# Analysis of the Impact of the Ontario Sound Recording Tax Credit

Prepared for

Canadian Independent Music Association

Prepared by:

Nordicity

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# Executive Summary

*Introduction*

In recent years Ontario's independent music labels ("indie labels") have launched and developed the careers of a long list of internationally acclaimed artists, including Metric, Broken Social Scene, and Alex Cuba, to name just a few. The success of many of Ontario's indie labels has helped the province flourish as one of Canada's – and North America's – leading centres for the development of musical artists, and sound recording and publishing.

Like many of the cultural industries in Canada, Canadian indie labels can receive public financial support from both federal and provincial governments so that they can continue to develop new Canadian artists, despite mounting pressure and competition from the global majors. In Ontario, the provincial government's primary support tool is the Ontario Sound Recording Tax Credit (OSRTC).

The Province introduced the OSRTC in 1999. Today, the OSRTC is co-administered by the Ontario Media Development Corporation (OMDC) and Ontario Ministry of Finance as part of OMDC's portfolio of tax credits for the cultural sector. In the most recently completed fiscal year, 2009-10, the OSRTC provided $1.5 million in financial support to 102 sound recording projects produced by 17 different music companies. These 102 projects had a total value of $8.1 million in terms of the sum total of project expenditures.

The Canadian Independent Music Association (CIMA), in its capacity as the national trade association representing Canadian-owned music companies in the English-language market, considers the OSRTC as one of the key pillars of government support for Ontario's music industry. CIMA is committed to ensuring that the OSRTC remains an effective tool for helping Ontario's music companies. In light of the importance CIMA places on the OSRTC and its role in promoting the industry's economic viability, CIMA commissioned Nordicity Group Ltd. ("Nordicity") in September 2010 to prepare an analysis of the impact of the OSRTC.

The purpose of this impact analysis is as follows:

- estimate and document – for the first time – the contribution that the OSRTC makes to the Ontario economy;
- assess the role the OSRTC plays in and its impact on promoting the development of Ontario's independent music industry; and,
- investigate how, if at all, the OSRTC should be changed to improve its efficacy in promoting industry development.

*Competitive position of Ontario's music industry*

Despite the pressures brought on by digital technologies, the music industry remains an important part of the Canadian economy, and in particular, Ontario's economy. As the location for the global majors' Canadian operations, and home to Canada's premier cluster of indie labels, Ontario accounted for 81% of Canada's total sound recording revenues in 2008 (the most recent year of published statistics).

Digital distribution of recorded music – to computers and mobile devices – is growing. As recently as 2005, digital distribution accounted for only 6% of global end-user spending on recorded music; by 2009, it comprised 31% of global sales, and is expected to surpass physical distribution as early as 2012.[1] However, digital revenues will not compensate for the overall declines in recorded music revenues. In

[1] PwC, *Global Entertainment and Media Outlook 2008-2012*, June 2008, p. 304.

Canada, sales of sound recordings dropped from $765 million in 2005 to $619 million in 2008, despite growing digital revenues. To compensate for falling revenues for recorded music, music labels are turning to other revenue sources. Music publishing (i.e., the licensing of music for use in other media), live performances and merchandising (which typically takes place at live performance venues) are becoming more central to music industry business models.

Ontario's indie labels are adapting their business models and pursuing these new revenue streams as vigorously as their international counterparts; however, their corporate development is not free of complication. Cash flow pressures and the challenge of growing international sales remain the two most top-of-mind issues for Ontario's indie labels.

Without a rolling portfolio of projects, Ontario's indie labels can easily experience cash flow shortages. Unfortunately, the OSRTC process can often exacerbate those cash flow pressures, as the tax credit receipt can develop into a two-year receivable. Improved cash flow can have a real impact on music companies' competitive position and financial performance. For example, delays in signing an artist could cause Ontario's indie labels to lose the artist to an out-of-province indie label or a global major. This outcome means that the economic benefits associated with that artist are lost to the Ontario music labels and the provincial economy. As little as an additional $20,000 can often mean the difference between the signing and not signing an artist by an indie label.

Furthermore, out-of-province (international) marketing is essential for the development of an emerging artist and their audience base. Indeed, an unexpected advantage of international marketing channels is the reach to both domestic and international markets. For example, Internet marketing is usually U.S.-based, and therefore reaches both American and Canadian consumers. The market dominance of U.S. and international media, such as television, magazines and web sites (e.g., MTV, NME and Pitchfork), often requires that these marketing channels be exploited simply to reach audiences within Canada. As such, Ontario-originated advertisements are often less effective than those from U.S. or international media. This issue is two-sided: resulting in increased marketing costs for Canadian businesses, and extending the market-reach to the much larger and more lucrative U.S. and international markets.

*Economic rationale for the OSRTC*

The economic rationale for the Province's financial support of the music industry, and the OSRTC in particular, are warranted primarily by the industry's economic importance. The music industry is not only important in terms of the economic activity it generates in and of itself, but also because of the vital role it plays in Ontario's world-class entertainment and creative cluster. The case for government intervention, however, is further warranted by two types of market failure that beset Ontario's music industry.

The importance of the music industry's role in the Ontario economy has already been established. Sound recording and music publishing in Ontario generated $499 million in revenues in 2008, or 80 cents of every dollar of music-industry revenues in Canada. Together, indie labels and the global majors employed an estimated 1,900 Ontarians in a wide range of technical, creative, managerial and administrative professions. Indeed, the broader economic importance of the music industry is not limited to sound recording and music publishing. Using international benchmarks as a reliable indication, the broader music industry in Ontario – which includes radio broadcasting, live performance, merchandising, physical-media manufacturing and instrument sales – could in fact be generating closer to $2.0 billion in revenues[2] and employ well over 5,000 Ontarians.

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[2] Ontario Music Industry Council, *The Music Industry in Ontario*, August 2009, p. 4.

While the global majors account for the vast majority of Ontario's music industry activity, the province's indie label ecosystem plays an even more significant role. Indie labels employ and train hundreds of Ontarians, providing Ontario with a pool of highly skilled and creative artists and managers that attract and stimulate international interest from key players such as the global majors. In this respect, the indie label ecosystem and the funding programs – such as the OSRTC – that support its growth, contribute to maintaining the overall sound recording and music publishing industry, as well as the broader creative industries.

Ontario's music industry not only contributes revenues, wages and jobs to the Ontario economy, but also bolsters the province's vibrant entertainment and creative cluster. Indeed, within the entertainment and creative cluster, the music industry is perhaps the most interrelated and commercially collaborative. Music is a product unto itself, but it is also an integral element of film and television programming. Moreover, it is increasingly seen as an active component of interactive digital media (e.g., in electronic games) and as part of the growing use of video on the Internet.

The characteristics of the music industry are such that a relatively small country, such as Canada, faces a significant risk of oligopoly--not having a vibrant ecosystem of music labels. The high level of risk, uncertainty of demand and the need to move quickly in response to audiences' ever-changing tastes lends advantage to companies that possess economies of scale and scope, and are vertically integrated. Canadian music labels are not able to achieve the required levels of size and vertical integration. Government intervention can remedy this disadvantage, ensuring that an ecosystem of music labels and supporting companies can continue to play a key role in Ontario's entertainment and creative cluster.

Sound recording production is, in essence, the R&D of the music industry, particularly with regards to emerging artists. Indeed, the development of emerging artists shares many of the characteristics of scientific R&D, and is consequently subject to significant economic spillovers. However, independent labels risk losing out on most of the economic returns that are more easily captured by distributors and major labels. This situation can also lead to a market failure that calls for intervention.

*OSRTC activity*

Program statistics show that use of the OSRTC has been relatively consistent over the last four years. With the exception of 2008-09, the tax credit has typically supplied around $1.5 million in annual financial assistance to 100 projects with total expenditures of $8 million. Participation among Ontario music labels has also been relatively consistent – with the exception of 2008-09. Approximately one-quarter of Ontario's 64 music labels use the OSRTC. For those three-quarters that do not use the OSRTC, most report that the legal and administrative burden associated with the tax credit was the primary reason they did not seek assistance from it.

Program statistics as well as the results of the survey show that marketing – and out-of-province marketing, in particular – is growing in importance. The share of OSRTC expenditures comprised by marketing activities rose from 47% to 59% between 2006-07 and 2009-10. This is not surprising since 69% of survey respondents reported that they use their tax credit to increase their marketing.

The number of projects with out-of-province marketing expenditures jumped to 43% in 2009-10 from 11% in 2006-07 (see Figure 19 in Section 4.4). Interviewees commented that the OSRTC guidelines regarding out-of-province marketing do not have a strong influence on their marketing decisions. Music labels are seeking to maximize the value of the product they create. This often requires labels to hire foreign public-relations and radio-relations professionals to help them promote their sound recordings.

*Key performance indicators*

The success of the OSRTC was evaluated in terms of the impact it has on the long-term development of Ontario's sound recording industry. The OSRTC leads directly to the creation and marketing of new sound recordings, and thereby, generates an impact on the Ontario economy when the production and marketing budgets are spent in Ontario. However, in the long-run, for the OSRTC to have a positive impact on the sound recording industry, it must have a more lasting effect on sound recording companies' ability to grow their revenues, diversify their revenues away from slow-growth segments, lead to more artist signings and foster greater exports.

On this basis, we used a quartiles analysis to assess the impact that OSRTC use intensity had on six key performance indicators (KPIs):

1. Revenue growth;
2. Digital revenues (share of revenues from digital-platform sales);
3. Revenue diversification (share of revenues from sources alternative to physical and digital sales);
4. International revenues (share of sound recording revenues from outside of Canada);
5. Rate of artist signings (annual number of new artists signed); and,
6. International promotion (number of international touring dates).

To assess the impact that the OSRTC had on industry development, we relied primarily on quartiles analysis, whereby we divided all of the survey observations into four groups corresponding with the intensity of OSRTC use: low, medium-low, medium-high, and high. We then calculated the mean level of each KPI within each OSRTC use intensity quartile and examined the results to identify any relationship between OSRTC use intensity and the KPI. In particular, we were looking for the existence of *positive* relationships between OSRTC use intensity and the KPI. A summary of the results of this analysis can be found in Table 1.

**Table 1 KPI results by OSRTC use intensity quartile (mean levels in each quartile)**

| | Low use | Medium-low use | Medium-high use | High use |
|---|---|---|---|---|
| Revenue growth (annual growth rate) | 4.1% | 0.6% | 0.9% | 8.8% |
| Digital revenues (share of revenues from digital-platform sales) | 19.4% | 10.6% | 23.8% | 28.1% |
| Revenue diversification (share of revenues from sources alternative to physical and digital sales) | 7.5% | 20.6% | 20.0% | 26.9% |
| International revenues (share of sound recording revenues from outside of Canada) | 18.8% | 26.3% | 29.4% | 17.5% |
| Rate of artist signings (annual number of new artists signed per $100,000 revenues) | 0.32 | 0.15 | 0.23 | 0.86 |
| International promotion (number of international touring dates per new release) | 8.6 | 20.1 | 18.7 | 26.5 |

Source: Nordicity survey of Ontario sound recording companies, November 2010.

In general, more intensive users of the OSRTC (i.e., the high-use quartile) had higher rates of revenue growth, a larger share of revenues from digital platforms and better revenue diversification across lines of business. With respect to the input KPIs, more intensive use of the OSRTC was also associated with higher rates of artist signings and higher rates of international touring. However, despite this higher rate of international touring, there was no positive relationship between OSRTC use intensity and international revenues (share of total revenues from outside of Canada); the share of international revenues in the low-use quartile was virtually the same as the share in the high-use quartile.

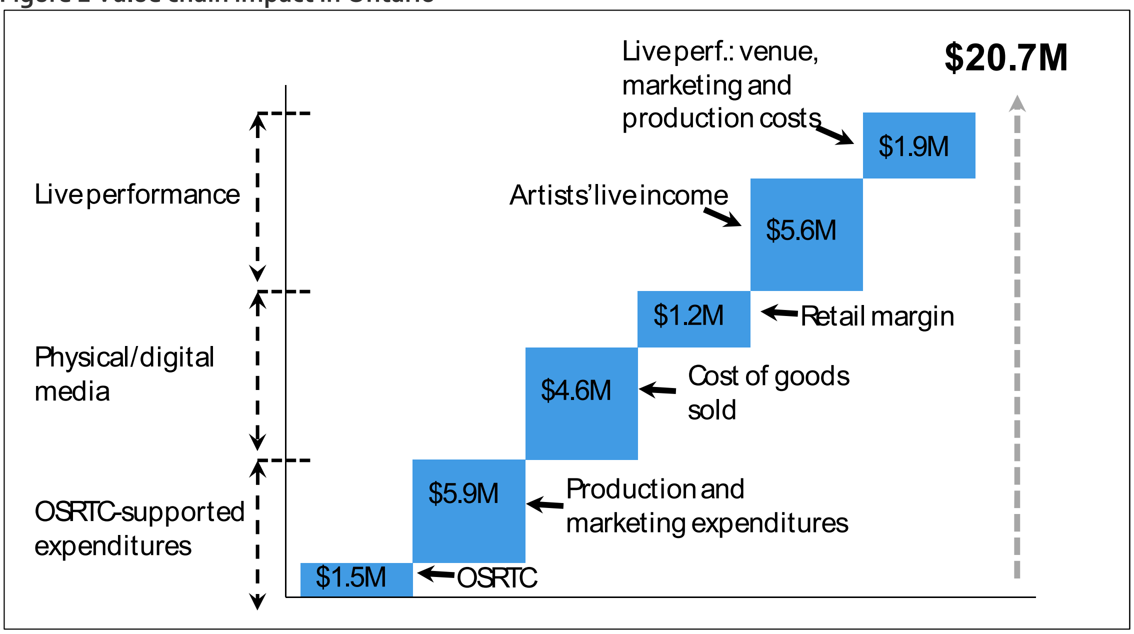
The absence of a correlation between OSRTC use intensity and international sales (or impact of one on the other) may be related to the tax credit guidelines that permit only 50% out-of-province marketing and promotion to be eligible for the tax credit. While Ontario sound recording companies can reach a large share of Canadian audiences through Ontario-based marketing campaigns, they require out-of-country marketing support and extensive touring to reach international audiences. With a tax credit design that excludes tour costs and may discourage out-of-country marketing, Ontario sound recording companies may not have the resources or incentives to build international audiences.

*Economic impact of the OSRTC*

The economic impact of the OSRTC reaches well beyond the production and marketing expenditures it supports. The OSRTC stimulates the creation and release of sound recordings that generate retail sales and live performance revenues for artists, venues and promoters. Tracing the effect of the OSRTC through the whole music value chain reveals that $1.5 million in financial support from the OSRTC consequently generates $29.7 million of global revenues.

Of this $29.7 million, $20.7 million, or 70% is captured by Ontario residents (artists and other workers) and businesses. In the long-term, this $20.7 million is supplemented by an additional $2.7 million in value chain revenues, which can be attributed to emerging artists who eventually break out and achieve gold record status. Without the benefit of the OSRTC, these successful artists may not have been discovered and subsequently signed to produce a break-out production.

**Figure 1 Value chain impact in Ontario**




Source: Nordicity analysis.

Taking into account both the immediate and the potential long-term impact of the OSRTC, we find that it leads to a $21.7 million increase in Ontario's GDP (on an annual basis), $16.5 million in additional wage income for Ontario and the creation of 503 new jobs in the Ontario economy.

Our research indicates that the rate of incrementality is 33%. In other words, one-third of OSRTC-supported projects would not proceed without OSRTC financial support. Furthermore, our analysis indicates that the tax credit helps companies expand their marketing expenditures and sales. We found that each dollar of marketing expenditure leads to two more dollars of music label revenue. This marketing effect suggests that the incrementality rate should in fact be higher, justifying an incrementality of 50%. On the basis of a 50% incrementality rate, the OSRTC assistance of $1.5 million led to GDP of $10.8 million, wages of $8.2 million and 251 new jobs in the Ontario economy on an annual basis.

The Ontario government collected $1.32 in revenues for every dollar it invested in the music industry through the OSRTC. As such, there appears to be room to increase the tax credit and maintain a fiscal breakeven position for the Province, regardless of the existence of any knock-on effect from a tax credit rate increase.

**Table 2 Incremental economic impact of OSRTC in Ontario**

| Value chain segment | Revenues | Direct economic impact | Spin-off economic impact (indirect + induced)[††††] | Total economic impact |
|---|---|---|---|---|
| **Sound recording production and marketing** | 4.2 | **GDP:** $0.4M<br>**Wages:** $0.4M<br>**Jobs**[†]:12 | **GDP:** $3.0M<br>**Wages:** $1.8M<br>**Jobs:**49 | **GDP:** $3.5M<br>**Wages:** $2.2M<br>**Jobs:**61 |
| **Retail sales** | 3.3 | **GDP:** $2.0M<br>**Wages:** $1.7M<br>**Jobs**[††]:56 | **GDP:** $1.3M<br>**Wages:** $0.7M<br>**Jobs:**20 | **GDP:** $3.3M<br>**Wages:** $3.0M<br>**Jobs:**76 |
| **Live performance** | 4.2 | **GDP:** $3.5M<br>**Wages:** $3.5M<br>**Jobs**[†††]:107 | **GDP:** $0.5M<br>**Wages:** $0.2M<br>**Jobs:**7 | **GDP:** $4.0M<br>**Wages:** $3.7M<br>**Jobs:**114 |
| **Total** | 11.7 | **GDP:** $5.9M<br>**Wages:** $5.6M<br>**Jobs:**176 | **GDP:** $4.9M<br>**Wages:** $2.6M<br>**Jobs:**76 | **GDP:** $10.8M<br>**Wages:** $8.2M<br>**Jobs:**251 |

Source: Nordicity analysis based on data from Statistics Canada and Conference Board of Canada.

Notes:

† Based on an average annual full-time salary of $36,000.

†† Based on an average annual full-time salary of $27,000.

††† Based on an average annual salary of $36,000 (artists income) and $29,000 (venues/promoters).

†††† All job estimates based on an annual average salary of $36,000.

**Table 3 Fiscal cost-benefit analysis**

| Category of Ontario government revenue | Calculation | Amount |
|---|---|---|
| Income taxes | 10.9% of wages ($8.9M) | $893,800 |
| Corporation taxes | 1.6% of GDP ($10.8M) | $172,800 |
| Retail sales taxes (RST) | 4.1% of GDP ($10.8M) | $442,800 |
| RST on sales of sound recordings | 8.0% × $2,895,000 (retail value of sales in Ontario) | $232,000 |
| RST on live performances | 8.0% × $2,044,000 (live perf. revenues in Ontario) | $164,000 |
| | **Total Ontario government revenues** | **$1,905,400** |
| | OSRTC outlays | $1,500,000 |
| | **Net fiscal benefit/(cost)** | **$405,400** |

Source: Nordicity calculations based on data from Statistics Canada, CANSIM tables 384-0001, 384-0002, and 385-0002.

