities and competition that drives renewal of both the industrial system and its constituent firms.

Clearly, this contradicts existing views that development is largely determined by forces of an exogenous nature such as the pace of technology, government policies and consumer demographics (e.g., Hannan and Freeman, 1977; Hrebeniak and Joyce, 1985). In a similar vein, cultural studies claim that the recurrent pattern in the music industry's sales growth is due to developments in the creative community itself (e.g., Peterson and Berger, 1975; Lopes, 1992). They argue that the creative potential present in the artistic community determines the industry's health, and that the cyclical growth of the industry is shaped by fluctuations in this exogenous variable. In other words, these studies acknowledge the existence of record companies, but downplay their role as endogenous forces of development. This thesis provides an alternative perspective, in which the industry has been shaped by the interactive search behavior of its constituent rivals over time. Spurs in industry growth have been a consequence of the creativity of record companies that managed to introduce novel business practices and launched new competitive regimes.

A second fundamental outcome of this research project is that a coevolutionary perspective towards the reciprocity between capabilities and competition allows for the inclusion of contradictory doctrines that focus on differences and similarities between firms in an industry. In particular, a marriage of the results of the historical study with those of the multiple-case study implies that rivals can be both different and similar to one another in terms of their capability bases at the same time. Table 8.2 compiles the new capabilities that were founded (and later on proliferated) during each competitive regime as discussed in Chapter 6. In essence, record companies that aspired to keep up with the competition, or to at least ensure survival, were forced to develop these basic capabilities. That is, they had no choice but to change their strategies, mindframes and organizations, and search for novel capabilities that conformed to the new rules of the game. In this respect, rival firms in the record business moved towards uniformity over a competitive regime as they copied and prolifer-

ated capabilities tied to the extraction, development and commercialization of creative resources.

Table 8.2: Competitive Regimes and New Capabilities

	Managerial	Input-Based	Transformation	Output-Based
Technology logic	• Market for home entertainment • Availability of minimum software • High fidelity of recordings	• Horizontal disc technology • Zinc masterplate for recording • Financial and technological knowledge	• Structured firm organization • Efficient manufacturing plant • Separate recording and production	• Quality gramophone disc • Technology license agreements • International strategic alliance
Software shift	• Market for music recordings • Availability of minimum hardware	• Theater and opera performers • Technological skills and experience	• Innovation in recording /manufacturing • Capacity-based production	• High release variety in recordings • High technological status
Star system	• Consumer preference for celebrities • Manipulation of consumer taste	• Compact roster of celebrities • Marketing and promotion budgets	• Avant-garde marketing campaigns • Economic rationale of costs vs revenues	• Network of distribution channels • Network of jukebox contracts
New music	• Upcoming popular youth market • Continuous generation of new music • High market responsiveness	• Roster of unproven and popular artists • Low-cost recording studios • All-round skills of owner/manager	• Talent discovery and development • Entrepreneurial management • Label culture of musical innovation	• Independent distribution network • Network of local radio contacts • Label reputation
Federal system	• Multiple market coverage • Synergy across focused labels	• Collection of acquired record labels • Headquarters' corporate knowledge	• Label autonomy in A&R and marketing • Shared administration and P&D setup	• High musical variety in album releases • Popular corporate image
Rights shift	• Cultivation of music property rights • Multiple-time buyers of music	• Multinational distribution networks • Scale-based CD manufacturing plants	• Cooperation within value chain • Specialization of artist development	• Expansion of record catalogues • Network of deals with independents

At the same time however, the case studies in Chapter 7 showed how different record companies displayed a significant degree of diversity in the specific way they developed new capabilities during the unfolding of a new competitive regime. While all of the studied companies were similar in their aim to converge creative music with commercial business (in line with the new competitive rules as initially pioneered by Island), each of them pursued a different route in its search for new capabilities. Table 8.3, displayed on the following page, recapitulates the basic features of the organizational change trajectories followed by the case companies, and shows substantial variation in terms of market positioning, capability development, organizational realignment and the learning of new skills. As time passed, these initial differences were amplified through exploitative search, which increased individual firm idiosyncrasy. Thus, based upon historical and multiple-case research into the music industry, it can be concluded that, in line with the integrative framework, the coevolution of capabilities and competition embodies multi-level but counter-moving patterns of firm uniformity and idiosyncrasy.

In other words, this idea suggests that both Schumpeterian and resource-based theories on the appearance of rival firms over time carry an element of truth, and that a synthesis of both perspectives could be of value to a dynamic theory of competitive strategy. Two basic themes appear to stand out in such a dynamic notion of strategy as fundamentally based on the concept of search behavior. First, it is important to realize that there is more than one way for firms to achieve similar strategic objectives and to develop new capability bundles in a competitive context. In this sense, Schumpeter's idea that competitive interaction makes rival firms move towards one another can be complemented with the resource-based argument that firms are essentially unique in their appearance and behavior. Similarly, the resource-based principle that companies need to be different to be competitively successful can be matched with the Schumpeterian view that the process of competition evolves around certain fundamental rules of the game. Such two-way integration allows for the theorem that a competitive advantage is built on capabilities and can therefore only be temporary.

The second theme is that interaction patterns among rivals and path dependencies at individual firms can have both a positive and a negative impact on the development of new capabilities. It has already been discussed how interactive behavior through acquisitions, joint ventures and strategic alliances among record companies speeded up the capability de-

velopment process at these firms. Although this was beneficial to the individual companies in their struggle to conform to the new competitive rules, it also pushed the industry into an early stage of exploitation and falling growth levels. This seems to conform to D'Aveni's (1994: 333) argument that "cooperation usually leads to more intense levels of competition." In a similar vein, it has been mentioned how the existence of path dependencies prevents firms to change their capabilities in times of competitive turbulence due to long-term commitments and excessive learning effects (e.g., Ghemawat, 1991; Levinthal and March, 1993). However, the case studies also showed that firms are able to break free from these competence traps; moreover, they narrated how record companies profited from their unique history by retaining its positive virtues and integrating them into new entrepreneurial actions.