*Policy options*

Through our research (interviews, survey, background research), we identified six possible options for changes to the tax credit, which have the potential to improve its effectiveness. These six options include:

1. Increase the tax credit rate so that it corresponds with tax credit rates for the other creative sectors.
2. Increase the eligibility of international marketing expenditures to match domestic expenditures (i.e., 100% eligible).
3. Include other specific costs as eligible expenditures, e.g. touring, manufacturing, and rights tracking.
4. Provide some form of collateral or guarantee on OSRTC, to facilitate cash flow financing.
5. Provide advances on tax credits to help established companies.
6. Reduce any real or perceived administrative burdens with the OSRTC application process.

While the scope of this study did not call for an assessment of policy options, we conducted an analysis of the economic and fiscal impact of Option#1, an increase in the OSRTC rate. In particular, we modelled the impact of increasing the OSRTC rate to 30%, 35% or 40%, so that it would be in line with the tax credit rates for the other creative sectors.

The results of this analysis indicate that if music labels channel two-thirds of the additional monies available as a result of a ten-point rate increase to marketing and promotion activities, their revenues could increase by $1 million. At the same time, overall retail revenues could increase by $2 million and live performance revenues could rise by $1.5 million.

As revenues increase through the value chain – and in particular the Ontario value chain – Ontario's GDP would increase by $2.2 million, Ontario residents' wages would rise by $1.7 million, and 52 new jobs would be generated in the Ontario economy.

**Table 4 Summary of cost-benefit analysis of OSRTC rates (all amounts in dollars except jobs)**

| | **30% tax credit rate** | **35% tax credit rate** | **40% tax credit rate** |
|---|---|---|---|
| Tax credit payment | $2,250,000 | $2,625,000 | $3,000,000 |
| Increase in marketing | $500,000 | 750,000 | 1,000,000 |
| Increase in sales | $1,000,000 | 1,500,000 | 2,000,000 |
| **Music industry revenues in Ontario** | | | |
| Sound recording production and marketing | 5.0M | 5.4M | $5.8M |
| Retail sales | 4.1M | 4.5M | $4.9M |
| Live performance | 5.0M | 5.4M | $5.8M |
| Total revenues | 14.1M | 15.3M | $16.5M |
| GDP | 13.0M | 14.1M | $15.2M |
| Wages | 9.9M | 10.8M | $11.6M |
| Jobs | 303 | 329 | 355 |
| Government revenues | 2,305,000 | $2,504,800 | $2,704,600 |
| Total OSRTC outlays | 2,250,000 | $2,625,000 | $3,000,000 |
| **Net fiscal benefit/(cost)** | **$55,400** | **($120,200)** | **($295,400)** |

Source: Nordicity estimates.

While the cost to the Province of this rate increase would be $750,000, our analysis indicates that a large share of this cost would be offset by $400,000 in incremental tax revenue for the provincial government.

What is more, the Province's overall fiscal position with respect to the OSRTC would remain positive at $55,400; total costs of $2,250,000 would be offset by incremental revenues of $2,305,400.

The results of the modelling of increases in the OSRTC rate show that while the net benefit to the Province does narrow at a 30% rate and turns slightly negative at 35% , it is arguably breakeven from the Province's perspective. It is only at a 40% rate that the Province's net cost increases to a point where it is equivalent to approximately 10% of its annual OSRTC payments.

# 1. Introduction

In this introductory section, we outline the purpose of the mandate, the operational aspects of the Ontario Sound Recording Tax Credit (OSRTC) (i.e., how it works and the overall level of support), the methodologies used in our analysis and a description of the structure of the report.

## 1.1 Purpose of report

For many decades, Ontario has been the home to numerous independent music labels ("indie labels"). In contrast to the large vertically integrated multinational music labels (the "global majors"), which distribute foreign artists and some foreign-produced Canadian artists in Canada, Ontario's indie labels, which are Canadian-controlled and owned, have advanced the Canadian music industry with the discovery, development and promotion of Canadian artists. In recent years, Ontario's indie labels have launched and developed the careers of a long list of acclaimed artists including Metric, Broken Social Scene, and Alex Cuba, to name just a few. The success of many of Ontario's indie labels has helped the province flourish as one of Canada's – and North America's – leading centres for the development of musical artists, and sound recording and publishing.

Like many of the cultural industries in Canada, Canadian indie labels can receive public financial support from both federal and provincial governments, so that they can continue to develop new Canadian artists, even in the face of competition with the global majors. The federal government supports the music industry through the Canada Music Fund (CMF). With annual financial resources of $25 million, the CMF is the umbrella program for the federal government's various funding programs administered by the industry or in partnership with federal agencies. Among these delivery organizations are the Foundation Assisting Canadian Talent on Recordings (FACTOR) and La Fondation Musicaction, both of which combine contributions from the CMF and broadcasters to help finance the production and distribution of Canadian artists in the English-language and French-language music markets.

This federal-government support is complemented by provincial-level initiatives. In Ontario, the provincial government's primary support tool is the OSRTC. The Province introduced the OSRTC in 1999; in the ensuing eleven years (1999 through 2010), it issued just over 3,000 tax credit certificates to 1,142 sound recordings. Today, the OSRTC is co-administered by the Ontario Media Development Corporation (OMDC) and Ontario Ministry of Finance as part of the OMDC's portfolio of tax credits for the cultural sector. In the most recently completed fiscal year, 2009-10, the OSRTC provided $1.5 million in financial support to 102 sound recording projects produced by 17 different music companies. These 102 projects had a total value of $8.1 million in terms of the sum total of project expenditures.

The Canadian Independent Music Association (CIMA), in its capacity as the national trade association representing Canadian-owned music companies in the English-language market, considers the OSRTC as one of the key pillars of government support for Ontario's music industry, and is committed to ensuring that it remains an effective tool for helping Ontario's music companies. In light of the importance CIMA places on the OSRTC and its role in promoting the industry's economic viability, CIMA commissioned an independent third party analysis of the impact of the OSRTC.

The **purpose of this impact analysis** is as follows:

- estimate and document – for the first time – the contribution that the OSRTC makes to the Ontario economy;
- assess the role the OSRTC plays in and its impact on promoting the development of Ontario's independent music industry; and,
- investigate how, if at all, the OSRTC should be changed to improve its efficacy in promoting industry development.

In September 2010, CIMA engaged Nordicity Group Ltd. ("Nordicity") to prepare this impact analysis. The following report presents the results of Nordicity's research and analysis.

## 1.2 What is the OSRTC

The OSRTC is a refundable tax credit available to eligible Ontario-based sound recording companies. The Ontario government enacted the OSRTC in December 1998, and it took effect on January 2, 1999. The OSRTC provides a tax refund to eligible sound recording companies for up to 20% of the eligible production and marketing expenditures that they incur for the development and promotion of emerging artists.

To be eligible for the OSRTC, a company must have been in operation in Ontario for at least 12 months, have earned more than 50% of its taxable income in Ontario, and demonstrate that more than 50% of its business was in the sound recording industry.

A sound recording company can only claim the OSRTC on its production and marketing expenditures for an emerging Canadian artist: that is, a Canadian citizen or permanent resident who is ordinarily resident in Canada and who has not had a gold recording as an individual or part of a group in the United States (U.S.)., and either Canada, United Kingdom (U.K.), France, Germany, Asia or Latin America. For a musical group, 75% of the members must meet the criteria of a Canadian emerging artist for the whole group to qualify.

Only certain expenditures qualify for tax relief under the OSRTC. These expenditures must be incurred within 24 months of the date of the first qualifying expenditure.

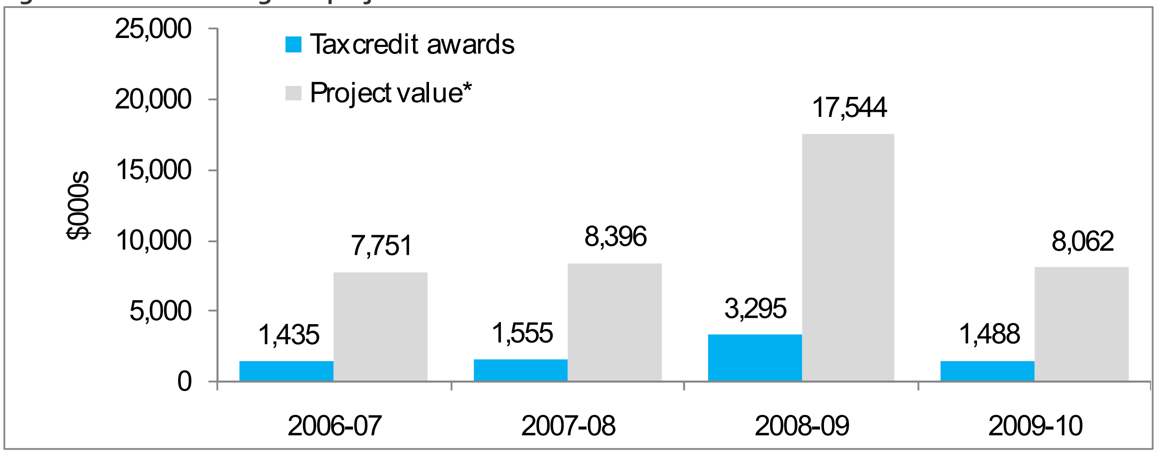
- Eligible companies may claim an OSRTC refund of 20% on their sound recording production expenditures, including artists' royalties, musician session fees, graphics, digital scanning, programming and testing.
- Sound recording companies can also claim a 20% tax credit on the costs of producing a music video directed by a Canadian or made at a production facility in Ontario.
- Direct marketing expenditures incurred inside Ontario, including certain recording-launch costs, are also eligible for a 20% tax credit.
- One-half of marketing expenditures incurred outside of Ontario are eligible for a 20% tax credit.
- Conversely, touring and performing costs; and the costs of manufacturing, shipping and distributing physical or digital sound recordings are <u>not</u> eligible.

As with other cultural sector tax credits, the receipt of other government assistance – including assistance from the federal government, but excluding assistance from FACTOR – reduces or *grinds* the share of a sound recording companies' expenditures that are eligible for the OSRTC. The combination of this assistance grind and the 50% inclusion rate for out-of-province marketing expenditures means that the overall effective assistance rate for OSRTC projects is typically lower than the statutory tax credit rate of 20%.

Between 2006-07 and 2009-10, the Province provided a total of just under $7.8 million in financial support through the OSRTC. Indeed, with the exception of 2008-09, the annual levels of OSRTC assistance and supported project values were consistently around $1.5 million and $8.0 million, respectively. In 2008-09, however, the level of OSRTC support temporarily rose to $3.3 million and the value of eligible projects jumped to $17.5 million.

The total value of the projects supported over this four-year period was $41.8 million. The effective rate of assistance was very consistent throughout this period: it was 18.5% in each year, except 2008-09, when it was 18.8%.

**Figure 2 OSRTC funding and project values**




Source: OMDC.
* Refers to sum of project expenditures and may include expenditures not eligible for the OSRTC.

**Table 5 OSRTC funding, project value and effective rate of assistance**

| | 2006-07 | 2007-08 | 2008-09 | 2009-10 | Total | Average |
|---|---|---|---|---|---|---|
| Tax credit awards ($) | 1,435,233 | 1,555,492 | 3,294,789 | 1,487,848 | 7,773,362 | 1,943,341 |
| Project value* ($) | 7,751,016 | 8,395,886 | 17,544,254 | 8,062,107 | 41,753,263 | 7,751,016 |
| Effective rate of assistance | 18.5% | 18.5% | 18.8% | 18.5% | -- | 18.6% |

Source: OMDC.
* Refers to sum of project expenditures and may include expenditures not eligible for the OSRTC.

## 1.3 Research methodology

This report draws upon data collected by Nordicity through secondary research, data from OSRTC application filings, interviews with Ontario music companies, and an online survey of Ontario music companies.

*Secondary research*

Nordicity collected and reviewed several documents that provided background on market developments in the music industry – globally and in Ontario – and business issues facing music companies. Nordicity also collected and reviewed several Canadian and international documents that provided statistical indicators, which Nordicity incorporated into the analysis. A list of all the documents used in the preparation of the report can be found in the References section.

*OSRTC filings*

OMDC supplied Nordicity with aggregated data from OSRTC filings for four fiscal years – 2006-07 through 2009-10.[3] These data detailed the annual amount of OSRTC funding, the value of the projects supported by the OSRTC, and the annual number of recipient projects and companies. These data also provided a breakdown of the types of expenditures – sound recording production, music video production, marketing (inside and outside Ontario) – supported by the OSRTC.

[3] This report presents annual statistics for the OSRTC for the period, 2006-07 to 2009-10. However, it is important to note that these statistics reflect the period in which an OSRTC project was certified rather than the year in which the sound recording production activity took place.

*Interviews*

Nordicity interviewed eight Ontario-based music companies for this study. This sample of eight companies included five current users of the OSRTC as well as three non-users – i.e., companies that produce and promote artists who are not eligible for the OSRTC. The sample of interviewees in each OSRTC-use category included at least one large, one medium-sized and one small company. The company-size categorization was based on company-size information available from CIMA's membership database.

**Table 6 Profile of interviewees**

| Company-size category | OSRTC users | Non-users | Total |
|---|---|---|---|
| Large | 1 | 1 | 2 |
| Medium | 3 | 1 | 4 |
| Small | 1 | 1 | 2 |
| **Total** | **5** | **3** | **8** |

Source: Nordicity research and CIMA.

*Online survey*

Nordicity obtained a significant amount of data for its research and analysis from an online survey of Ontario music companies. CIMA distributed the online-survey invitation to all 97 of its Ontario members. In total, 31 companies responded to the online survey out of 64 CIMA members identified by Nordicity as sound recording companies operating in Ontario.[4] As such, the overall survey response rate was 48%.[5]

Of the 31 responding companies, 13 have produced artists who were eligible for the OSRTC. These 13 companies included 8 OSRTC users (i.e., companies that used the OSRTC between 2005 and 2009) and 5 non-users. The 8 OSRTC-user companies represented 47% of the 17 companies that used the OSRTC in 2009-10.

These eight companies accounted for 59% of OSRTC projects in 2009-10, and 39% of OSRTC projects between 2006-07 and 2009-10. They also accounted for 44% of the sum of OSRTC project values in 2009-10 and 29% of the sum of OSRTC project values over the four-year period, 2006-07 to 2009-10.

[4] Statistics Canada reports that 152 *establishments* were operating in Ontario in record production (North American Industry Classification System [NAICS] 512210) and integrated record production and distribution (NAICS 512220) in 2008 (source: Statistics Canada, *Service Bulletin: Sound Recording and Music Publishing*, catalogue no. 87F0008X, 2008). Statistics Canada's establishment count is higher than CIMA's for several reasons. First, Statistics Canada's figure includes foreign-owned companies, while CIMA's membership only includes Canadian-owned companies. Second, it is possible that not all Canadian-owned sound recording companies based in Ontario are CIMA members. Third, it is important to note that an *establishment* is a smaller reporting unit than a *company*. According to Statistics Canada, "an active statistical establishment is one production entity or the smallest grouping of production entities which produces as homogeneous a set of goods and/or services as possible; which does not cross provincial boundaries; and for which records provide data on the value of output together with the cost of principal intermediate inputs used and cost and quantity of labour resources used to produce the output." (source: Statistics Canada, *Service Bulletin: Sound Recording and Music Publishing*, catalogue no. 87F0008X, 2008, p. 9). It is likely that the number of establishments would exceed the number of companies, since a company is likely to maintain separate accounting records for its subsidiary companies or divisions.

[5] The response rate is calculated on the basis of the number of CIMA members in Ontario engaged in sound recording activities (64), and excludes Ontario-based CIMA members engaged in other music industry activities such as music-festival organization, concert promotion, artist publicity, and accounting and legal services.

**Table 7 Respondent coverage of online survey**

| | 2009-10 | | | 2006-07 to 2009-10 | | |
|---|---|---|---|---|---|---|
| | Survey respondents | Total OSRTC activity** | Survey coverage rate | Survey respondents | Total OSRTC activity** | Survey coverage rate |
| Number of OSRTC user companies | 8 | 17 | 47% | 8 | 37 | 22% |
| Number of OSRTC-supported projects | 58 | 102 | 57% | 207 | 532 | 39% |
| Total value of OSRTC-supported projects* | $3.52M | $8.06M | 44% | $12.05M | $41.75M | 29% |

Source: Nordicity survey and OMDC.
* Refers to sum of project expenditures and may include expenditures not eligible for OSRTC.
** Total OSRTC activity during the specified time period, as reported by OMDC.

## 1.4 Outline of report

This report is organized into eight sections.

- Following this introduction, **Section 2** describes the key market trends and business issues in the music industry and how they affect indie labels, including those in Ontario.
- **Section 3** outlines the economic rationale for the OSRTC.
- **Section 4** provides an overview of OSRTC activity with statistics on the annual value of OSRTC use and the profile of companies using it. It also examines OSRTC recipients' use and perception of the tax credit.
- **Section 5** draws upon the survey data to analyze how the OSRTC impacted selected key performance indicators (KPIs) of music industry development.
- **Section 6** presents an analysis of the economic impact the OSRTC.
- **Section 7** outlines and assesses the options for changing the OSRTC, so that it could be more effective in today's music-industry environment.
- In **Section 8** we summarize the key findings and policy options originating from the research and analysis.

## 2. Competitive Position of Ontario's Music Industry

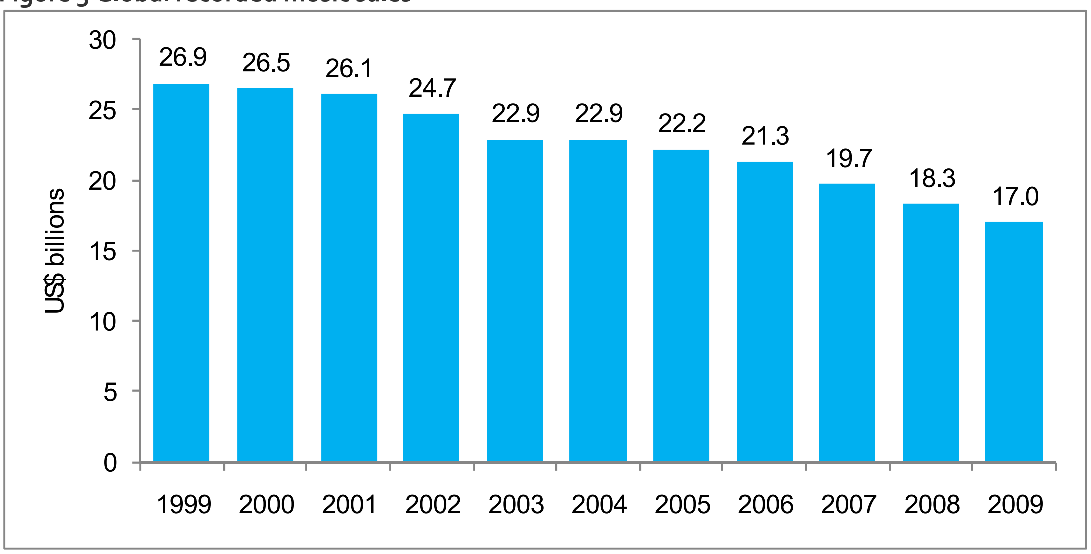
This section presents an overview of the music industry in Ontario. It outlines the size and structure of the industry, and the key industry developments that have fundamentally altered the production, promotion and distribution of music. Finally, this section identifies and discusses key issues currently facing Ontario's music industry.

### 2.1 Market developments in the music industry

Music – perhaps humanity's oldest art – commands universal interest and global appeal. In the 20th century, the music industry was revolutionized by the invention of recorded music, ranging from the vinyl record to the digital compact disc. With music transformed into a commodity more easily bought and sold within and among jurisdictions, a global marketplace was created. Indeed, by 1999 global consumer spending on recorded music peaked at US$26.9 billion.[6] Since 1999, for the reasons discussed below, the recorded music industry has experienced a steady decline in year-over-year sales, as it has weathered the disruptive influences of emerging digital technologies – most notably illegal file-sharing and the advent of legal digital distribution services with low retail price points such as iTunes.

According to the International Federation of the Phonographic Industry (IFPI), global sales of sound recordings plummeted by 36% between 1999 and 2009, dropping from US$26.9 billion to US$17.0 billion (Figure 3). Between 2005 and 2009, global sales dropped by 23% from US$22.2 billion. In Canada, sales of sound recordings fell at an even faster rate of 32% between 2005 and 2009, dropping from $665 million to $451 million (Figure 4).

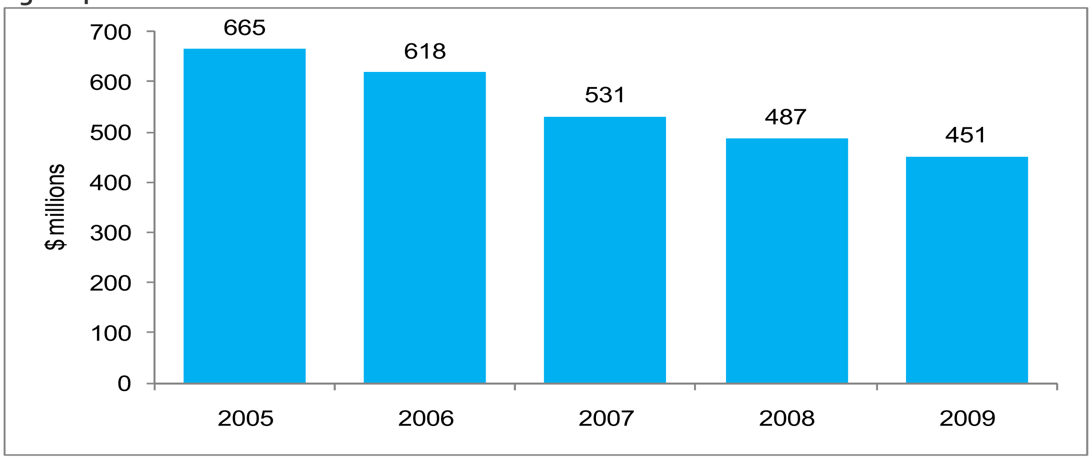
**Figure 3 Global recorded music sales**




Source: International Federation of the Phonographic Industry.

[6] International Federation of the Phonographic Industry, *Recording Industry in Numbers*, 2010, p 5.

**Figure 4 Recorded music sales in Canada**




Source: International Federation of the Phonographic Industry.

But despite the pressures brought on by digital technologies, the music industry remains an important part of the Canadian economy--and Ontario's economy, in particular. As the location for the global majors' Canadian operations, and home to Canada's premier cluster of indie labels, Ontario accounted for 81% of Canada's total sound recording revenues in 2008 (the most recent year of published statistics). This 81% share of national sound recording activity translated into $500 million in revenues and the direct employment of 1,800 individuals within the Ontario music industry.

**Ontario's Music Industry: Key Facts**

Recorded Music Operating Revenues (2008): $499 million*

Share of Canadian Sound Recoding Revenues (2008): 81%*

Number of Sound Recording Companies (independent and major, 2008): 152*

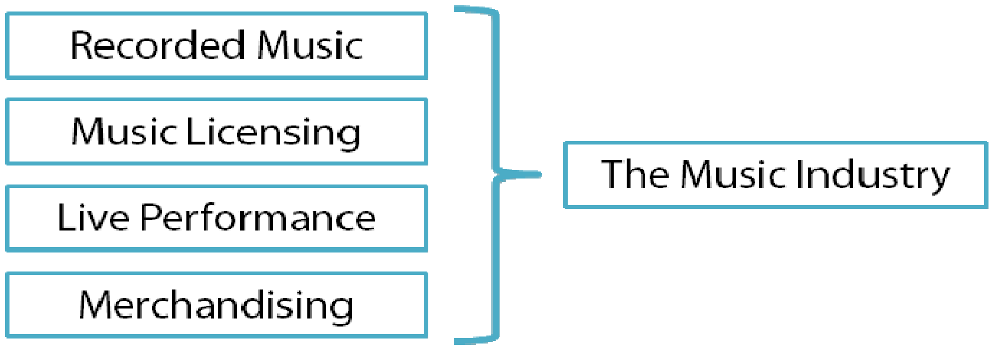
Direct Employment (2007): 1,800**

* Statistics Canada, *Service Bulletin: Sound Recording and Music Publishing*, catalogue no.87F0008X, March 2010.
** Special tabulation of Statistics Canada Labour Force Survey data, obtained by Ontario Ministry of Culture and Tourism.

### 2.1.1 Structure of the music industry

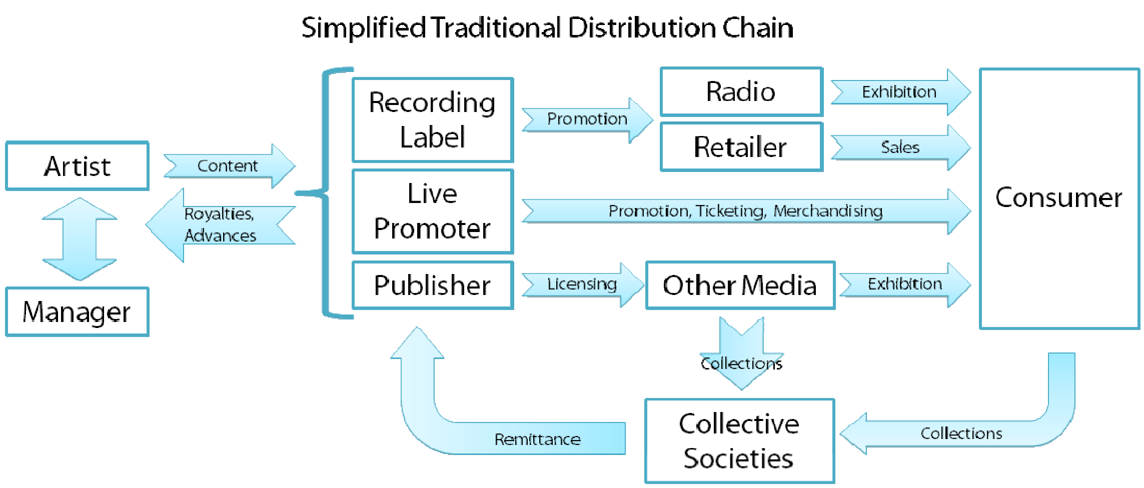
It is important to note that the music industry is comprised of several segments, of which recorded music is but one (Figure 5).

**Figure 5 Key segments of the music industry**




Within this structure, there has traditionally been a fairly stable distribution model (Figure 6).

**Figure 6 Simplified traditional distribution chain**




This model has grown increasingly complex for reasons elaborated upon in the following sub-section. For example, artists may attempt to use digital technologies to bypass the recording label and sell (and market themselves) directly to the consumer. Alternatively, a music label may opt to take on the traditional roles of a manager, live promoter and/or publisher. In short, the distribution chain prevalent at the end of the 20th century has undergone significant changes, but no single replacement business model has yet emerged.

### 2.1.2 Key industry developments

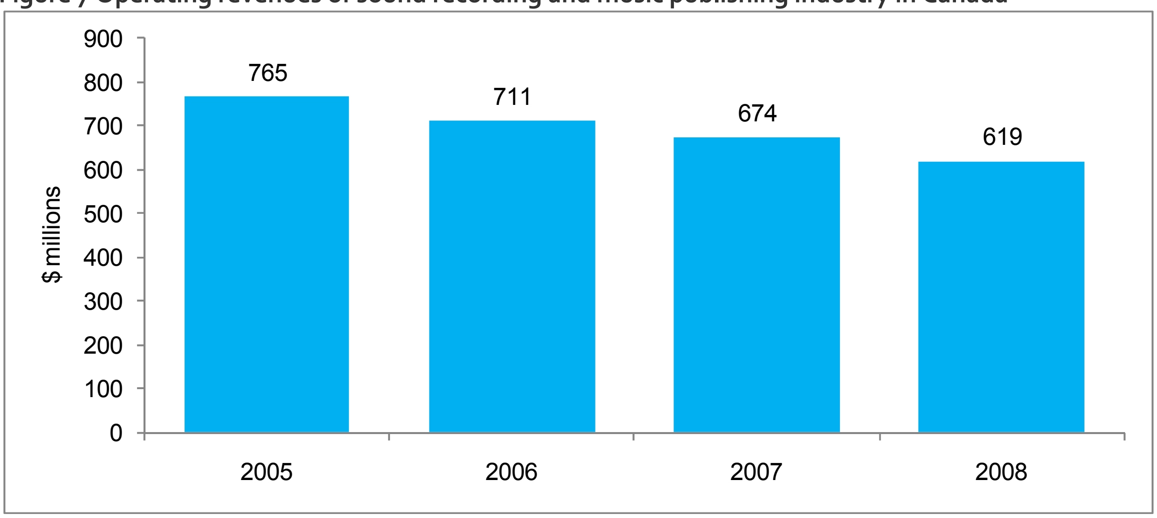
Whereas in the second half of the 20th century, the recorded music industry tended to dominate the revenues generated by the overall music industry, the first decade of the 21st century saw a shift away from this structure.

First, as a result of the deleterious impact of illegal file-sharing there has been an increased reliance on more diverse revenue streams or models. Second, the disruption of traditional recorded music revenue streams by digital technologies has also changed the manner by which music is distributed and promoted. A summary of these changes is presented below.

**Revenue Models:**

- As recorded music revenues continue to decline – falling in Canada from $765 million in 2005 to $619 million in 2008[7] (Figure 7) music companies are turning to other revenue sources to (partially) offset these losses.
- For example, music publishing revenues (i.e., the licensing of music for use in other media) grew in Canada from $119 million in 2005 to $142 million in 2008 (Figure 8).[8] Similarly, live performances and merchandising (which typically takes place at live performance venues) have also become more central to music industry business models.
- As a consequence of this revenue diversification, music companies are increasingly active in more aspects of the music business. For example, some music labels have adopted so-called *360 deals* with artists, by which the music labels undertake all aspects of the distribution and promotion chain – and so extract revenue from all aspects.

**Figure 7 Operating revenues of sound recording and music publishing industry in Canada**




Source: Statistics Canada, CANSIM table 361-0005.

**Distribution:**

- Digital distribution of recorded music – to computers and mobile devices – has grown in importance. As recently as 2005, digital distribution accounted for only 6% of global end-user spending on recorded music; by 2009, it made up 31% of global sales. Digital distribution is expected to surpass physical distribution as early as 2012.[9]

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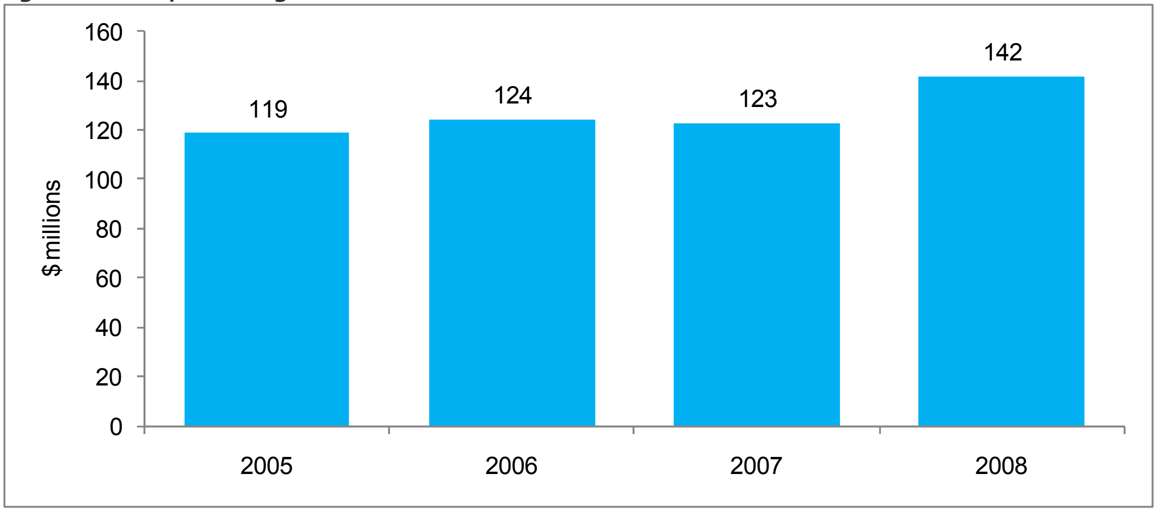
[7] Statistics Canada, *Sound recording and music publishing, summary statistics*, CANSIM table 361-0005, 2010. Note that the statistics published by Statistics Canada prior to 2005 are not comparable to the statistics published for 2005 and later, due to a change in methodology by Statistics Canada.

[8] *Ibid*.

[9] PwC, *Global Entertainment and Media Outlook 2008-2012*, June 2008, p. 304.

- One feature of these digital distribution channels is the ability to sell individual songs, in addition to entire albums.

**Figure 8 Music publishing revenues in Canada**




Source: Statistics Canada, CANSIM table 361-0005.

- Notably, digital marketplaces do not have limited shelf space (as would a traditional retailer). As such, discovery of music in a limitless storefront has become a key challenge.
- Given the digital nature of this distribution, the costs of reaching international audiences have decreased as an operating expense for recording companies – thereby increasing the potential profit available from international markets.

**Promotion:**

- Given the increased importance of live performance and merchandising revenues, and the expanded digital reach of recorded music, artist and album promotion is increasingly critical.
- Whereas consumer discovery of new artists traditionally took place in the domestic market via radio broadcasting, that medium increasingly exhibits more established Canadian artists (generally in order to satisfy Canadian content regulations). Accordingly, consumers' discovery of new artists is now derived using social media (first MySpace, then Facebook *and* last.fm, and more recently iTunes' Ping) in addition to through live performances.
- While the costs of production may have been reduced by more accessible digital technologies (e.g., Avid's Pro Tools digital mastering software), the costs of marketing have not commensurately declined. Marketing and promotion still requires music labels to purchase ad space, and engage public relations services and radio-relations professionals – two areas somewhat unaffected by technology.

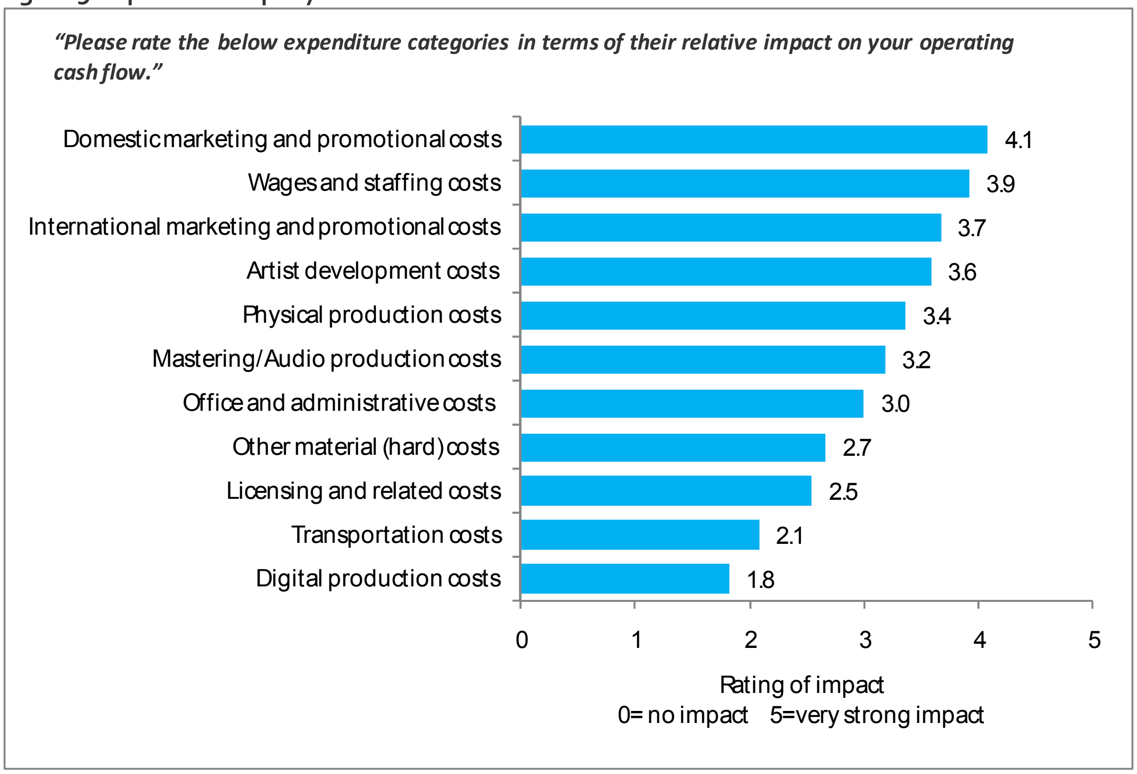
## 2.2 Key Issues facing the Ontario music industry

The music industry in Ontario is, as described above, in a state of change, growth and transition. Such growth is not, however, free of complication. In this sub-section, we outline a number of the key issues currently facing Ontario's music industry.