Table 8.3: Organizational Change and New Capabilities

	Positioning	Capabilities	Organization	Skills
Island	Commercially alternative record label	Formation of A&R and marketing	Major/indie staff at top/front-line positions	Marketing new and alternative music
Virgin	Globally focused record company	Convergence of A&R and marketing	Internal network of divisionalized sub-labels	Coordinating planning and creative functions
BMG	Internationally-oriented local record corporation	Incorporation of local A&R	Music division of project-based front-line labels	Managing a network of creative interfaces
Warner	Locally-oriented American record corporation	Formation and coordination of A&R	Central division between separate label groupings	Sharing cross-label grouping knowledge
Roadrunner	Internationally-oriented diversified record label	Creation of multinational coordination	IT-oriented headquarters with local units	Sharing intra-corporate knowledge
Independiente	Internationally-oriented alternative record label	Development of international base	Temporary cross-functional project teams	Communicating effectively and efficiently
V2	Transnational music company	Creation of (inter) organizational setup	Network of interlinked record labels	Coordinating local-global business processes

This research project aimed to contribute to an enhanced understanding of the concept of coevolution and, to achieve this aim, generated a dynamic and integrative framework that crosses multiple levels of analysis. It led to the following conclusions: Over the past two decades, strategic management thinking has evolved from the point of view that the sources of a company's success lie in the industry to the belief that the determinants of superior performance are to be found in the firm itself. Obviously, it is both. Firms do not search in isolation but exist in ecologies of competition, and this is why barriers to entry and barriers to imitation do not last forever. Rival firms search for new capabilities within their organization, but they also search for capabilities that rest in their competitive environment. The coevolutionary perspective advocated here enables an integrated view of these search processes at both firm and industry levels, and shows how their interaction makes industries and firms coevolve endogenously over time. Moreover, it allows conflicting perspectives on firm differences and similarities to be united if one perceives coevolution of capabilities and competition as multi-level but countermoving patterns of firm uniformity and idiosyncrasy.

METHODOLOGICAL ISSUES AND FUTURE RESEARCH

The above discussion suggests that there seem to be at least three points of value tied to the dual nature of the empirical research design as applied in this study. First of all, the incorporation of both a historical study and a multiple-case study facilitated description and analysis of the topic from a clear longitudinal perspective. Traditionally, research into strategy and competitive advantage has searched for the determinants of superior positions at a particular point in time. However, Porter (1991) argued that the strategic management academy should be more concerned with studies of dynamic processes instead of continuing to address this 'cross-sectional problem.' Moreover, he claimed that inquiries into the more intriguing 'longitudinal problem' should focus on the two fundamental variables of initial conditions and managerial choice. This thesis proved his point as it exhibited that (1) history does matter because of path dependencies, and (2) firms do shape their future as a result of voluntary actions. In other words, it dealt with what Van den Bosch (1997) explained as the balance between determinism and strategic choice.

Second, following the original aim of the current study, the dual methodology enabled the investigation of processes at different levels of

analysis as more recently advocated by academics such as Levinthal (1995) and Henderson and Mitchell (1997). One of its major benefits was that some of the findings that had been independently generated from the individual studies pointed at the existence of similar patterns and mechanisms, especially with regard to the direction and causality of search behavior. In addition, the individual methods of historical and multiple-case study proved to be complementary: defaults in one method could be met by revelations in the other (and vice versa). For example, the reported absence of in-depth insights into imitators' search behavior in the historical study was to some extent relieved by detailed insights into adaptors' search behavior as reported in the multiple-case study. In turn, the lack of clarity into the refinement of capabilities in the multiple-case study could be partly covered by specific findings on how capabilities were proliferated as analyzed in the historical study.

Leonard-Barton (1990), who encountered similar research benefits, maintained that such parallels and matches between distinct methodologies enhance both internal and construct validity. This seems to be particularly important to the third advantage of the dual methodology, which has already been extensively discussed in the above: the integration and synthesis of findings tied to different levels of analysis in pursuit of a more dynamic notion of strategy and competitive dynamics. Despite these various benefits, application of the dual methodology is clearly not a bed of roses. The researcher can be overwhelmed by the sheer volume of data involved in the empirical part of the research, and can accordingly be confronted with problems related to its collection or organization. However, these dangers can be dealt with through careful planning and structured coordination of activities at the outset of a project. A more serious problem is that it can be dangerous to cover up faults in one study by revelations in the other because, in the end, one investigates different levels of analysis. Thus, the paramount advantage of the dual methodology can, at the same time, be its major liability.

This pitfall suggests that, in the future, additional research could be of value to the ideas developed here and, in particular, to the further refinement of the integrative framework constructed in Chapter 4. It appears that more effort needs to be put into an investigation of the impact of exogenous forces, a topic that has been underexposed in the current project. A reason for this omission can be found in the fact that the music industry has traditionally not been heavily influenced and restricted by governmental policies – although this may change in the near future as record

companies do become more concerned with the protection of their intellectual property rights. It is therefore imperative that the just explored concept of coevolution of capabilities and competition has to be studied in other creative or traditional industries as well. In this respect, a number of possible trajectories for future research are suggested in more detail in the following pages.

Much of the empirical work that has (implicitly) studied the search behavior of firms, has traditionally focused on pioneering companies that exhibit superior performance (e.g., Peters and Waterman, 1982; Kanter, 1983; Leonard-Barton, 1995; Christensen, 1997). However, empirical findings from the historical study suggest that an appreciation of how search subsequently takes place at imitators is indispensable for a thorough understanding of competitive dynamics. As firms do not search in isolation, it seems to be important to at least know the determinants and effects of search as competitive interactions among firms at the industry level. Moreover, as more and more industries appear to have experienced a shift towards hypercompetition (D'Aveni, 1994), further research into search as a fast-response driver to imitation would be of value, especially since most companies take on the role of imitator. Such studies would require a fine-grained analysis of the behavior of rival firms during a particular competitive regime.