### 2.2.1 Cash flow

Like most cultural industries, managing cash flow and operating with significant gaps between expenses and the time at which revenues appear and are converted to cash, has proven to be a major challenge. Applicants to the OSRTC were asked to rate a set of expenditure categories in terms of their relative impact on the company's operating cash flow. The results in Figure 9 show that marketing and payroll costs are the most critical elements of the constant cash flow challenge for Ontario music businesses. Physical production costs also continue to put pressure on operating cash flow (OCF), as physical media remain an important distribution platform.

**Figure 9 Impact of company costs on cash flow**




Source: Nordicity survey.
n=13

Improved cash flow can have a *real* impact on music companies' long-term financial performance. Cash flow is critical to music companies' ability to grow and compete. However music companies do not have the type of assets that banks consider secure enough for collateral. Music companies must often wait for up to 180 days for their trade receivables, even while their suppliers demand terms of 30 days. In large part, banks consider the music industry's business environment to be too risky, so they are not inclined to accept receivables or other assets against which companies can apply for credit.

Music companies require cash to sign new artists. Delays in signing an artist could cause Ontario's indie labels to lose the artist to an out-of-province indie label or a global major. This outcome means that the economic benefits associated with that artist are lost to the Ontario music labels and the provincial economy. As little as an additional $20,000 can often mean the difference between the signing and not signing an artist by an indie label.

The OSRTC process can exacerbate the cash flow issue, as the tax credit receipt can develop into a two-year receivable; whereby two years elapse between incurring an OSRTC-eligible expenditure and receiving the tax credit refund from the Province. Because of the low project amounts and volumes, chartered banks do not provide interim financing in the way they do for film and television producers with tax credit receivables. Without a rolling portfolio of projects, music companies can easily experience cash flow shortages.

### 2.2.2 International marketing and promotion

*International Marketing*

Out-of-province marketing is essential for the development of an emerging artist and their market and audience base. Most interviewees agreed that international marketing is integral to the development of an emerging artist, and were unanimous in noting that the OSRTC inclusion rate for international marketing expenses should be increased from 50% to 100%. As one reputable record label stated, international marketing is "unavoidable," and thus, given the need to reach expanded markets, seemingly inelastic. One Ontario record label cited that 30-40% of their artists rely upon U.S. and international audiences.

While the marketing of artists within Canada can be served from Ontario-based publicists and marketing agencies, international marketing requires specialized U.S., European or international channels. Because international marketing is more specialized and expensive, and because only 50% of expenditures are eligible for an OSRTC rebate of 20%, the effect of the tax credit does not reach nearly as far as for Ontario marketing expenditures. Although OSRTC's geographic limitations do cause some companies to be more cautious in export marketing, international marketing expenses remain less elastic than domestic marketing expenses, particularly when associated with a planned tour.

An unexpected advantage of international marketing channels is the reach to both domestic and international markets (e.g., Internet marketing is usually U.S.-based, reaching both American and Canadian consumers). The market dominance of U.S. and international media, such as television, magazines and web sites (e.g., MTV, NME and Pitchfork), often means that these marketing channels must be exploited simply to reach audiences within Canada. As such, Ontario-originated advertisements are often less effective than those made in U.S. or international publications. This issue is two-sided: it means increased marketing costs for Canadian businesses, but it also extends the market-reach to the much larger and potentially more lucrative U.S. and international markets.

In addition to increasing international sales and exports, enhancing the OSRTC-eligible international expenditures would also lead to an increase in international marketing investment, which is required to help emerging artists gain a larger and more diverse audience, and thus greater sales and stability. In turn, it would increase the rate of project marketing, speed up the revenue cycle, and ultimately improve cash-flow for businesses.

Producers spend their marketing budgets on the tools that will best reach their target market, and are rarely influenced to buy locally based on tax credit incentives. However, there are occasional instances, such as with printing expenditures, where music labels will take into consideration commercial cost factors alongside shipping costs and the 20% offset (applicable to 50% of the expenditure) by the tax credit. As a secondary benefit, increasing the rate to 100% would enable companies to maintain their out-of-province relationships in the value chain and retain their key operations within Ontario.

# 3. Economic Rationale for the OSRTC

In this section we put forward the economic rationale for the Province's financial support of the music industry, and in particular, the support of the production and marketing of emerging artist recordings by way of the OSRTC. We begin by reviewing the economic importance of the music industry in Ontario, both in terms of the economic activity it generates an in terms of the vital role it plays in Ontario's entertainment and creative cluster. We then outline two forms of market failure that beset Ontario's music industry and provide additional rationale for government intervention.

## 3.1 Economic importance of the music industry

Later in this report, we analyze and quantify the economic impact of the OSRTC. At this point, we demonstrate the economic importance of the overall music industry.

### 3.1.1 Economic importance of the music industry in Ontario

As the home to a vibrant ecosystem of indie labels and the Canadian operations of the four global majors, the music industry plays an important role in the Ontario economy. Sound recording and music publishing in Ontario generated $499 million in revenues in 2008, or 80 cents of every dollar of music-industry revenues in Canada.[10] Together, indie labels and the global majors employed an estimated 1,900 Ontarians[11] in a wide range of technical, creative, managerial and administrative professions.

The broader economic importance of the music industry, however, is not limited to sound recording and music publishing. If international benchmarks are any indication, the broader music industry in Ontario – which includes radio broadcasting, live performance, merchandising, physical-media manufacturing and instrument sales – could very well be closer to $2.0 billion in revenues[12] and employ well over 5,000 Ontarians.

Ontario benefits economically from Canada's music industry because the majority of indie labels, managers, and publishers are located in Ontario. As well, many of the other players in the music value chain are also located in the province, for example:

- DVD and CD manufacturing: CINRAM is one of the world's largest digital disc manufacturers and is located in Ontario.
- Live venue operation: the Air Canada Centre (Toronto), Molson Amphitheatre (Toronto), and Scotiabank Place (Ottawa), all employ hundreds of staff for live events.
- Most of the national collective rights societies as well as national associations for the music industry are located in Ontario, including the Society of Composers Authors and Music Publishers of Canada (SOCAN), the Canadian Recording Industry Association (CRIA), CIMA, and the Canadian Musical Reproduction Rights Agency (CMMRA).
- Several post-secondary music training institutions such as Trebas Institute, Harris Institute, Metalworks, Humber College and Fanshawe College are located in Ontario.
- The four global majors as well as the largest concert promoters base their Canadian operations in Ontario.

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[10] Statistics Canada, *Sound recording and music publishing, summary statistics*, CANSIM table 361-0005, 2010.

[11] Special tabulation of Statistics Canada Labour Force Survey data, obtained by Ontario Ministry of Culture and Tourism.

[12] Ontario Music Industry Council, *The Music Industry in Ontario*, August 2009, p. 4.

The music industry is composed of an ecosystem that includes merchandise, booking agents and managers, tour promoters, retailers, musicians, producers and engineers. Thus, the music industry has numerous spin-offs, which amplify the economic impact of the sound recordings it produces. With these innovative spin-offs, social importance, and trickle-down industries in mind, the music industry should be viewed through a wider lens than merely assessing the income of the artists and indie labels.

It is without question that the global majors account for the vast majority of Ontario's music industry activity and stimulate most of the knock-on effect on the broader music industry. However, in a creative industry such as music, which is driven by human capital, the global majors and the economic activity they generate is attracted by the assurance of a pool of highly skilled and creative artists and managers in any given region. The indie label ecosystem, while smaller in revenues, employs and trains hundreds of Ontarians who provide this workforce magnet for the global majors. In this respect, the indie label ecosystem and the funding programs – such as the OSRTC – which support its growth, contribute to maintaining the larger economic ecosystem and the broader music industry that accompanies it.

### 3.1.2 The role of the music industry in Ontario's entertainment and creative cluster

Ontario's music industry – including indie labels and global majors – not only contributes revenues, wages and jobs to the Ontario economy; it also bolsters the province's vibrant entertainment and creative cluster. In many respects, the music industry is a core component of Ontario's entertainment and creative cluster, which, itself, is a key element in the province's digital media and communications industry – one of the industries that the Ontario government has identified for driving innovation and economic growth in the province.[13] Indeed, within the entertainment and creative cluster, the music industry is perhaps more interrelated with other industries than any other creative industry in the entertainment and creative cluster. Music is a product unto itself, but it is also an integral element of film and television programming. Moreover, it is increasingly seen as an active component of interactive digital media (e.g., in electronic games) and as part of the growing use of video on the Internet.

Music should also be considered important within the context of innovation and the transition of individual creative industries to the digital world. The music industry has been greatly affected by digital technology for many years – longer than other creative industries. The experience of the music industry with digital technologies – both positive and negative – foretells the eventual experience of all creative industries. While the Internet and other digital technologies are available to them, other traditional creative industries have yet to experience the full impact of digital transitions on their production and distribution activities.

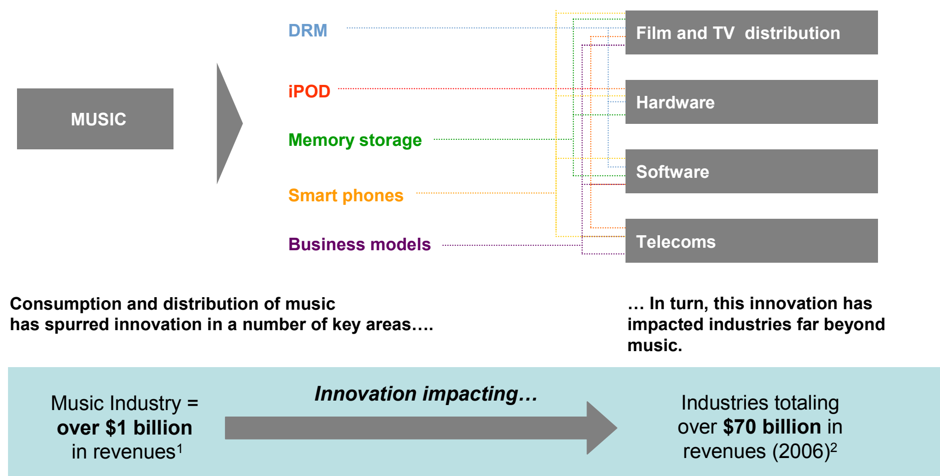
While music is still very much a sector on its own, it is perhaps the creative industry that is most linked to the other creative industries. And it is becoming more so due to the growing ubiquity of music in digital media. Music is a *leading indicator* in the sense that, if the music sector can successfully adapt to the digital era, it will bode well for the entire creative sector.

Furthermore, the demand for music has led to substantial technological innovation in platforms and communications – particularly in the distribution of music content. This music-inspired demand has had a significant impact on the wider economy, particularly in the electronics industry, which has used technology to develop new products and services. Figure 10 illustrates a small portion of the 'spin-off' technologies that have stemmed from innovation in the music business.

[13] Ontario Ministry of Research & Innovation, *Seizing Global Opportunities: Ontario's Innovation Agenda*, 2008, p. 12.

Figure 10

**Music Industry – the multiplier effect on innovation**




[1] This rounded amount of national music industry revenues is conservative as it does not capture all the revenues of music in Canada

[2] Industry Canada estimate for the information communications technology industry in 2006 (in 1997 dollars) added to Film and TV figures from the CFTPA

Music is an integral part of the creative industries and a key part of Ontario's emerging digital media cluster. As such, the continued health of the industry (or conversely its demise) will have profound impacts on the cultural, social and economic landscapes of Ontario.

## 3.2 Market failure in the Canadian music sector

The wide-ranging economic importance of the music industry in general – and indie labels in particular – to the Ontario economy and the province's entertainment and creative cluster provide a compelling economic rationale for the Province to support the industry. However, the argument for support is made even more compelling by the unique economic structure and dynamics of the sound recording industry – a structure and dynamic that is not immune to market failure.

### 3.2.1 Lack of scale in Canadian market

As with other creative media industries, the demand uncertainty and very high degree of risk in the music industry lend advantages to companies that are large enough to not only invest in development and production, but also to exercise control over distribution. The success rate in music is generally thought to be approximately 10%.[14] In other words, a music label has to produce at least one successful sound recording to cover the losses it incurs on the other nine.[15] This is a very high level of risk – even higher than feature film production. Nevertheless, the level of upfront investment required by a music label is

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[14] Harold L. Vogel, *Entertainment Industry Economics: A Guide for Financial Analysis*, 7th ed., Cambridge: Cambridge University Press, 2007, p. 244.

[15] Vogel, p. 244.

far less than that required for a film.[16] The combination of a high risk and relatively lower upfront investment requirements – when compared to film – suggests that the optimal strategy for music labels to achieve financial success is to spread the risk across multiple recordings.[17]

The need for a large diversified portfolio of projects calls for economics of scale and scope. It also calls for highly efficient and unencumbered distribution, particularly given the short cycle typical of some sound recordings – consumer tastes and preferences can change quickly.[18] Given these economic dynamics, it is not surprising that only four global majors now dominate the vast majority of the worldwide music sales market. Even where many indie labels are successful in artist development and production, they often have to rely on the large integrated global majors for the distribution of their sound recordings.

Canadian-controlled music companies lack the global scale and vertical integration to take on the high risk inherent in the music industry and exercise enough control of distribution. This lack of scale and vertical integration challenges the ability of Canadian independent production labels to sustain their businesses and hinders their capacity to invest in Canadian talent for which the economic value of the IP is also exploited by Canadians. As such, there is a risk of market failure in the production of Canadian music. The market for Canadian product – left to its own device – would likely reduce to a fraction of its current size, leaving the foreign-controlled majors to dictate music-production decisions in Canada and control the economic exploitation of Canadian artists' works. This potential outcome raises particular risks for Ontario, which is the home of Canada's Canadian-owned English-language music industry. The potential market outcome also raises risks of leaving Ontario's entertainment and creative cluster without a significant Canadian-owned music industry component – such an outcome could have negative spillovers on the other components of the industry cluster.

### 3.2.2 Music labels as research and development leaders

The second type of market failure that could arise within the music industry is related to the role of indie labels as drivers of entertainment and creative research and development (R&D). Indie labels conduct R&D in a number of ways. Indeed, sound recording *production* is actually a form of R&D, because until a sound recording is created and marketed to audiences, there is no way of assessing its likelihood of economic success. The R&D activities carried out by indie labels include (but are not limited to) the following:

- **Artist discovery and development:** Music labels typically undertake to find, nurture and develop recording artists. Such activities require a significant time and financial investment whereby the final results – much like scientific R&D activities – are unpredictable. Indie labels, such as those located in Ontario, are typically more able to take risks on artist development, leading to a more varied and dynamic music industry – one appealing to a wider range of audiences.
- **Business models:** It is the recording companies – and indie labels in particular – that tend to experiment with new business models, revenue streams and distribution technology. Such experimentation tends to require significant investment and while the financial capital available to indie labels is typically quite limited, recording companies are best poised to make such investments.
- **Innovative marketing:** Although artists and managers have long played a meaningful role in the marketing of music, music labels are often in a position to assign a staff member to undertake

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[16] Vogel, p. 244.

[17] Vogel, p. 244.

[18] Vogel, p. 245.

marketing and promotion activities. Indie labels, in particular, are agile enough to ensure that employees assigned to marketing take advantage of the newest means for music marketing (e.g. social media).

As with most R&D, the fact that there are positive spillover benefits from the activity means that the originator of the R&D often cannot capture all of the economic benefits associated with the innovation or invention that arises from it. In music, the indie music label plays a vital role in assembling the inputs – financial, creative, technical, and promotional – to create and sell a new musical work. However, much of the economic value either lies with the artist or is captured by the distributor through the economic exploitation of the IP.

At the end of recording deal – typically up to seven years – the artist can leave the label. In effect, the music label can only obtain, at most, seven years of protection for its investment. In order to obtain shelf space for a recording – either in stores, on digital platforms or on the radio – indie labels often have to relinquish considerable exploitation rights to distributors. Clearly, these two dynamics amplify the risk for indie labels. It may discourage them from engaging in the level of sound recording production that would allow them to remain competitive – even in niche markets. Instead, the Canadian music entrepreneurs who would otherwise be wiling to start a label would revert to *fee-for-service* or *in-house* music production and artist & repertoire (A&R) activities for the foreign-controlled labels. New Canadian artists would still be discovered and developed, but a larger share of the economic value created by these artists would flow out of Canada, since there would be a lack of any ecosystem of independent music labels to capture this economic value.

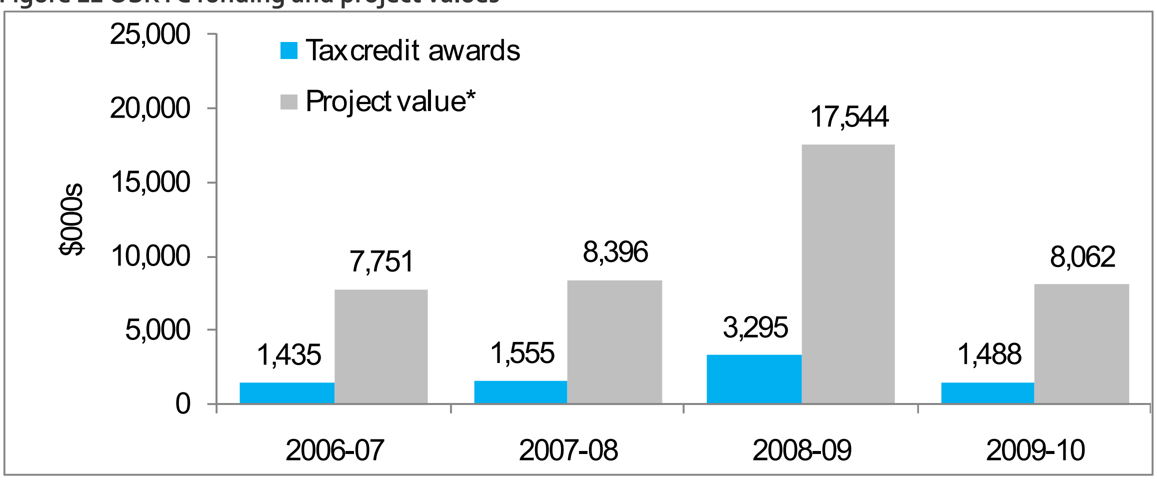
# 4. OSRTC Activity

In this section, we analyze the data extracted by OMDC from the last four years of the successful applications by sound recording companies to obtain tax credits through the OSRTC mechanism. Where relevant to contextualize these data, we report on the results of the Nordicity survey of Ontario sound recording companies eligible for the OSRTC. We also compare the support provided by Société de développement des entreprises culturelles (SODEC) in Québec to that of Ontario.

## 4.1 Profile of OSRTC use

During three of the past four fiscal years (2006-07 to 2009-10), the annual levels of OSRTC financial support were relatively stable. With the exception of 2008-09, the OSRTC provided between $1.4 million and $1.5 million in tax credit support. The total volume value of OSRTC-supported productions (sum of total project expenditures) supported by the OSRTC was also relatively stable: it ranged from $7.8 million to $8.4 million.[19]

**Figure 11 OSRTC funding and project values**




Source: OMDC.
* Refers to sum of project expenditures and may include expenditures not eligible for the OSRTC.

As indicated in Figure 11, OSRTC activity in 2008-09 was significantly higher than in the other three fiscal years analyzed. In 2008-09, the total value of expenditures for OSRTC-eligible projects more than doubled to $17.5 million; the level of OSRTC support rose accordingly, to $3.3 million. The precise reason for this temporary jump is unknown. However, the statistics clearly show that the increase was due to a doubling of the number of OSRTC-supported projects, rather than an increase in the average size of projects.

The annual number of projects – typically around 100 per year – jumped to 229 in 2008-09, while the average size of each project, $76,612, was consistent with the average in other years during the four-year period (Figure 12). Meanwhile, the average effective OSRTC assistance rate was relatively consistent: it was equal to 18.5% in three of the four years, and only varied from this rate in 2008-09, when it drifted up to 18.8% (Table 8).

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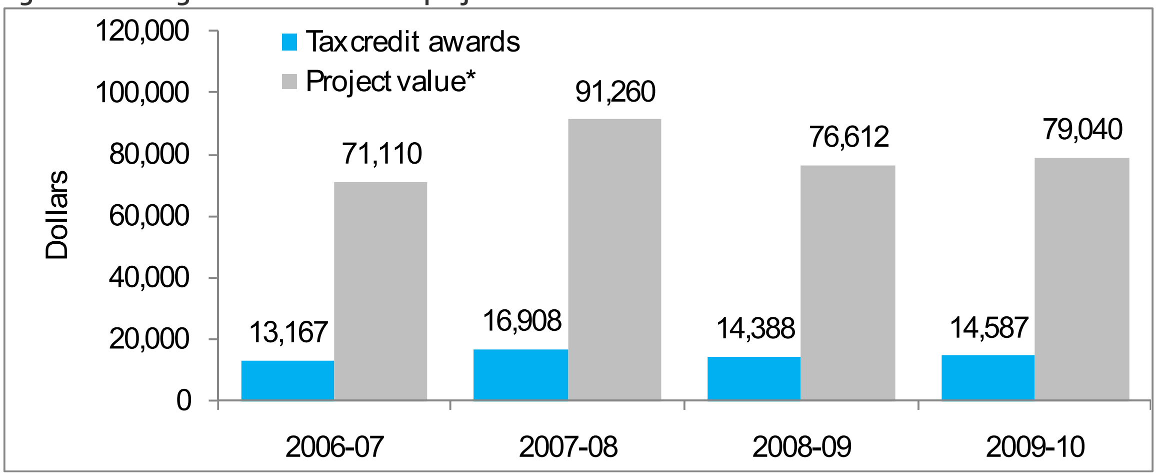
[19] Note that the statistics for OSRTC activity reflect the period in which an OSRTC project was certified rather than the year in which the sound recording production activity took place.

**Table 8 OSRTC funding, project value and effective rate of assistance**

| | 2006-07 | 2007-08 | 2008-09 | 2009-10 | Total | Average |
|---|---|---|---|---|---|---|
| Number of projects | 109 | 92 | 229 | 102 | 532 | 133 |
| Tax credit awards ($) | 1,435,233 | 1,555,492 | 3,294,789 | 1,487,848 | 7,773,362 | 1,943,341 |
| Project value* ($) | 7,751,016 | 8,395,886 | 17,544,254 | 8,062,107 | 41,753,263 | 7,751,016 |
| Effective rate of assistance | 18.5% | 18.5% | 18.8% | 18.5% | -- | 18.6% |

Source: OMDC.
* Refers to sum of project expenditures and may include expenditures not eligible for the OSRTC.

**Figure 12 Average OSRTC award and project value**




Source: OMDC.
* Refers to sum of project expenditures and may include expenditures not eligible for the OSRTC.

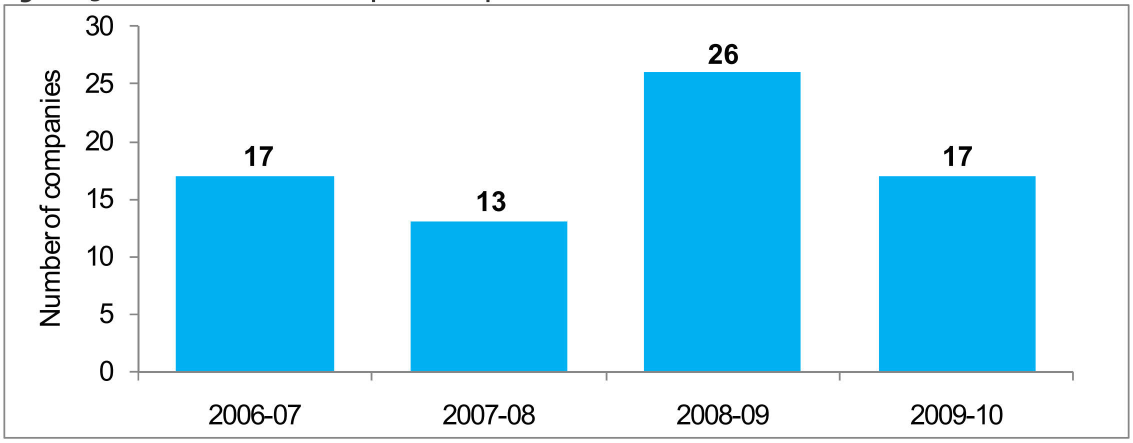
## 4.2 Profile of OSRTC users

In 2009-10, 17 companies received OSRTC support. This total was down from 26 in 2008-09, but in line with the number of companies receiving OSRTC support in 2007-08 (13) and 2006-07 (17). Statistics from CIMA's membership database indicate that there are an estimated 64 Canadian-owned sound recording companies operating in Ontario.[20] Therefore, overall usage of the OSRTC is in the range of 20% to 40%. Conversely, the rate of non-use is 80% to 60%.

According to the interview research, this non-use among Ontario-based music companies is typically due to ineligibility of the artists. However, even where an artist is eligible, small companies appear to believe that the application form used by OMDC and Canada Revenue Agency (CRA) is more burdensome than the application form used by FACTOR. One interviewee commented that the current application process raises the administrative costs of applying for the OSRTC in relation to FACTOR and other support programs. Indeed the survey research – although based on only four non-user companies – actually suggests that the legal and administrative costs of applying for the OSRTC is the most important reason for non-use (Figure 14). Lack of awareness and the small size of the OSRTC refund were also cited as reasons for non-use. In contradiction to the interview research, the lack of an emerging artist was cited as the least important reason for non-use.

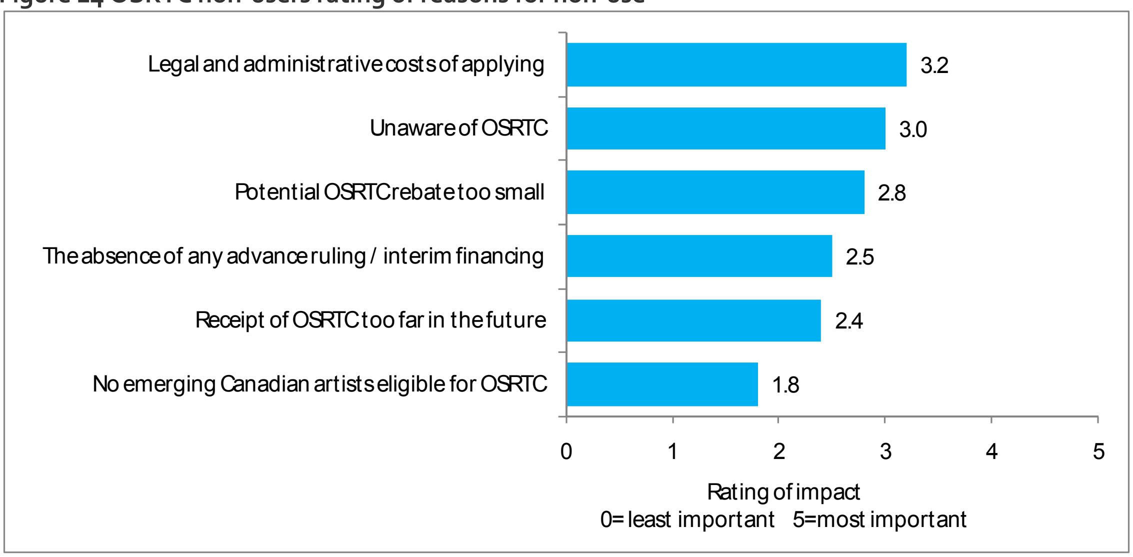
[20] The figure of 64 companies derived from CIMA's membership database is lower than the figure of 152 establishments reported by Statistics Canada. Please see Section 1.3 for a detailed explanation.

**Figure 13 Number of OSRTC-recipient companies**




Source: OMDC.

**Figure 14 OSRTC non-users rating of reasons for non-use**



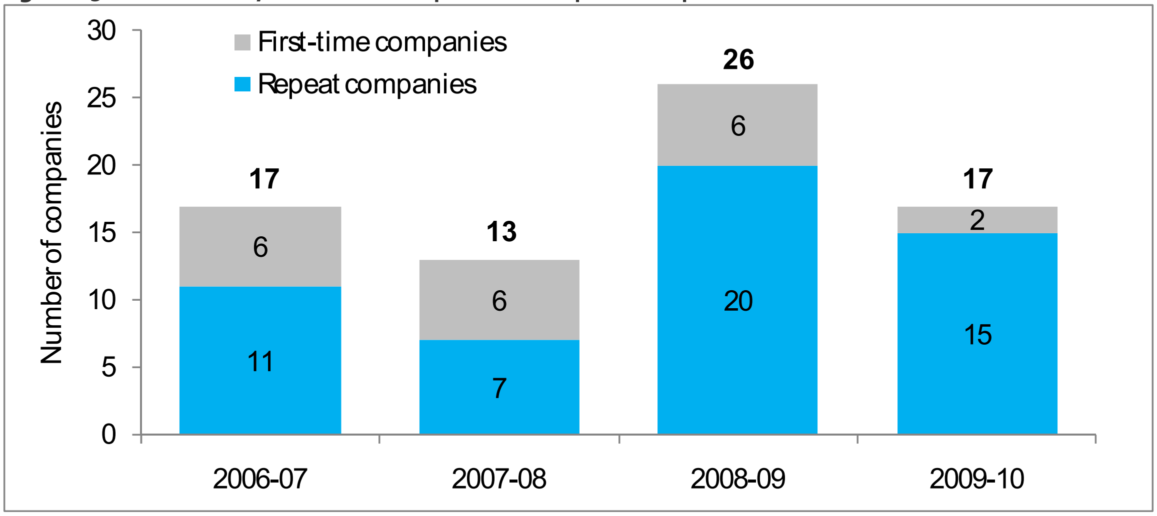

Source: Nordicity survey.

The results suggest that there might be scope for the Province to increase the use of the OSRTC among Ontario's music industry by lowering the cost-benefit aspect of the OSRTC. The Province could help lower the overall costs of applying for the OSRTC and/or increase the financial benefit that music companies can derive from it.

Data on OSRTC-recipient companies during the period, 2006-07 to 2009-10, show that most were repeat users. The vast majority (88%) of the companies receiving OSRTC support in 2009-10 were repeat users (Figure 15). In the other years during the four-year period, repeat users comprised a somewhat smaller share--as low as 54% in 2007-08, for example.

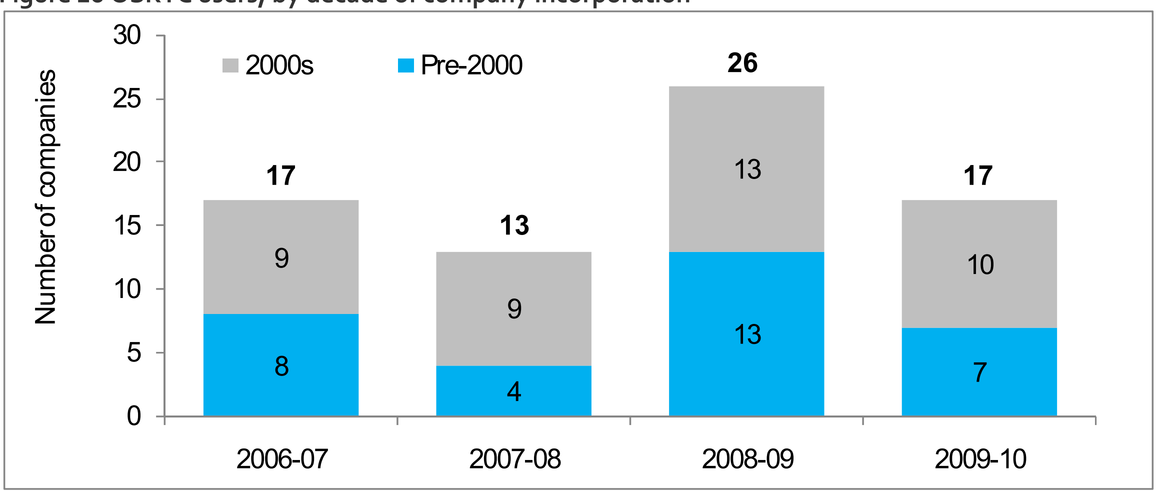
The majority of companies using the OSRTC were also relatively young; they were incorporated in 2000 or after. For example, of the 17 OSRTC recipients in 2009-10, 10 were incorporated in 2000 or later. In earlier years of the four-year period, young companies (formed in 2000 or later) accounted for at least 50% of recipients.

**Figure 15 OSRTC users, first-time companies vs. repeat companies**




Source: OMDC.

**Figure 16 OSRTC users, by decade of company incorporation**

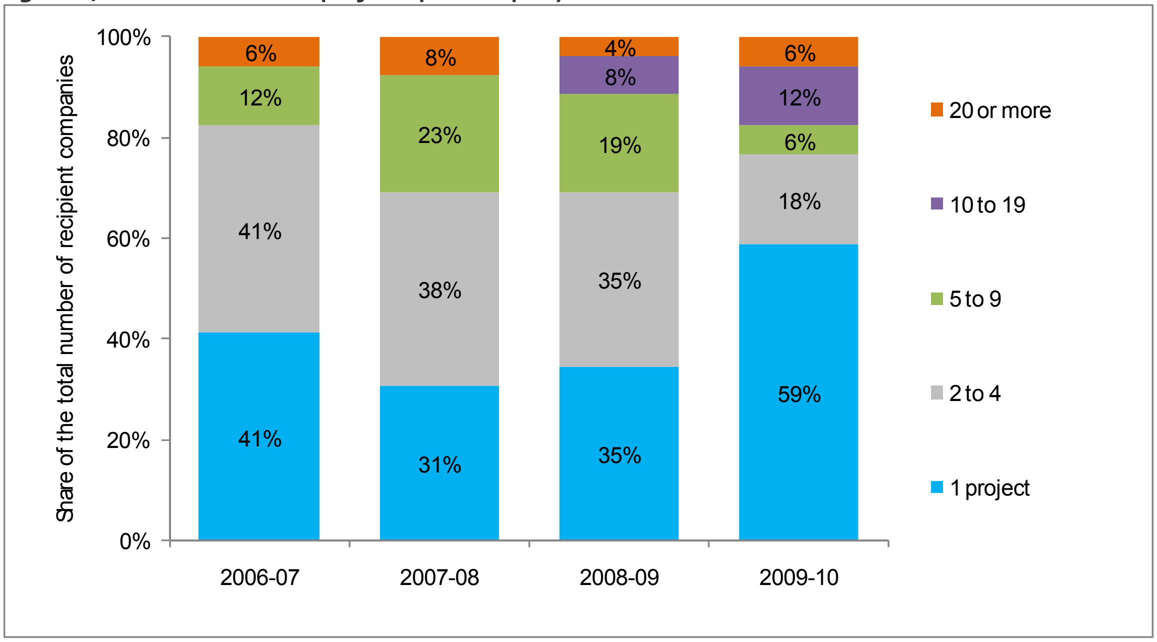



Source: OMDC.

Over the span of the four-year period, there was divergence in the profile of recipient companies in terms of the number of projects per company. While most companies had between two and four OSRTC projects in 2006-07, by 2009-10, the majority of companies had only one project (Figure 17). However, the total number of projects stayed at around 100 per annum, since a larger share of companies received support for a larger portfolio of projects. The share of companies with 10 or more projects increased from 6% in 2006-07 to 18%[21] in 2009-10.

[21] Figure includes 6% of companies that reported 20 or more projects plus the 12% that reported 10-19 projects.

Figure 17 Annual number of projects per company

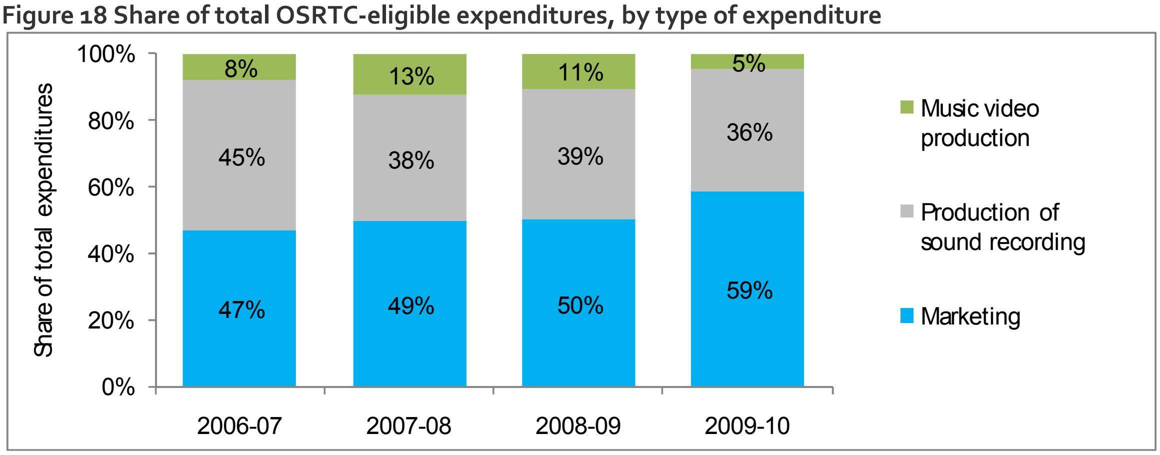



Source: OMDC.