In a similar vein, the majority of research efforts that has (implicitly) focused on the outcome of companies' search behavior in terms of capabilities, has mainly been concerned with content instead of process issues (e.g., Bower and Hout, 1988; Prahalad and Hamel, 1990; Chesbrough and Teece, 1996; Miller and Shamsie, 1996). That is, the focus of attention was on what (type of) capabilities are developed at firms, but not on how these capabilities are actually generated and cultivated. In addition, preliminary findings from the multiple-case study suggest that the field of strategic management is in need of more knowledge on how newly created capabilities are refined over time, especially since such behavior can culminate in the rise of core rigidities or competence traps. One way to track capability refinement is to conduct in-depth case studies of firms (which have been identified up front as having created new capabilities) over significant periods of time.

A third research issue that deserves attention in the future concerns the effects of a shift in behavior from exploration to exploitation and vice versa. Levinthal and March (1993) argued how excessive exploitation endangers the health of both the industry and the firm. Although evidence

from the music industry shows that firms are able to break free from this negative spiral by commencing or returning to explorative search, the data on the spiral itself is still somewhat ambiguous. Whereas the idea that negative returns to exploitation exist at the firm level has received more attention in recent years (e.g., Ghemawat, 1991; Leonard-Barton, 1992; Rumelt, 1995), there is still little knowledge on the degenerative effects of exploitative behavior by rivals at the industry level. Studies into this process of 'self-destruction' should not only observe the health of an industry in terms of specific industry-wide measures, but should also take notice of the possibility that major exogenous events conceal or impact such a degenerative process.

Whereas the research trajectories suggested above directly involve the process of coevolution and emphasize the potential value of the search concept to the field of strategic management, the following suggestions spring from more specific empirical observations. The historical analysis could not find any evidence that capabilities had been proliferated during the first competitive regime. A lack of data from these earlier years could be a possible explanation, but a more credible one can be found in studies on technological competition for so-called 'dominant designs' (Anderson and Tushman, 1990; Suárez and Utterback, 1995). Here, rivals compete for a technological standard, a struggle in which the firm that manages to lock its technology into the market is the eventual winner (Arthur, 1989). This firm usually has a progressive licensing policy, meets customer demand via a wide availability of compatible software, and creates a limited number of horizontal strategic alliances (Hill, 1997).

The music industry's first competitive regime was indeed characterized by this technological struggle for standardization, and Victor clearly met the requirements for winning the battle between disc and cylinder. Because rivals were, for some years, not certain about what system to adopt, it is very likely that capabilities were not (or only to a limited degree) proliferated at the industry level. When it was finally clear that the disc system had won out, it was not long before the industry moved to the next regime in which rivalry evolved around the production of records. And the music industry has been a software-based industry ever since, during which capabilities were proliferated in each subsequent competitive regime. Essentially, the shift in the industry's nature from hardware to software raises the interesting question whether further exploitation of capabilities matters at all in industries were technology plays a dominant role in the rise and fall of competitors over time.

Looking at the attributes of organizational change in the multiple-case study, it can be observed how firm organization played a significant role in the creation of new capabilities. This is no surprise if one remembers that companies in the music industry depend to a large degree on the knowledge and communicative capacities of their people. It seems that music companies can provide fertile ground for studies into the contribution of knowledge and organizational form to the firm's ability to develop new capabilities. Organizational form is claimed to be crucial to a firm's performance (Bartlett and Ghoshal, 1989; Hedlund, 1994) and to its ability to balance exploration and exploitation of capabilities (Volberda, 1998). Knowledge flows, which underlie the firm's organizational form, evolve over time, determine changes in the integration of knowledge components (Van Wijk and Van den Bosch, 1998), and therefore shape alterations in the firm's capabilities development process.

As an empirical jungle, the music industry seems to offer enormous opportunities to the field of strategic management. Its rich history can be of value to those interested in path dependencies, while intriguing developments such as digital distribution of music can be an input into studies concerned with the value of intellectual property rights to firm behavior. Furthermore, the music industry is a 'creative business' where creative resources have to be marketed commercially, and plays the role of major content provider in a converging network of industries. Also, the observed diversity in record company behavior, as well as the value of knowledge- and relationship-based resources to record companies' performance, can be illuminative to those concerned with the 'hidden' determinants of firm success. As for me, there can be no doubt that the choice for this uncharted empirical setting played an important part in the ambitious goal of contributing to a dynamic theory of strategy.

Appendix A: Interview Guidance Questions

The semi-structured interviews were, to a large degree, framed around basic knowledge of the firm's development during the nineties, which had been generated through preliminary data collection. Still, to enable eventual cross-case comparison, similar issues and topics had to be covered, and in this respect the general questions below guided the interviews.

Questions of a personal nature, involving the interviewee's
- previous working experience
- current job description
- role in the organization

Questions concerning the company's development, in terms of
- key historical events
- positioning and performance over time
- future goals and objectives

Questions regarding the company's strategic reorientation, as to
- its core rationale
- new market opportunities
- executive responsibility

Questions on major steps in the company's transformation, such as
- cost-cutting activities
- major staff appointments
- setup of new departments or divisions

Questions on changes in the company's organization, especially its
- main organization principle
- organizational processes
- key nodes and activities

Questions concerning the company's learning experiences, in terms of
- changing emphasis on activities
- managing business and artist policies
- developing unknown skills

Questions regarding (changes in) the company's core philosophy on
- artist development
- international perspective
- determinants of growth

Questions on the company's attitude towards cooperation, in terms of
- licensing and distribution deals
- joint ventures and alliances
- intracorporate knowledge transfer

Questions of a general nature, involving the interviewee's ideas on
- major changes within the industry
- key developments in competition
- impact of future technologies