## 4.3 Trends in OSRTC-eligible expenditures

OSRTC statistics indicate that marketing expenditures are becoming an increasingly important component of music companies' sound recording operations. In 2006-07, marketing expenditures accounted for 47% of total OSRTC-project expenditures, while production accounted for 45% and music videos 8%. The share of OSRTC-project expenditures devoted to marketing rose steadily during the four-year period; by 2009-10, it stood at 59%, while the share of OSRTC-project expenditures devoted to sound recording production was at 36%.

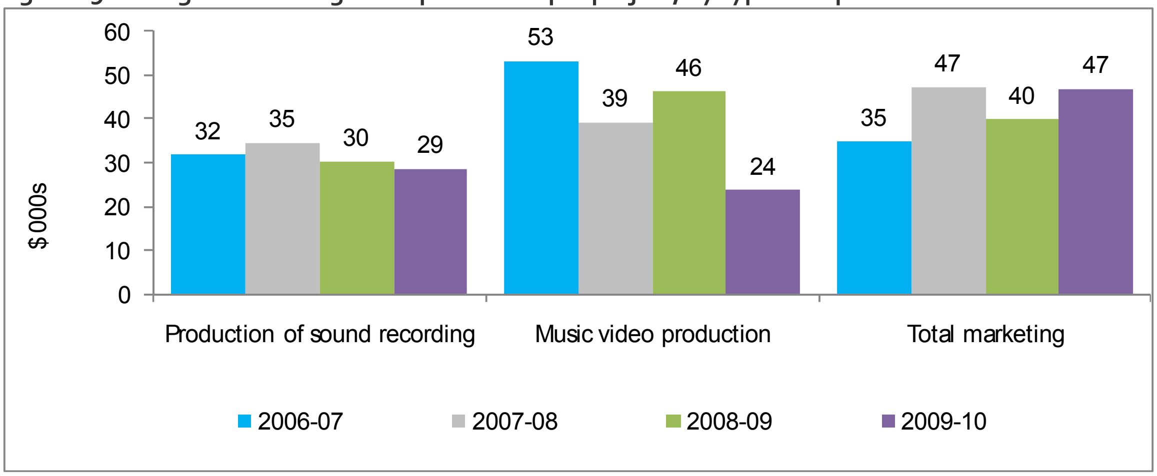
Figure 18 Share of total OSRTC-eligible expenditures, by type of expenditure




Source: OMDC.

On a per-project basis, average sound recording production expenditures dropped steadily from $35,000 in 2007-08 to $29,000 in 2009-10. For projects with a music video, the average expenditures on this component of the sound recording also dropped from an average of $53,000 across 12 music videos to $24,000 across 17 music videos in 2009-10. Meanwhile, marketing expenditures went in the opposite direction of the trends in sound recording production and music video production. Average per-project marketing expenditures for OSRTC-supported projects increased from $35,000 in 2006-07 to $47,000 in 2009-10. For some projects, the marketing budget was over $100,000 and even reached as high as several hundred thousand dollars.

**Figure 19 Average OSRTC-eligible expenditures per project, by type of expenditure***

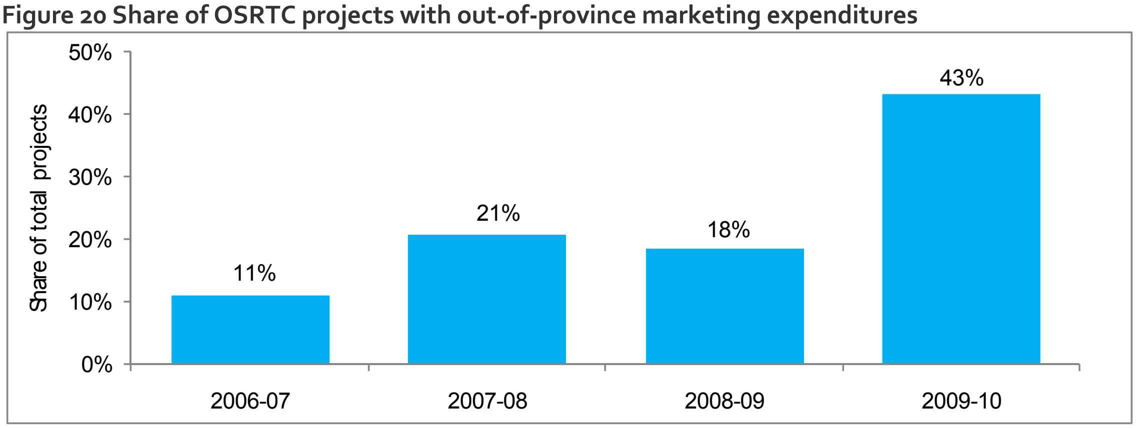



Source: OMDC.
* Averages for marketing and music video production exclude projects without these types of expenditures.

## 4.4 Out-of-province marketing

In recent years, more Ontario music companies have made out-of-province marketing a component of their overall marketing strategy, despite the fact that only 50% of these expenditures can be included in the calculation of the OSRTC. Indeed, the increased role of the Internet – and social networking sites – in the marketing of music makes out-of-province marketing vital to building audiences outside of Ontario and even important to building them inside the province. In 2009-10, 43% of OSRTC projects had some type of out-of-province marketing expenditures.

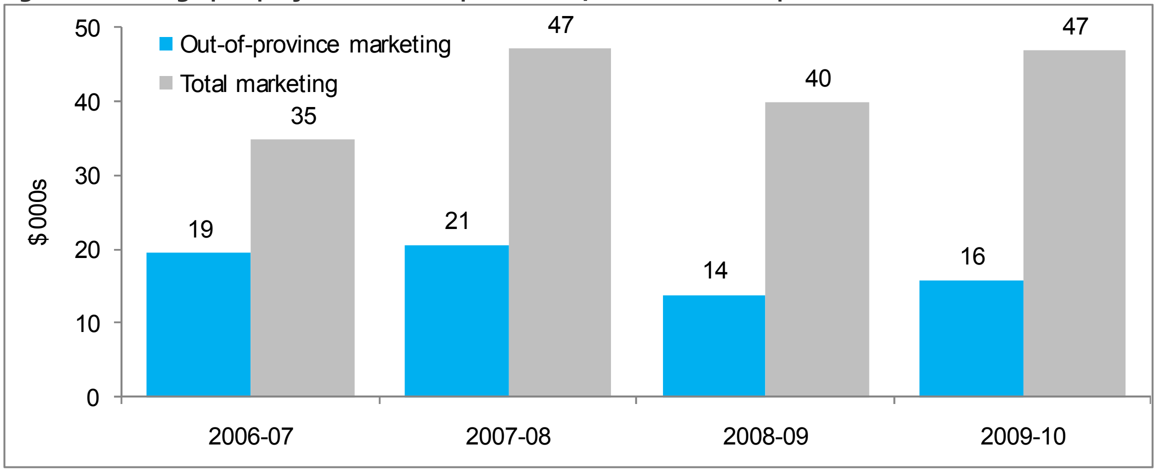
**Figure 20 Share of OSRTC projects with out-of-province marketing expenditures**




Source: OMDC.

Despite the higher incidence of out-of-province marketing, the average level of out-of-province marketing expenditures was only $16,000 per project in 2009-10, or one-third of the overall average marketing budget of $47,000 per project.

Figure 21 Average per-project market expenditures, total vs. out-of-province*

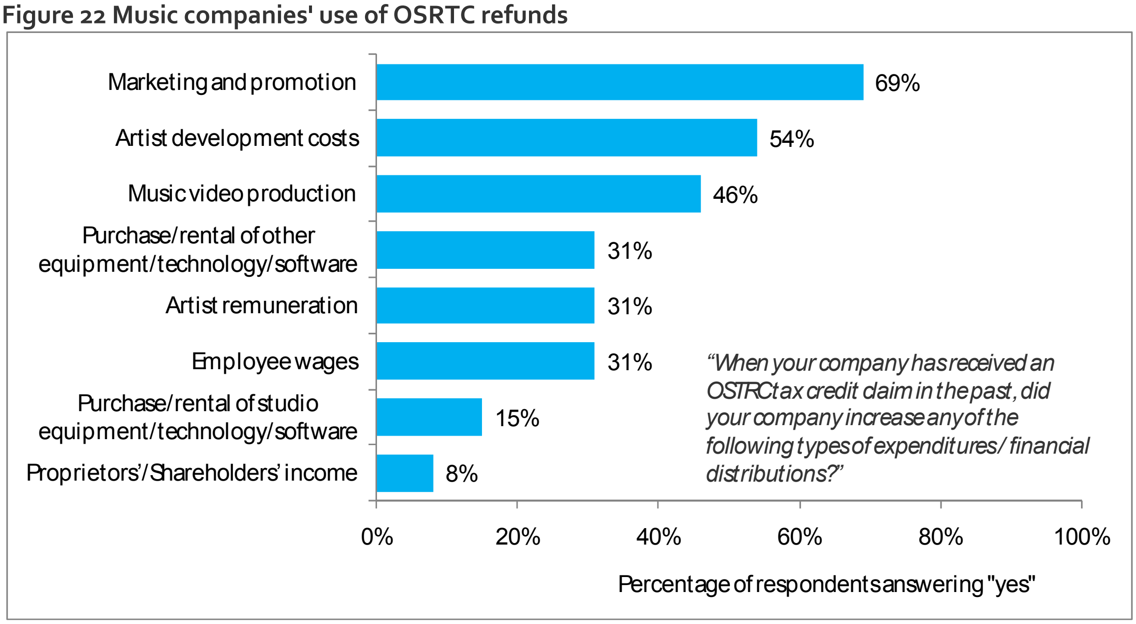



Source: OMDC.
n=8
* Averages for marketing and music video production excludes projects without these types of expenditures.

## 4.5 Music companies' use of OSRTC refunds

Marketing and promotion is also top of mind for OSRTC users when they receive their OSRTC refund. Of the top three uses of OSRTC refunds reported by OSRTC users, marketing and promotion is the leading use; and the third most popular use is production of music videos, which is deemed an essential form of marketing by the sound recording industry.

Figure 22 Music companies' use of OSRTC refunds




Source: Nordicity survey.

As shown in Figure 22, approximately 69% of OSRTC users report that they spend the proceeds of their tax credit on marketing and promotion. Indeed, companies report that the revenue supplement provided by the OSRTC is often invested in more and *better* marketing for artists (e.g., posting a music video on international web sites).

The second most popular use of OSRTC is artist development; 54% of OSRTC users report that they use the OSRTC refund for their artist development activities. The third most popular use of the OSRTC is the production of music videos; 46% of OSRTC users reported that they increased their music video production upon receiving their OSRTC refund.

The online survey results also indicate that OSRTC users are reinvesting their OSRTC refunds in driving the sales of their sound recordings and reinvesting in their artists. Thirty-one per cent of survey respondent reported that they invested their OSRTC refunds in purchases of business technology – as opposed to sound recording technology – and remuneration of their artists and personnel. Only a small fraction of OSRTC users invests the OSRTC refund in sound recording technology. And very few, if any, OSRTC users are able to retain the OSRTC proceeds in the form of proprietors/shareholders' income.

## 4.6 Music tax credits in Québec

In this section we compare the OSRTC to the music tax credit administered by SODEC in Québec. The OSRTC serves sound recording projects in Ontario, Canada's largest province and the centre of the English-music industry. It is therefore pertinent to compare it to Québec, Canada's second-largest province and the centre of the French-music industry, and SODEC's *Crédit d'impôt pour la production d'enregistrements sonores* (CIPES) in particular.

The OSRTC and CIPES provided nearly the same level of financial support to the sound recording industries in their respective provinces in 2009-10. Based on the year of tax credit certification, the OSRTC provided just under $1.5 million in 2009-10, while the CIPES provided just shy of $1.6 million in financial support. On a per-capita basis, however, Québec's level of support in 2009-10 was actually 82% higher. The CIPES funding in 2009-10 was equal to 20 cents per capita; in Ontario, OSRTC funding was equal to 11 cents per capita.

**Table 9 Comparison of OSRTC and CIPES funding levels**

| | | 2006-07 | 2007-08 | 2008-09 | 2009-10 | Total/ average |
|---|---|---|---|---|---|---|
| Ontario | OSRTC funding ($) | 1,435,233 | 1,555,492 | 3,294,789 | 1,487,848 | 7,773,362* |
| | Population | 12,665,000 | 12,793,000 | 12,932,000 | 13,065,000 | 12,864,000** |
| | Per-capita funding ($) | 0.11 | 0.12 | 0.25 | 0.11 | 0.60 |
| Quebec | CIPES funding ($) | 591,443 | 1,017,545 | 1,347,165 | 1,565,327 | 4,521,480* |
| | Population | 7,632,000 | 7,687,000 | 7,751,000 | 7,828,000 | 7,725,000** |
| | Per-capita funding ($) | 0.08 | 0.13 | 0.17 | 0.20 | 0.59 |

Source: OMDC, SODEC and Statistics Canada.

Note: The four-year average per-capita funding is calculated by dividing the total (*) amount of funding by the annual average (**) population during the four-year period.

In prior years, however, annual levels of CIPES funding were lower than those in Ontario, corresponding with CIPES' introduction of the *digital audio-visual* and *video recording* streams in 2006. As such, when viewed over a longer time period – 2006-07 to 2009-10 – per-capita funding levels in the two provinces were nearly equal. In Ontario, OSRTC funding was equal to 60 cents per capita, while in Québec, CIPES funding was equal to 59 cents per capita.

**Table 10 Comparison of CIPES and OSRTC**

| | CIPES | OSRTC |
|---|---|---|
| **Credit Allowance** | 17.5% total expenditures (35% of eligible labour costs/expenditures, not exceeding 50% of total production costs) † | 20% of qualifying expenditures |
| **Credit Limit (Sound)** | $43,750 | N/A |
| **Credit Limit (Video)** | $21,875 | No limit if expenditures in Ontario |
| **Out-of-province spend** | 100% | 50% eligible expenses |
| **Eligible Products** | Sound recording<br>Audio-video recording<br>Video recording | Sound recording<br>Video recording |
| **Eligible Expenditures** | Only labour expenses related to production activities | All expenses related to production and direct marketing of the sound recording and music video production (i.e. both property used and labour) |
| **Eligible Content** | Québec content scorecard (5/9 min.) | N/A |
| **Eligible Artist** | N/A | Emerging artist (75% emerging group)<br>Canadian citizen/resident |
| **Eligible Company** | ▪ A tax-paying establishment in Québec<br>▪ Québec-controlled company recognized by SODEC as a sound recording business (or entered into agreement with a recognized company) | ▪ A Canadian-controlled company primarily operating in the sound recording business in Ontario for the last 12 months prior to year in which they are claiming the credit.<br>▪ Earned more than 50% of its taxable income in Ontario in the previous tax year<br>▪ Implemented a distribution plan to market at least one sound recording in the previous tax year |
| **Direct Marketing Expenditures** | Ineligible | Eligible |
| **Manufacturing Expenses** | Eligible (up to 20,000 copies) | Ineligible |
| **Marketing Expenses** | Ineligible | Eligible (100% in Ontario plus 50% outside of Ontario) |
| **Expenditure Cycle** | 18 months from launch | 24 months from first expenditure incurred |
| **Application Fee** | Yes<br>($4 per $1,000 of production cost) | Yes |

Sources: Revenu Québec, *Crédit d'impôt pour la production d'enregistrements sonores*, http://www.revenu.gouv.qc.ca/fr/entreprise/impot/societes/credits/culture/enregistrementssonores.aspx; OMDC, *Ontario Sound Recording Tax Credit*, 2011, http://www.omdc.on.ca/Page3398.aspx.

† These rates were changed in 2009. For claims prior to March 2009 the rates were 29% of eligible expenditures, not exceeding 45% of total production costs.

*Credit allowance*

Unlike OSRTC's total-expenditure eligibility, CIPES is a labour-based refundable tax credit. Support is set at 17.5% of total production costs, markedly lower than the OSRTC's total-expenditure rate of 20%. However, these figures can be misleading, as CIPES offsets up to 35% of eligible labour costs and expenditures incurred during production of an eligible sound recording project, with the requirement that labour costs not exceed 50% of total production costs. While CIPES has an overall support limit of $43,750 per qualified sound or digital AV recording, and $21,875 per qualified video, the OSRTC does not have such a maximum credit cap restriction to its support.

*Eligible expenditures*

The CIPES is restricted to covering only labour expenditures. In addition, the company must meet eligibility requirements in all three expenditure categories: (i) employees; (ii) product; and, (iii) the production. Expenditures include salary or wages of the company's eligible employees, hired workers and service providers or contractors registered in Québec. These labour expenses must be directly attributable to the production of the recording and incurred by the company during the year of production work, and paid for by the time of filing the claim. Included are reasonable production fees and administration costs and all activities related to production, from concept to completion.

In contrast, the OSRTC is not restricted to labour-only expenditures. Instead, it requires that 100% of both recording production and direct marketing expenditures be primarily incurred in Ontario. Unlike CIPES, the OSRTC also allows for applicants to claim marketing expenditures.

One of CIPES's competitive edges is its provision that deems manufacturing costs as tax-credit eligible. While Ontario bars all manufacturing expenses from the OSRTC, CIPES provides support for eligible manufacturing expenses incurred within 18 months of the initial album launch, to a maximum of 20,000 copies. Meanwhile, to date neither CIPES nor OSRTC support music companies' costs associated with touring or distribution.

*Eligible applicants*

As a whole, the eligibility requirements for CIPES in Québec are less restrictive than those for OSRTC in Ontario. For businesses, CIPES requires that applicants be a tax-paying company with an establishment in Québec, and controlled by a Québec resident. The business must be recognized by SODEC as a sound recording production company or have entered into agreement with a recognized company. The eligibility requirements for artists are even more liberal, requiring only that the artist pass the 'QC content scorecard' with a minimum pass grading of 5/9 evaluated on all creative personnel involved in the production.

Conversely, the requirements are more stringent in Ontario, where OSRTC eligible companies must be a Canadian-controlled sound recording business operating as such in the province for at least 12 months. In addition, the company must have earned more than 50% of its taxable income in Ontario within the previous tax year. Similarly, OSRTC eligibility for artists is more rigorous, requiring the artist be a Canadian citizen or permanent resident, and an emerging artist (or group consisting of 75% emerging artists) having not produced a gold recording in the U.S. and either Canada, U.K. France, Germany, Asia or Latin America.