Appendix B:
Computation of US Music Sales

To obtain a somewhat more transparent understanding of the long-term growth pattern in record sales, available current value figures have been translated into constant value figures, guided by annual growth ratios. The current values (in $ millions) are derived from the Recording Industry Association of America, as reported by Gronow (1983) for the years 1921-1968, and from the International Federation of the Phonographic Industry as reported by Hung and Morencos (1990) for the years 1969-1990. Data between 1910 and 1920 were incomplete, and have therefore been estimated on the basis of United States GNP figures as presented in Mitchell (1993). Regression was performed in line with Sanjek's (1991) account that sales in 1920 were reported to be $100 million. The resulting pattern appeared to be consistent with Gronow's (1983) assumption that US record sales in the early 1910s must have been at least 30 million records (with an average retail value of 1 dollar), and that growth was slow until the war years and rose rapidly afterwards. The constant values (in $ millions) were computed to take account of rising consumer prices and to correct for inflation, according to the following simple formula: constant value = current value / (consumer price index * 0.01). CPI figures for the period 1913-1990 were collected from the US Department of Labor - Bureau of Labor Statistics, and were corrected for 1990 as 100. Whereas annual growth ratios concern current values, real growth ratios are based upon constant values; both reflect the difference between a particular year and the previous one. The figures and tables displayed in Chapter 6 are based on the following table:

Year	Current Value in $ Millions	Annual Growth Ratio	Consumer Price Index	Constant Value in $ Millions	Real Growth Ratio
1910	39	-	n/a	-	-
	39	0	n/a	-	-
	43	10	n/a	-	-
	43	0	7.6	565.8	-
	42	-2	7.7	545.5	-4
1915	44	5	7.7	571.4	5
	53	20	8.3	638.6	12
	66	25	9.8	673.5	5
	84	27	11.6	724.1	8
	92	10	13.2	697.0	-4
1920	100	9	15.3	653.6	-6
	106	6	13.7	773.7	18
	92	-13	12.9	713.2	-8
	79	-14	13.1	603.1	-15
	68	-14	13.1	519.1	-14
1925	59	-13	13.4	440.3	-15
	70	19	13.5	518.5	18
	70	0	13.3	526.3	2
	73	4	13.1	557.3	6
	75	3	13.1	572.5	3

Year	Current Value in $ Millions	Annual Growth Ratio	Consumer Price Index	Constant Value in $ Millions	Real Growth Ratio
1930	46	-39	12.8	359.4	-37
	18	-61	11.6	155.2	-57
	11	-39	10.5	104.8	-32
	6	-45	10.0	60.0	-43
	7	17	10.3	68.0	13
1935	9	29	10.5	85.7	26
	11	22	10.6	103.8	21
	13	18	11.0	118.2	14
	26	100	10.8	240.7	104
	44	69	10.6	415.1	72
1940	48	9	10.7	448.6	8
	51	6	11.2	455.4	2
	55	8	12.5	440.0	-3
	66	20	13.2	500.0	14
	66	0	13.5	488.9	-2
1945	109	65	13.8	789.9	62
	218	100	14.9	1463.1	85
	224	3	17.1	1309.9	-10
	189	-16	18.4	1027.2	-22
	173	-8	18.2	950.6	-7
1950	189	9	18.4	1027.2	8
	199	5	19.9	1000.0	-3
	214	8	20.3	1054.2	5
	219	2	20.4	1073.5	2
	213	-3	20.6	1034.0	-4
1955	277	30	20.5	1351.2	31
	377	36	20.8	1812.5	34
	460	22	21.5	2139.5	18
	511	11	22.1	2312.2	8
	603	18	22.3	2704.0	17
1960	600	-1	22.6	2654.9	-2
	640	7	22.9	2794.8	5
	687	7	23.1	2974.0	6
	698	2	23.4	2982.9	0
	758	9	23.7	3198.3	7
1965	862	14	24.1	3576.8	12
	959	11	24.8	3866.9	8
	1173	22	25.6	4582.0	18
	1358	16	26.6	5105.3	11
	1586	17	28.1	5644.1	11

Year	Current Value in $ Millions	Annual Growth Ratio	Consumer Price Index	Constant Value in $ Millions	Real Growth Ratio
1970	1660.0	5	29.7	5589.2	-1
	1744.0	5	31.0	5625.8	1
	1924.0	10	32.0	6012.5	7
	2001.0	4	34.0	5885.3	-2
	2186.4	9	37.7	5799.5	-1
1975	2378.3	9	41.2	5772.6	0
	2732.0	15	43.5	6280.5	9
	3500.8	28	46.4	7544.8	20
	4131.4	18	49.9	8279.4	10
	3685.4	-11	55.5	6640.4	-20
1980	3862.1	5	63.0	6130.3	-8
	3969.9	3	69.5	5712.1	-7
	3641.6	-8	73.8	4934.4	-14
	3814.3	5	76.2	5005.6	1
	4370.4	15	79.5	5497.4	10
1985	4387.8	0	82.3	5331.5	-3
	4651.1	6	83.9	5543.6	4
	5567.5	20	86.9	6406.8	16
	6254.8	12	90.5	6911.4	8
	6464.1	3	94.9	6811.5	-1
1990	7368.8	14	100	7368.8	8

Appendix C: Major Acquisitions 1986-1996

Purchaser	Record Company	Year	Price
Bertelsmann	RCA Records	1986	$300 million
PolyGram	Go! Discs (49%)	1987	£0.75 million
Sony	CBS Records	1988	$2 billion
PolyGram	Island Records	1989	£272 million
Thorn-EMI	Chrysalis Records (50%)	1989	£54 million
PolyGram	Big Life Records (49%)	1989	£1.5 million
PolyGram	A&M Records	1990	$500 million
Time-Life	Warner Communications*	1990	$14 billion
MCA	Geffen Records	1990	$550 million
Thorn-EMI	IRS Records	1990	£2.25 million
Matsushita	MCA	1990	$6.6 billion
Virgin	EG Records	1991	$3 million
Thorn-EMI	Chrysalis Records (50%)	1991	£35 million
Thorn-EMI	Virgin Music Group	1992	£560 million
Sony	Creation Records (49%)	1992	£3.5 million
PolyGram	Big Life Records (51%)	1993	n/a
PolyGram	Motown	1993	$300 million
Seagram	MCA (80%)	1995	$5.7 billion
BMG	Conifer Records	1995	n/a
MCA	Interscope (50%)	1996	$200 million
PolyGram	Go! Discs (51%)	1996	£20 million

* Warner Music Group is part of Warner Communications

Sources: Monopolies and Mergers Commission (1994), *The Supply of Recorded Music*, London: HMSO; Editorial, "The Acquisition Question," *Music Business International*, April 1996, p. 16.

Appendix D: Case Study Secondary Sources

Island Records

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Music Week:
"A&M and Island AIM to Take the High Road," March 24, 1990.
"Marot In, Three Out at Island," July 28, 1990.
"PolyGram Takes Reins of Island Finances," September 22, 1990.
"Island Shapes Up," January 26, 1991.
"Island Splits Video Division," February 16, 1991.
"Island Back to A&R Roots," March 30, 1991.
"Island's MD in Obscenity Row," June 8, 1991.
"PolyGram to Fight NWA Case," August 24, 1991.
"Island Beats Obscenity Rap," November 11, 1991.
"Marot Hires Rowe," March 14, 1992.
"Island Rejigs as Rowe Arrives," May 9, 1992.
"U2: We're With Island for Good," June 12, 1993.
"Island Elevates Four Senior Staff," April 2, 1994.
"Island's Manners Moves Up," May 14, 1994.
"Island Goes Solo in US as Turnover Doubles," July 2, 1994.
"New Acts Boom in UK Gold Rush," November 19, 1994.
"Pulp and Tricky Help Island to Victory in A&R Category," March 16, 1996.
"Rowe to Leave Island as Label Restructures, " October 4, 1997.
"Blackwell Walks as Island Era Ends," November 15, 1997.

Virgin Records

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Music Week:
"The Master Motivator," April 13, 1991.
"AVL Drops Name in Circa Merger," June 1, 1991.
"Virgin Wins Conroy Deal," December 21, 1991.
"Virgin Axes 80 Jobs," June 13, 1992.
"Now Virgin's Axe Falls on Classics," June 20, 1992.
"Ten MD to Quit Virgin," November 7, 1992.
"Virgin Axes Protein Diet," November 7, 1992.
"Virgin Doubles LP Share," October 29, 1993.
"New Virgin Division Takes in Hut," December 11, 1993.
"Hut Frontman Heads Virgin Indie Launch," February 19, 1994.
"Virgin Blooms as EMI Profits Grow," June 4, 1994.
"A&R with Attitude," June 18, 1994.
"Signed, Sealed and Delivered," June 18, 1994.

"Virgin Poaches ffrr's Thompson," March 18, 1995.
"Virgin Restructures Management Team," April 29, 1995.
"Signed and Sealed," July 22, 1995.
"New Signings Give Virgin Strength Across All Genres," October 7, 1995.
"Singles Add Spice to Virgin's Year," September 28, 1996.
"Virgin Celebrates Eight MW Award Victories," March 15, 1997.
"Virgin Duo Take on US," October 4, 1997.

BMG International UK

Editorial, "Deconstruction Seals RCA Deal," *Record Mirror*, July 1992, p. 1.

Music Week:
"BMG Sets Up New Indie A&R Division," June 23, 1990.
"24 Redundant at BMG," April 13, 1991.
"Principled Principal," September 21, 1991.
"MCA Extends BMG Deal for Global Push," September 11, 1993.
"Deconstruction Builds Label Deal," August 6, 1994.
"RCA Celebrates Mercury Victory," September 24, 1994.
"Dino Duo Quit to Set Up BMG-Backed TV Label," October 8, 1994.
"RCA Regroups to Stress Key Styles," December 3, 1994.
"Deconstruction in Heavenly Link-Up," April 22, 1995.
"Farbman to Spearhead BMG's Global Ambitions," November 4, 1995.
"BMG Acquires Conifer Records," November 18, 1995.
"Arista Opens the Door for Transatlantic A&R," September 28, 1996.
"BMG Confident of Topping a Bum," September 28, 1996.
"Delirious Deal Boosts RCA Dance Repertoire," November 2, 1996.
"BMG to Boost Output in Chocolate Factory Move," September 13, 1997.
"Preston and Marsh in Big Apple Summit," September 15, 1997.

Warner Music UK

Editorial, "Uncertain Times at Warner," *Music Business International*, June 1995, p. 7.
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Music Week:
"Ertegun's Stamp Underpins WEA's East West Records," January 20, 1990.
"Compilations Corner Big Budgets," November 24, 1990.
"WEA's A&R Hunt Ends at Geffen," February 9, 1991.
"East West Boosts A&R," August 3, 1991.
"Bellas Heads WEA," March 21, 1992.
"East West Buys Stake in Anxious," March 28, 1992.
"Dunbar Role in Doubt as East West to Rejig," January 30, 1993.
"WEA Puts DJ and Artist into A&R," June 12, 1993.
"A&R Chief to Stem US Flow at WEA," January 29, 1994.
"Oakenfold Set for East West," April 9, 1994.
"The Rising Price of TV Advertising," May 28, 1994.
"Rivalry Intensifies Between TV Labels," October 15, 1994.
"Majors Move In on Compilations Boom," December 17, 1994.
"Europop Champion Celebrates with a Second Nr1," July 15, 1995.
"Diversity Pays Off for Warners," September 23, 1995.
"Warner Taps Craig for Strategy Role," October 14, 1995.
"A&R Is Driving WEA's Reputation as a Hitmaker," June 1, 1996.
"ESP Off to a Flying Start," June 1, 1996.
"Dewhirst Is Tempted by Warner.esp Catalogue," August 3, 1996.

"Telstar Joins Universal to Bolster TV Business," May 3, 1997.
"Telstar TV and Warners Link for Catalogue Deal," June 21, 1997.
"Rejig Sees Expanded Role for Warner.esp," November 29, 1997.