Moreover, the OSRTC has several requirements above and beyond those set out by CIPES. Applicants must be primarily a sound recording company, encompassing more than 50% of its business, primarily through a permanent establishment in Ontario. They must also have implemented a distribution plan to market at least one prior sound recording within the previous tax year. Further stipulations unique to the OSRTC require that the company enter into contracts with the artists, and bear the financial risks associated with its business or be related to a company that does.

One interviewee with experience applying for both OSRTC and CIPES found that the OSRTC application process – and in particular the budget template for the application form – is more onerous and less user-friendly than for CIPES.

*Eligible products*

Both CIPES and OSRTC cover expenditures for sound and digital audio-visual recordings. However, Québec designates video clips as an additional tax credit stream. Each excludes any recordings inciting hatred against an identifiable group, containing undue exploitation of sex and crime, horror, cruelty or violence.

Across all three avenues of CIPES tax credits (sound, digital audio-visual and video clip recordings); they require products to be a non-exclusive recording that satisfies the Québec content requirements with a minimum score of 5/9 on the 'QC content scorecard'.[22] It is required that products be produced by an eligible company whereby 75% of labour expenditures have been directed to individuals residing within Québec at the end of the tax year prior to the tax year in which production began. Within the stream of sound recordings, products must be produced for commercial distribution and contain 60% musical content in terms of minutes; as well comedy-show recordings are not eligible for the tax credit.

Meanwhile, the OSRTC has more specified content requirements for products to qualify as eligible. First, an emerging Canadian group or artist, must perform any (and all) of the music or lyrics featured on the recording. Second, the music must be primarily composed by, and/or lyrics primarily written by Canadians; or the recording production activities must have taken place in Ontario.[23] Third, in stark contrast to CIPES, the producer of an OSRTC recording must have exclusive contractual control of the master tape for at least five years after completion. Fourth, much like CIPES' musical content requirement of 60%, OSRTC excludes primarily spoken word, wildlife or nature sound recordings, and those for instructional use, advertising or promotional purposes. Finally, unique to OSRTC, sound recordings must have a total playing time minimum of at least 15 minutes.

Québec makes a distinction between sound recordings and digital audio-visual recordings, while Ontario tends to combine them. As such, in Québec, digital audio-visual recordings are eligible as stand-alone projects, not requiring the product to be related to promoting a pre-existing certified recording. Meanwhile, the Digital Audio-Visual Recording stream excludes all productions that are eligible for any provincial multimedia, film or television production tax credits.

For video recordings, both CIPES and OSRTC require the product to be created for the purpose of promoting the original recording, and obtain a certificate of eligibility issued by SODEC and OMDC respectively.[24] Video certification from SODEC must be acquired within 18 months of the end of the tax year in which production of the master tape was completed. Any tax credit claim on the same recording in subsequent taxation years must be claimed within 18 months following the end of each tax year. Meanwhile, OMDC offers a larger window of 24 months from the date that the first eligible expenditure was incurred. Unlike Québec again, Ontario also requires the video to be directed by a qualified Canadian or made at a production facility in Ontario, where the principal performer is the same as the one in the related eligible sound recording.

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[22] Note: Scorecard can be viewed at http://www.sodec.gouv.qc.ca/libraries/uploads/sodec/pdf/ddp/credit_sono_info23-03-2009.pdf, p.4.

[23] Note: A qualifying Canadian is one who is a Canadian citizen or permanent resident ordinarily resident in Canada at the time of composition or writing (Source: OMDC).

[24] Revenu Québec, *Tax Credit for the Production of Sound Recordings*, 2010, downloaded at http://www.revenu.gouv.qc.ca/en/entreprise/impot/societes/credits/culture/enregistrementssonores.aspx.

# 5. Key Performance Indicators

In this section we evaluate the impact of the OSRTC on the development of Ontario's sound recording industry. This evaluation is comprised of an analysis that draws upon data from the online survey to assess the relationship between various levels of OSRTC use and several pre-defined key performance indicators (KPIs) associated with the sound recording industry's corporate development.

## 5.1 Overview

The core of the evaluation of the OSRTC's impact on the development of the Ontario music industry lies in the identification and measurement of its impact on KPIs.

**Key performance indicators defined**

For the purposes of this study, we define a key performance indicator (KPI) as a measurement of an activity or program's achievement. In other words, KPIs are *output* or *input* measures. Such metrics are linked to the objectives of the program or activity for which they are dev eloped. For example, a KPI of the success of a call centre aiming to improve its efficiency might be the number of successfully fielded calls per hour.

In particular, the evaluation analysis examines the relationship between OSRTC use and the following six KPIs:

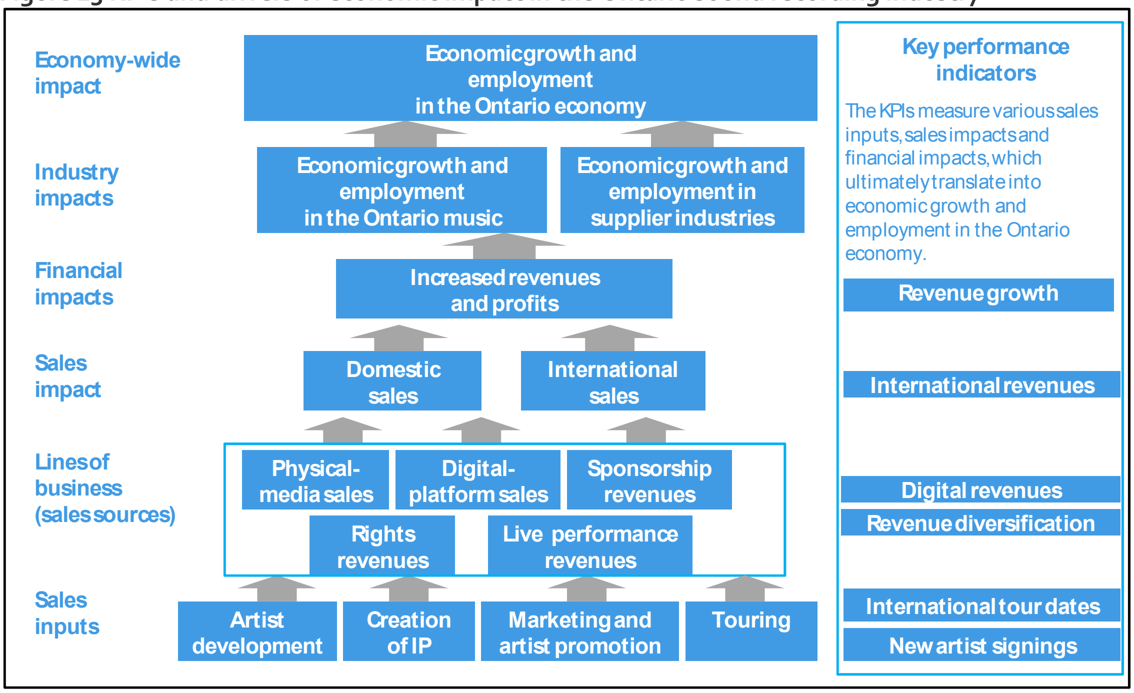
- Revenue growth;
- Digital revenues (share of revenues from digital-platform sales);
- Revenue diversification (share of revenues from sources alternative to physical and digital sales);
- International revenues (share of sound recording revenues from outside of Canada);
- Rate of artist signings (annual number of new artists signed); and,
- International promotion (number of international touring dates).

We selected these KPIs because they represent aspects of financial and corporate performance that are most likely to lead to sustainable industry development in today's music industry and thereby provide Ontario with long-term sustainable economic benefits. In today's globally competitive music industry, Canadian companies must continue to grow their businesses through exploitation of digital platforms, expansion into new revenue sources, and development of international audiences and sales.

Figure 23 provides a simple graphical depiction of the path, or economic-impact chain, through which the sound recording industry benefits the Ontario economy. It begins (at the top of the diagram) with the ultimate Ontario-economy-wide impact that the sound recording industry can have, and then traces the various sources and drivers of this ultimate impact. The KPIs measure various sales inputs, sales impacts and financial impacts, which ultimately translate into economic growth and employment in the Ontario economy.

The sound recording industry itself contributes directly to economic growth and employment in Ontario through its expenditures on the development of artists and the production of master recordings, as well as expenditures on the staff and artists employed by music companies to complete these activities. The sound recording industry also makes an indirect contribution to Ontario's economic growth and employment through its purchases of inputs – goods and services – from other Ontario businesses. These other businesses, which supply goods and services to the sound recording industry include companies that manufacture physical-media, provide recording-studio services, provide legal and accounting services, manage advertising and marketing campaigns, operate music venues, and retail sound recordings.

**Figure 23 KPIs and drivers of economic impact in the Ontario sound recording industry**




The sound recording industry's direct and indirect industry impact grows as its revenues grow. However, with a view to the long-term development of the sound recording industry, profits from these revenues are also important. The profits or surplus income earned by sound recording companies gives them financial resources that they can deploy as either working capital to bridge the fluctuations in revenues or as risk capital for investment in artists, geographic expansion or new lines of business. As such, while in the short term (or on a static basis), increased revenues would be sufficient to drive the economic contribution of the sound recording industry, in the long term (from a dynamic perspective), profits are also necessary. The implication: an environment that leads to increased revenues *and profits* will, in turn, increase the industry's own growth and its direct and indirect contributions to the Ontario economy.

Increased revenues and associated profits can only come about through higher sales. For Ontario's sound recording industry, these sales can come from domestic or international sources. While domestic sales are important, the Canadian market is rather limited. The industry's long-term development will depend on its ability to generate international sales.[25] As such, an international-revenues indicator is another KPI associated with industry development.

Up until this point in the impact chain, the drivers of the industry's economic contribution are generic – they could be applied to almost any industry. At the lines-of-business stage of the impact chain, the drivers become particular to the sound recording industry. The sound recording industry's domestic and international sales can come from a variety of business lines. Figure 23 identifies five key lines of business

[25] Nordicity, CUTO and FRUKT, *A Strategic Study for the Music Industry in Ontario*, prepared for Ontario Media Development Corporation, September 2008, p. 48.

or sources of revenue: physical-media sales, digital-platform sales, sponsorship revenues, rights revenues and revenues from live performances.

From this group of business lines – or sales sources – we have identified two KPIs, which are closely associated with industry development. The digital-revenues KPI measures companies' and the industry's performance in earning revenues from the side of the sound recording sales segment that continues to experience growth. The second KPI, revenue diversification, measures sound recording companies' performance in earning revenues from outside its two conventional sources: physical-media sales and digital-platform sales. These alternative sources of revenue are also experiencing faster growth than the conventional sources.

To generate sales, sound recording companies must harness several inputs. In the impact chain diagram, we identify four inputs that may be considered most closely associated with long-term industry development. To generate sales, sound recording companies must discover and develop artists. Eventually these artist development activities must lead to the creation of intellectual property (IP) for the sound recording company – that is, the production of a master recording. These two inputs lead to the creation of a product. The two other inputs, marketing and artist promotion, and touring drive the sales of the sound recording. From this group of sales inputs, we have identified artist signings and international tour dates as KPIs. The first KPI is an indicator of sound recording companies' R&D activity – essential to company and industry development. The second indicator demonstrates companies' and the industry's ability to pursue international sales – a key driver of long-term industry growth.

## 5.2 Analytical methodology

To measure the impact of OSRTC on the six identified KPIs, ideally, we would compare two groups of identical companies – one that accessed the OSRTC and one that did not – before and after the introduction of the OSRTC. Unfortunately, this type of analytical methodology was not available to us. As an alternative, we assessed the impact of the OSRTC by analyzing if and how relative levels of OSRTC use may have affected the outcome of each KPI. To do this, we developed a consistent measure of OSRTC use: OSRTC use intensity.

The OSRTC use intensity metric was calculated as equal to the amount of OSRTC-supported expenditures as a percentage of revenues. This metric accomplished two goals. It measured OSRTC use in terms of OSRTC-supported expenditures and then it adjusted – or controlled – for the overall size of each user's operation. With respect to the first element, OSRTC use, we chose a dollar-based measure rather than a project-based measure because the latter may be distorted by the size of the projects. A particular OSRTC user could have had many small OSRTC projects, but this would not have necessarily meant that the company was a more intensive user than a company that had a small number of large projects.

Ideally, to normalize the OSRTC use (or control for company size), one would have used total company expenditures as a divisor. However, data for total company expenditures were not available to us. In light of this, we used estimated total company revenues as a proxy for expenditures. With these data points, we calculated an OSRTC use intensity amount for each year, 2005 to 2009, for each of the eight OSRTC-user companies in the survey sample.

To assess the impact that the OSRTC had on industry development, we used two analytical approaches. We conducted a quartiles analysis between the OSRTC use intensity observations and each KPI. We also conducted a simple correlation analysis between the OSRTC use intensity observations and each KPI.

The quartiles analysis divided all of the observations into four groups, corresponding with the intensity of OSRTC use: low, medium-low, medium-high, and high. We then calculated the mean level of each KPI within each OSRTC use intensity quartile and examined the results to identify any relationship between

OSRTC use intensity and the KPI. In particular, we were looking for the existence of *positive* relationships between OSRTC use intensity and the KPI.

For five of the six KPIs, we conducted the quartiles and correlation analyses on a lag basis. That is, we compared the OSRTC use intensity in a particular year (year = t) to the KPI in the subsequent year (year = t+1). This lagged approach recognized the time duration of the sound recording production and marketing process; in general, sound recording companies must incur production and marketing expenditures before they can generate revenues. We did not apply the lagged model to the analysis of the artist-signings KPI since this input activity is intended to take place contemporaneously with OSRTC expenditures.

In the remainder of this section, we present the results of the quartiles analysis used to assess the impact of the OSRTC on each KPI; the results of the correlation analysis can be found in Appendix A with the figures cited in the analysis below.

## 5.3 Revenue growth

Revenue growth lies at the core of industry development. Without consistent revenue growth – particularly growth that exceeds inflation or the annual increase in the cost of inputs – any industry will be unable to generate the surplus income needed to reinvest in the development of new products, the marketing of existing products or expansion into new markets. The revenue-growth KPI, therefore, indirectly gauges the sound recording industry's capacity for reinvestment in new artists and business models, more and better marketing and promotion, and expansions into international markets.

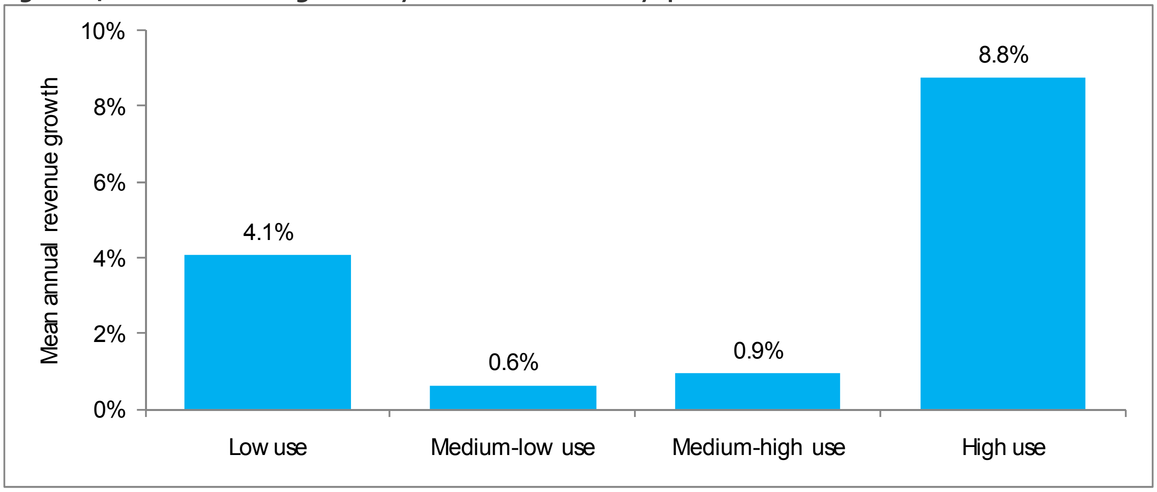
In the music industry, the importance of revenue growth as a KPI is further underlined by the fact that the industry on the whole has been experiencing a sustained period of revenue contraction, as consumers opt for illegal downloading or shift their purchases to single soundtracks. As noted in Section 2.1, global sales dropped by 23% between 2005 and 2009 (Figure 3), while sales of sound recordings in Canada fell by 32% during that same period (Figure 4).

Despite the steep and sustained declines in revenues experienced by the overall music industry in recent years, Ontario-based sound recording companies that used the OSRTC appear to have generated annual revenue growth more often than not.[26] Out of the 32 observations of annual change in revenue, companies reported positive change in revenue 26 times; they reported a negative change in revenues or no change in revenues, six times (Figure 35).

More importantly, we observed that there was a positive relationship between OSRTC use intensity and annual rates of revenue growth. The average annual growth rate within the low-use quartile was 4.1%, and thereby, higher than the mean annual revenue growth rates in the medium-low-use quartile (0.6%) and medium-high use quartile (0.9%) (Figure 24); however, the highest rate of average annual revenue growth was, by a large margin, in the high-use quartile. High-intensity users of the OSRTC displayed an average annual growth rate of 8.8%, more than double the rate in the low-use quartile.

[26] To measure revenue growth, the survey asked respondents to select a revenue-change range for each year, 2005 to 2009. We converted these range data to point estimates by using the median for each range. For example, for a respondent that reported revenue growth of 20.0% to 19.9%, we used a point estimate of 15.0%. For the lower- and upper-bound ranges, we used boundary threshold. For example, for a respondent that reported revenue growth of 20.0% or more, we used a point estimate of 20.0%.

**Figure 24 Annual revenue growth by OSRTC use intensity quartile**




Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32

## 5.4 Digital revenues

Digital platforms for music, such as iTunes, are rapidly becoming increasingly more important to the music industry. On an industry-wide basis, growing digital-platform revenues are not completely compensating for the drop-off in physical-media sales. However, music labels that restructure their business models with a view to earning more of their revenues from digital platforms are more likely to experience revenue growth and sustain their position in the market, since this is the segment of the industry that is growing. According to IFPI, digital-platform revenues in Canada grew from $16 million in 2005 to $81 million in 2009 (Figure 25).