Roadrunner Records

Music Week:
"Dark Horse Bags Top Polydor Job," September 28, 1991.
"A&R Man Leonard Shifts to Roadrunner," September 18, 1993.
"Frenchman in as Devlin Moves on," September 10, 1994.
"Hitman Returns with New Label," November 19, 1994.
"Roadrunner Recruits Robinson," April 1, 1995.
"Roadrunner Launches Dance Label," April 22, 1995.
"Roadrunner UK Races Off into Some New Musical Directions," March 16, 1996.
"Devlin Recruited as MD of Roadrunner," June 15, 1996.
"PolyGram Picks Up Roadrunner Deal," January 25, 1997.

Independiente

Music Week:
"Major League Contender," July 6, 1991.
"Go! Discs Recruits Heneghan," November 7, 1992.
"Go! Earns A&R Prize," March 11, 1995.
"Kennedy Vows to Keep Go! Discs on Course," August 31, 1996.
"Heneghan Offered Top Job at Go! Discs," September 7, 1996.
"Travis: Independiente's First Signings," December 14, 1996.
"Go! Discs to Close After Departure of Heneghan," January 18, 1997.
"Go! Discs Staff Reunite in Macdonalds New Team," February 8, 1997.
"Cool Deal Puts Teamwork Behind Weller," May 3, 1997.
"Independiente Signs Up Gilmour," September 27, 1997.

V2 Music Group

Editorial, "Label Start Ups Follow Different Patterns," *Music Business International*, December 1997, p. 21.
Scott, A. (Ed.), "Independents Report 1997," *Music Business International*, December 1997.

Music Week:
"Pearce Swaps to Licensing Division," February 29, 1992.
"Branson Stirs the Pot," December 23, 1995.
"Branson Returns to Challenge Majors," March 30, 1996.
"Pearce Joins Branson in New Label Venture," March 30, 1996.
"Columbia's Gurr to Join New Branson Venture," May 18, 1996.
"V2 Begins to Take Shape," July 13, 1996.
"Forte to Build V2's Publishing Offshoot," July 27, 1996.
"V2 Signs First Band and Hires A&R Man," August 17, 1996.
"V2 Buys Big Cat Share as Launch Date Approaches," October 30, 1996.
"Gee Street Licensing Goes to V2," December 7, 1996.
"V2 Clinches DJ Mix Deal as Branson Moves into Dance," March 1, 1997.
"V2 launches New Imprints," March 15, 1997.
"V2 Strikes North American Deal," March 29, 1997.
"Branson Sells V2 Stake to Fund Name Signings," June 21, 1997.
"Underworld Deal Marks V2's First Birthday," December 6, 1997.
"Branson's Cash Gives the Luxury of a Long-Term Approach," December 13, 1997.

Appendix E: Industry Profits and Turnover

Computation of industry-wide figures on turnover, profitability and margins are based on data presented in the 1997 and 1998 editions of *The UK Record Industry Annual Survey*. Both issues display accumulations of the financial performance figures of the British industry's main record companies, most of them experiencing a turnover of more than £500,000 per annum. These firms include over 60 independent labels, the six majors, and a number of record companies linked to the latter by means of shareholdings. Whereas data concerning 'independents' has been adopted directly from the original source, the major companies have been separated from the linked ones for purposes stated in the thesis. The category 'majors' concerns BMG Entertainment International UK & Ireland (including BMG Eurodisc, the Arista label in the UK), EMI Records, PolyGram Record Operations, Sony Music Entertainment UK, Universal Music UK and Warner Music UK. The International branches of these companies – that is, the units responsible for dealing with overseas fellow subsidiaries within the overall corporation – have been left out because no profit figures were available for the period under consideration (1991-1996).[1] The following companies have been categorized under the heading 'linked':

Company	Linked to	Via Shareholding
A&M Records	EMI	100%
China Records	Warner	50%
Chrysalis Records	EMI	100%
Creation Records	Sony	49%
FFRR Records	PolyGram	49%
Gee Street Records	PolyGram	50%
Food	EMI	100%
Go! Discs	PolyGram	49%
Island Records	PolyGram	100%
Know Existence	PolyGram	100%
M&G Records	BMG	100%
Magnet Records	Warner	100%
PWL International	Warner	50%
This Record Co	PolyGram	100%
Tommy Boy Music	Warner	100%
Virgin Records	EMI	100%
ZTT	Warner	50%

Other linkages, such as the joint ventures between Anxious Records and Warner and between Dome Records and EMI, or the 75% stake of BMG in Dedicated are recognized, but not incorporated as no gross or operating profit figures were available.

For each of the three categories, turnover, gross profit (margin) and operating profit (margin) were computed and/or accumulated, as presented in the following table:

[1] Together, these units were responsible of more than £220 million on turnover in 1996.

	1991	1992	1993	1994	1995	1996
Turnover						
Majors	739.7	778.2	759.9	846.3	929.7	1055.0
Linked Labels	198.2	198.0	204.4	246.9	268.6	298.8
Independents	238.6	248.1	311.3	334.5	345.8	303.6
Gross Profit						
Majors	171.9	182.0	190.9	231.9	285.3	336.2
Linked Labels	72.7	71.1	69.5	89.8	96.2	113.3
Independents	n/a	61.1	87.4	107.1	104.4	86.2
Gross Profit Margin						
Majors	23.2	23.4	25.1	27.4	30.7	31.9
Linked Labels	36.7	35.9	34.0	36.4	35.8	37.9
Independents	n/a	24.6	28.1	32.0	30.2	28.4
Operating Profit						
Majors	8.7	11.7	(9.7)	33.5	50.5	69.6
Linked Labels	12.9	(9.3)	26.3	25.3	28.5	37.5
Independents	4.1	(0.8)	10.4	14.1	3.2	(10.3)
Operating Profit Margin						
Majors	1.2	1.5	(1.3)	4.0	5.4	6.6
Linked Labels	6.5	(4.7)	12.9	10.2	10.6	12.6
Independents	1.7	(0.3)	3.3	4.2	0.9	(3.4)

(in £ millions)

Notes:

(1) There is a consistently negative impact on major operating profits by continuing operating losses at EMI Records over the period 1991-1996.

(2) There is a consistently negative impact on linked operating profits by continuing operating losses at Chrysalis Records, Know Existence and PWL International over the period 1991-1996.

(3) During the period 1991-1996, Virgin Records' average share of turnover and gross profits in the linked category has been 48% and 64% respectively.

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Wetenschappelijk onderzoek in de bedrijfskunde op het gebied van strategisch management richt zich specifiek op ondernemingsgedrag op de lange termijn. In het afgelopen decennium heeft dit veld een raadselachtig dubbelleven geleid. Veel deskundigen zijn ervan overtuigd dat concurrentie de basis vormt voor het handelen van managers. Immers, winstgerichte ondernemingen wedijveren over het algemeen met andere bedrijven in het verkrijgen van aandacht en financiële middelen van consumenten en andere afnemers. Andere onderzoekers, daarentegen, beweren dat specifieke competenties van ondernemingen ten grondslag liggen aan commercieel succes. Indien een bedrijf unieke en tevens superieure vaardigheden bezit, zal het weinig te duchten hebben van andere spelers op dezelfde markt.

Beide zienswijzen zijn logisch en lijken verenigbaar: juist door haar sterke kanten te benadrukken, kan een onderneming de concurrentieslag winnen. Maar het zijn de wetenschappelijke ontwikkelingen binnen het het strategisch management veld die de zaak om twee redenen complex maken. Allereerst is er het probleem dat de theorievorming van beide perspectieven zich richt op verschillende niveaus van analyse. Terwijl het verloop van de concurrentiestrijd zich afspeelt binnen een bedrijfstak, is de ontwikkeling van vaardigheden een ondernemingsaangelegenheid. Ten tweede is er de complicatie dat de bestaande theorie over concurrentie in wezen statisch is, en haar tegenhanger op het gebied van vaardigheden dynamisch van aard is. Concurrentieanalyses bezien de relatieve positie van een onderneming op een bepaald moment in de tijd, terwijl beschouwingen over vaardigheden vooral de ontwikkeling van competenties over tijd onder de loep nemen.

Doelstelling en Theorie

Gezien het tijdsafhankelijke karakter van strategie, heeft dit promotieonderzoek tot doel tegemoet te komen aan bovenstaande tekortkomingen en bij te dragen aan de vorming van een dynamische theorie over strategie die verschillende niveaus van analyse integreert. Specifiek betekent dit dat gepoogd wordt inzicht te verkrijgen in de wederkerige verbanden (ofwel de 'co-evolutie') tussen concurrentiedynamiek en ondernemingsvaardigheden zoals deze zich op lange termijn voordoen. Daartoe zijn in het eerste hoofdstuk drie onderzoeksvragen geformuleerd die zich richten op (1) de mate waarin ondernemingen daadwerkelijk uniek zijn in een context van rivaliteit, (2) hoe het proces van co-evolutie zich manifesteert op beide niveaus van analyse en (3) de essentie van het zoekgedrag van bedrijven naar nieuwe vaardigheden tijdens dit proces. Deze vragen bepalen aldus de richting van het onderzoek dat uiteindelijk resulteert in het ontwerp van een empirisch toetsbaar theoretisch raamwerk.

In hoofstuk 2 en 3 wordt allereerst de bestaande theorie over vaardigheden en concurrentie aan een nadere analyse onderworpen. Het vaardigheden gedachtengoed, geworteld in het werk van Edith Penrose, beweert dat een zekere mate van heterogeniteit binnen een groep van ondernemingen kan leiden tot een duurzaam concurrentievoordeel bij één van hen. Bedrijven kunnen, door de tijd heen, unieke competenties ontwikkelen die moeilijk te doorgronden zijn voor anderen. Deze ondoorzichtigheid, tezamen met de onstane padafhankelijkheden, werpt barrières op die voorkomen dat andere ondernemingen die competenties kopiëren. Deze ideeën staan in scherp contrast met het klassieke economische werk van Joseph Schumpeter

dat zich op het niveau van de industrie als geheel richt.[1] Hij en zijn volgelingen beargumenteren dat concurrentievoordelen tijdelijk van aard zijn door onvermijdelijk imitatiegedrag. Innovaties of zogenaamde 'creatieve destructies' zullen gekopieerd worden, hetgeen opnieuw mogelijkheden schept voor weer anderen om nieuwe praktijken te introduceren.

Ondanks dat beide doctrines dynamisch van aard zijn, bevinden zij zich op verschillende niveaus van analyse. Terwijl de eerste zich richt op de ontwikkeling van de individuele onderneming in termen van haar vaardigheden, concentreert de tweede zich op de evolutie van de bedrijfstak als geheel door opeenvolgende creatieve destructies. Om deze kloof te overbruggen wordt in hoofdstuk 4 de zoekgedrag-theorie, afkomstig van organisatiekundigen Richard Cyert en James March, geïntroduceerd: ondernemingen zoeken actief naar alternatieven voor bestaande praktijken en doen dit door middel van exploratie van nieuwe vaardigheden of middels exploitatie van bestaande competenties. Dergelijk zoekgedrag komt binnen de onderneming tot stand maar wordt geïnitieerd door gebeurtenissen in haar directe omgeving. De convergentie van deze drie theorieën gaat gepaard met de formulering van een aantal proposities die, wanneer gebundeld, ten grondslag liggen aan een geïntegreerd raamwerk van co-evolutie.

Methode en Empirie

De muziekindustrie vormt het empirisch kader waarin voornoemde proposities en raamwerk getoetst worden op hun validiteit. Zowel haar 120-jaar lange historie als het persoonsgebonden en kennisintensieve karakter dat deze bedrijfstak onderscheidt van meer traditionele sectoren motiveerde de keuze voor de muziekindustrie. Hoofdstuk 5 presenteert een overzicht van de gebruikte onderzoeksmethoden alsmede een discussie over de analyse en validiteit van de verzamelde data. Het empirisch onderzoek is tweeledig van aard. Het eerste deel beslaat een historische studie, waarbij het onstaan en de verdere ontwikkeling van de Amerikaanse muziekindustrie tot aan de jaren negentig bestudeerd wordt. Het tweede gedeelte behelst een meervoudige case-studie van zeven platenmaatschappijen in Groot-Brittannië waarin gekeken wordt naar specifieke organisatieveranderingen gedurende de periode 1990-1997. In beide delen staat een procesdimensie centraal waarin gezocht wordt naar opeenvolgende patronen van gebeurtenissen en de oorzaken daarvan.

De evolutie van de muziekindustrie wordt in detail beschreven in hoofdstuk 6. Daarbij wordt zowel descriptief als analyserend te werk gegaan om zodoende de beschrijving van de data en de daaruitvolgende uitleg aan elkaar te koppelen. Het blijkt dat de ontwikkeling van deze bedrijfstak een zestal opeenvolgende regimes van concurrentie beslaat. Elk regime onderscheidt zich van het voorgaande door veranderingen in de regels van het concurrentiespel zoals die zich uiten in specifiek benodigde vaardigheden, nieuwe product-markt combinaties en alternatieve organisatievormen. Bovendien wordt duidelijk dat deze regimes afwisselende periodes kennen waarin exploratie en exploitatie van vaardigheden plaatsvond. Vanaf het moment dat de meeste rivalen nieuw geïntroduceerde competenties van

[1] Daar waar theorie aangaande ondernemingscompetenties zich de afgelopen jaren grotendeels ontwikkeld heeft binnen het strategisch management veld, is Schumpeters gedachtengoed op puur socio-economische basis gestoeld. Toch is de keuze voor deze dynamische theorie een bewuste, aangezien bestaande alternatieven binnen het veld, zoals Michael Porters vijf-krachten model, statisch van aard zijn.

pioniers hadden gekopieerd, werden voordien losstaande vaardigheden verder uitgebuit door de bundeling daarvan in specifieke ondernemingsactiviteiten.

Terwijl de historische analyse vooral de industrie als geheel in beeld brengt, laat de meervoudige case-studie in hoofstuk 7 de lotgevallen van een zevental platenmaatschappijen zien gedurende één enkel regime. Ook hier worden descriptie en analyse gecombineerd om zodoende de essentie van de aanwezige processen beter te kunnen begrijpen. Uit deze studie blijkt dat individuele ondernemingen middels organisationele vernieuwing vaardigheden ontwikkelen zodat zij hun concurrentie-omgeving kunnen manipuleren of, wat vaker voorkomt, zich daaraan kunnen aanpassen. Processen van imitatie via samenwerking of concurrentie zorgen dat rivalen zich hierbij duidelijk naar elkaar toe bewegen. Tegelijkertijd verschillen ondernemingen significant in de manier waarop zij dat doen door het bestaan van ondernemingsspecifieke padafhankelijkheden. Deze verschillen worden gedurende de loop van een bepaald regime groter doordat de bestudeerde bedrijven de neiging vertoonden nieuw ontwikkelde competenties verder te exploiteren.

Conclusies

De empirische bevindingen ondersteunen de proposities in sterke mate en lijken daarmee de validiteit van het integratieve raamwerk te bevestigen. In dat model staat het zoekgedrag naar vaardigheden centraal, hetgeen aansluit bij de algemene indruk dat ondernemingen zulk gedrag vertonen in interactie met andere rivalen. Twee primaire conclusies, gepresenteerd in het laatste hoofdstuk, kunnen uit dit onderzoek getrokken worden. Allereerst blijkt dat het endogene proces van co-evolutie tussen ondernemingsvaardigheden en concurrentiedynamiek de belangrijkste motor is achter de ontwikkeling van de bedrijfstak. Datgene wat ondernemingen zelf doen tijdens het zoeken naar nieuwe competenties in een interactieve context van mededinging bepaalt uiteindelijk het verloop van de industrie. Dit in tegenstelling tot het meer gevestigde en deterministische idee dat exogene krachten als technologie, demografie en politiek de loop der dingen bepalen. Ondernemingen zijn niet alleen in staat zichzelf te transformeren, maar tevens de hele bedrijfstak waarin zij opereren.

De tweede conclusie is van onderzoekstechnische aard. Het gebruik van een duale methodologie heeft als voordeel dat aparte doch integreerbare studies gericht op verschillende niveaus van analyse kunnen leiden tot een sterkere theorievorming. Zo kwamen in het onderhavige onderzoek eensluidende bevindingen naar boven die onafhankelijk van elkaar in de verschillende deelstudies hun oorsprong vonden. De gebruikte tweeledige methodologie faciliteert bovenal de integratie van niveau-gebonden waarnemingen, waardoor tegengestelde doctrines met elkaar verenigd kunnen worden. Ondernemingen verschillen significant van elkaar vanwege hun unieke verleden, maar vertonen tevens grote overeenkomsten door de aanwezigheid van concurrentiekrachten. Toekomstig onderzoek binnen het veld van strategisch management dat dynamiek hoog in het vaandel heeft, zal zich in toenemende mate bewust moeten worden van het belang van niveau-overschrijdend onderzoek. Studies in de muziekindustrie of andere bedrijfstakken gericht op entertainment kunnen daarbij wellicht tot verrassende inzichten leiden.

Before taking up his position as a PhD research associate at the Rotterdam School of Management's Strategy Department, Marc Huygens studied business administration with a degree in strategic management at the Erasmus University Rotterdam. During those years, he not only made a living out of jobs as diverse as cook, stevedore, and roadie, but also developed an interest for business management. He was involved as project coordinator in the design, creation, and launch of Europe's best-selling strategy textbook *Strategy: Process, Content, Context*, authored by Bob de Wit and Ron Meyer. At the same time, he worked at Horringa & de Koning, the Dutch affiliate of the Boston Consulting Group, from which he derived his award-winning masters thesis on the relationship between business portfolio diversification and corporate headquarters capabilities. These activities, together with his interest in entertainment industries, culminated in Marc's latest research project on competitive dynamics within the music industry.