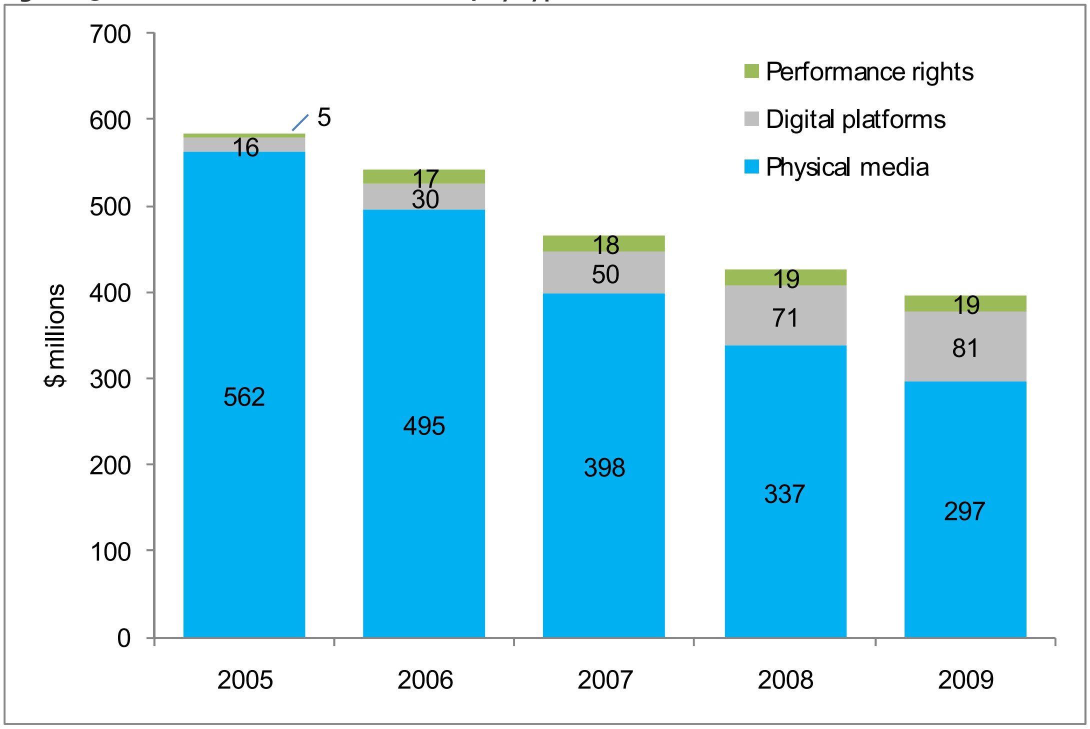
The digital-revenues KPI seeks to capture the impact that the OSRTC has on indie labels' ability to migrate to digital business models, by measuring the share of revenues they derived from digital platforms. The quartiles analysis indicates that there was indeed a positive relationship between the intensity of OSRTC use and the share of revenues derived from digital platforms.

At 28.1% of revenues, the high-use quartile displayed the highest average share of revenues from digital platforms (Figure 26). Moreover, the share of revenues from digital platforms rose steadily from the medium-low-use quartile to the high-use quartile. In other words, companies with more intense OSRTC use in a given year were more likely to derive a higher share of their revenues from digital platform sources in the subsequent period.

Conversely, less-intensive users of the OSRTC in any given year were more likely to derive a lower share of revenues from digital platforms in the subsequent year, although the mean share of revenues from digital platforms was higher in the low-use quartile (19.4%) than in the medium-low-use quartile.

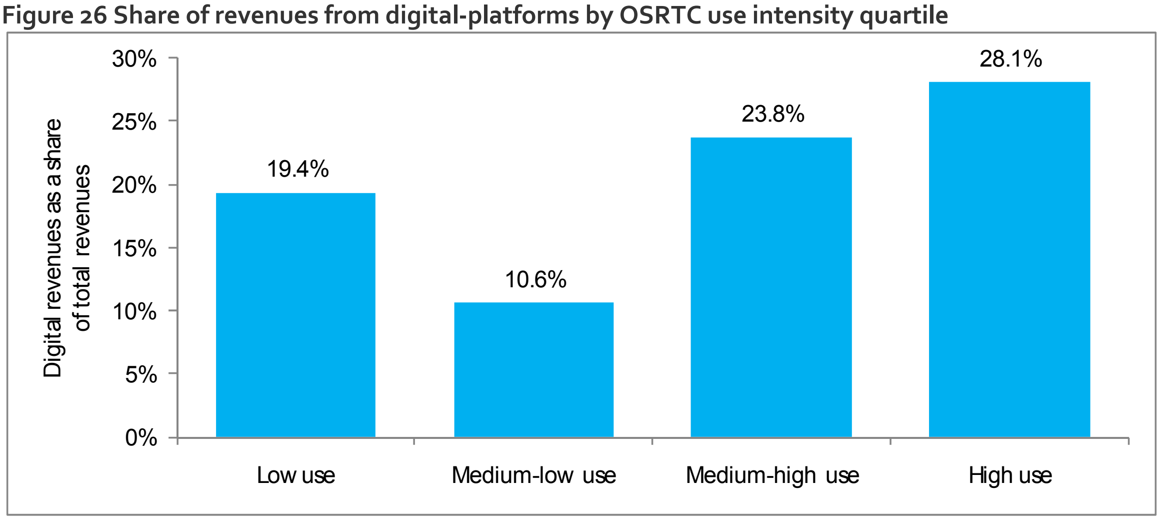
It would appear that sound recording companies with more intensive use of the OSRTC were able to move more quickly into distribution of music over digital platforms, and thereby, position themselves for faster growth in future periods.

**Figure 25 Recorded music sales in Canada, by type**




Source: International Federation of the Phonographic Industry.

**Figure 26 Share of revenues from digital-platforms by OSRTC use intensity quartile**



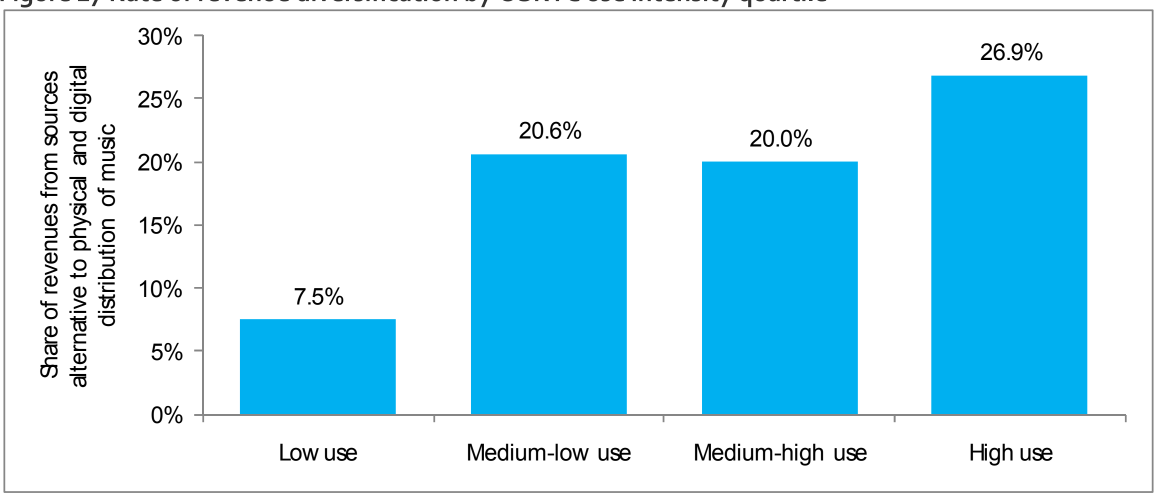

Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32

## 5.5 Revenue diversification

For music labels – both majors and indies – growing digital-platform sales are unlikely to completely replace the drop in physical-media sales. Indeed, Figure 25 shows that they have not yet done so in Canada. As such, music labels must also seek to diversify their revenue sources away from the sale of sound recordings, per se. They must re-evaluate and adapt their business models in order tap into other sources of revenues, including merchandise sales, sponsorship activities, live performances and music royalties.

The quartiles analysis of this KPI indicates that the OSRTC may assist companies in their efforts to diversify their revenues. While the direct channel through which the OSRTC affects revenue diversification is not known, exactly, the general financial support provided by the OSRTC does help companies expand their marketing efforts or invest in new lines of business. Indeed, companies with higher rates of OSRTC use intensity were more likely to earn a larger share of their revenues from alternative revenue sources between 2005 and 2009. The high-use quartile displayed the highest rate of revenue diversification, 26.9%, while the low-use quartile displayed the lowest rate of revenue diversification, 7.5% (Figure 27). The average rates of revenue diversification in the two medium-use quartiles fell in between the low-use and high-use quartiles – suggesting that there was a strong positive relationship between OSRTC use and revenue diversification.

**Figure 27 Rate of revenue diversification by OSRTC use intensity quartile**




Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32

## 5.6 International revenues

While digital revenues and revenues from alternative lines of business are important to overall music industry growth and development, because Canada is a limited market, international revenues are also critical to Canadian music companies.[27] For an industry where economies of scale are significant, such as sound recording production, independent music labels must generate revenues in the U.S. and elsewhere in order to earn the levels of revenues and profits required to reinvest in new and existing artists and lines of business.

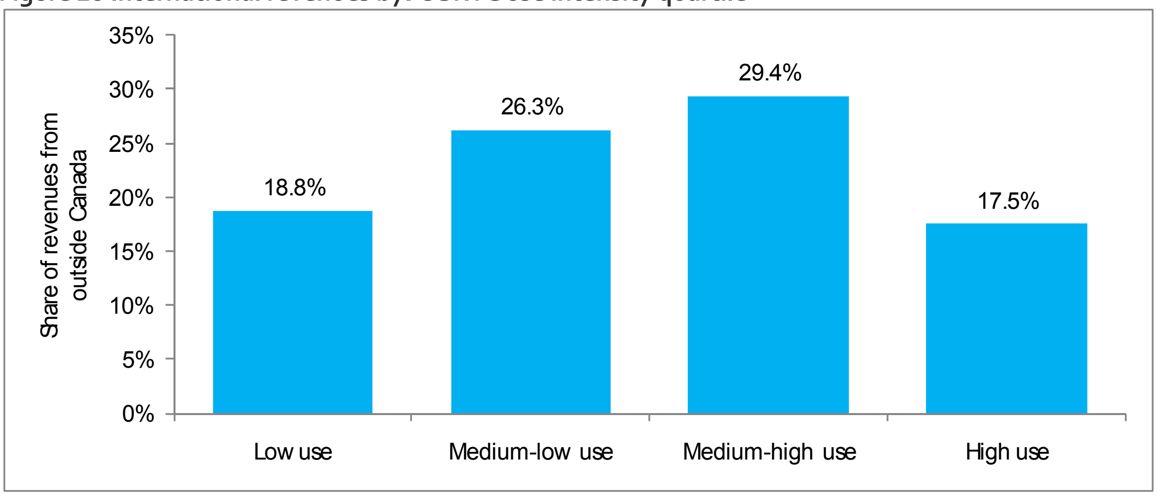
To gauge sound recording companies' track record in expanding into international markets and earning revenues from these markets, we asked them to report the percentage of revenues earned from outside of Canada – i.e., international revenues. The quartiles analysis indicates, however, that, between 2005 and 2009 there was no observable positive relationship between the rate of OSRTC use and the share of revenues from outside of Canada in the subsequent year.  This suggests that the OSRTC has no impact on expansion into international markets.

[27] Nordicity, CUTO and FRUKT, 2008, p. 48.

The average share of revenues from outside of Canada was 18.8% in the low-use quartile (Figure 28), which was virtually the same rate as the average of 17.5% in the high-use quartile, illustrating that there was no discernible difference in rates of international revenues between low- and high-intensity users of the OSRTC. Furthermore, the rates of international revenue diversification in the medium-use quartiles were higher than the rate observed in the high-use quartile.

As with the other revenue-based KPIs, we attempted to observe the relationship between OSRTC use and the KPI on a lagged basis; we measured the correlation between OSRTC use – as reported by the survey – and the international-revenue share one year hence. The lack of a positive relationship in the correlation analysis may be due to the fact that there is a longer lag between OSRTC use and the development of international revenues.

**Figure 28 International revenues by. OSRTC use intensity quartile**




Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32

The interview research suggests that music labels often delay the international release of a Canadian recording until several months after its Canadian release. What is more, interviewed music companies report that international promotion often requires a greater financial investment than domestic promotion, and accordingly, they may prefer to have a better understanding of the market potential of a sound recording before making this second-stage investment in international distribution. The costs associated with international marketing also mean that music labels, might, in fact, wait for their OSRTC refund before making investments in an international release. This would suggest that a longer lag could potentially exist between OSRTC use and international sales.

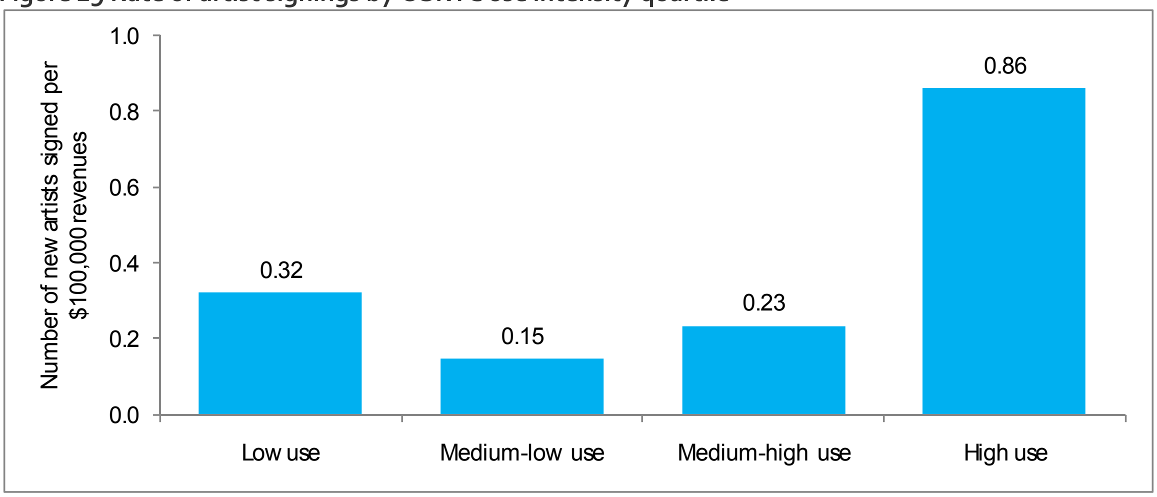
However, the lack of an observable positive relationship between OSRTC use and international revenues on a one- year lag basis could also be related to the fact that the OSRTC guidelines exclude touring costs and discount marketing expenditures outside of Ontario by 50%. While Ontario artists can more readily obtain radio play in Canada and perform on a relatively low-cost basis within Ontario – because there is no need for airfares or substantial hotel and vehicle costs – gaining an audience following outside of Canada requires touring and spending on public-relations and radio-relations services. And since the OSRTC does not provide as much support (or any, in the case of touring costs) for these activities, OSRTC use would not necessarily lead a company to engage in more international promotional activities that would increase international revenues.

## 5.7 Artist signings

One of the key inputs to music-company and industry development is the discovery and development of new artists. This is of particular importance to the independent music industry, which has to rely even more on new artists, because they can often lose successful breakout artists to one of the majors, once their recording contract expires.

It would appear that higher rates of OSRTC use were associated – in a relatively strong manner – with higher rates of artist signings. While the rate of artist signing was higher in the low-use quartile compared to the medium-use quartiles, the high-use quartile displayed the highest rate of artist signing by a very large margin (Figure 29). The low-use quartile displayed an average rate of 0.32 new artists per $100,000 in revenues. In the high-use quartile, the rate was more than 2.5 times higher, at 0.86 new artists per $100,000 in revenues.

**Figure 29 Rate of artist signings by OSRTC use intensity quartile**




Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=40

This strong positive relationship was supported by other survey data and the interviews. As noted in Figure 22 (Section 4.5), 54% of OSRTC users reinvested their OSRTC refund in artist development, including the signing of new artists. Interviewees also reported that the cash they receive through the OSRTC helps them to sign new artists.

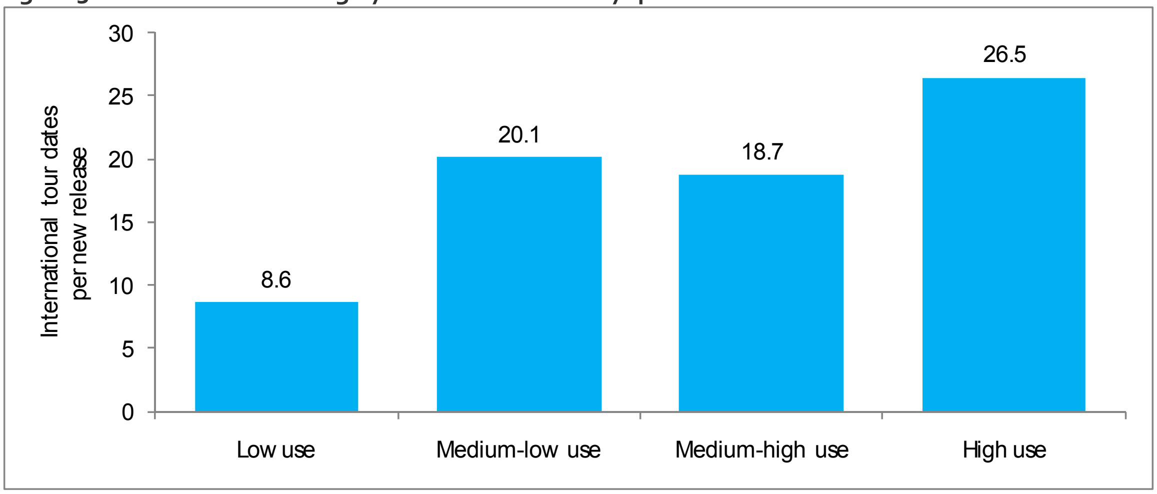
## 5.8 International promotion

Another input that is important to the long-term development of Ontario's music industry is international promotion. The limited size of the Canadian market makes the development of international audiences essential to corporate and industry development in Ontario's music industry. International touring and promotion, therefore is vital to long-term industry development because it helps to build audiences, and thereby, sales outside of Canada.

To proxy a company's degree of international promotion, we calculated the annual number of international tour dates per new release, from the survey data. When international promotion is measured on this basis, the quartiles analysis suggests that there was a positive relationship between OSRTC use and the international promotion of emerging Ontario artists (Figure 30). The average number of international tour dates per new release was 26.5 in the high-use quartile compared to 8.6 in the low-use quartile. The average rates of international touring in the two medium-use quartiles fell between the high- and low-use quartiles.

Again, there may not be a mechanism through which the OSRTC can effectively directly influence international touring since costs are not eligible for OSRTC support. However, the OSRTC does provide music labels with monies for international marketing and the production of *better* music videos – both of which can enhance the likelihood of the success derived from international touring.

**Figure 30 International touring by OSRTC use intensity quartile**




Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32

## 6. Economic Impact Analysis

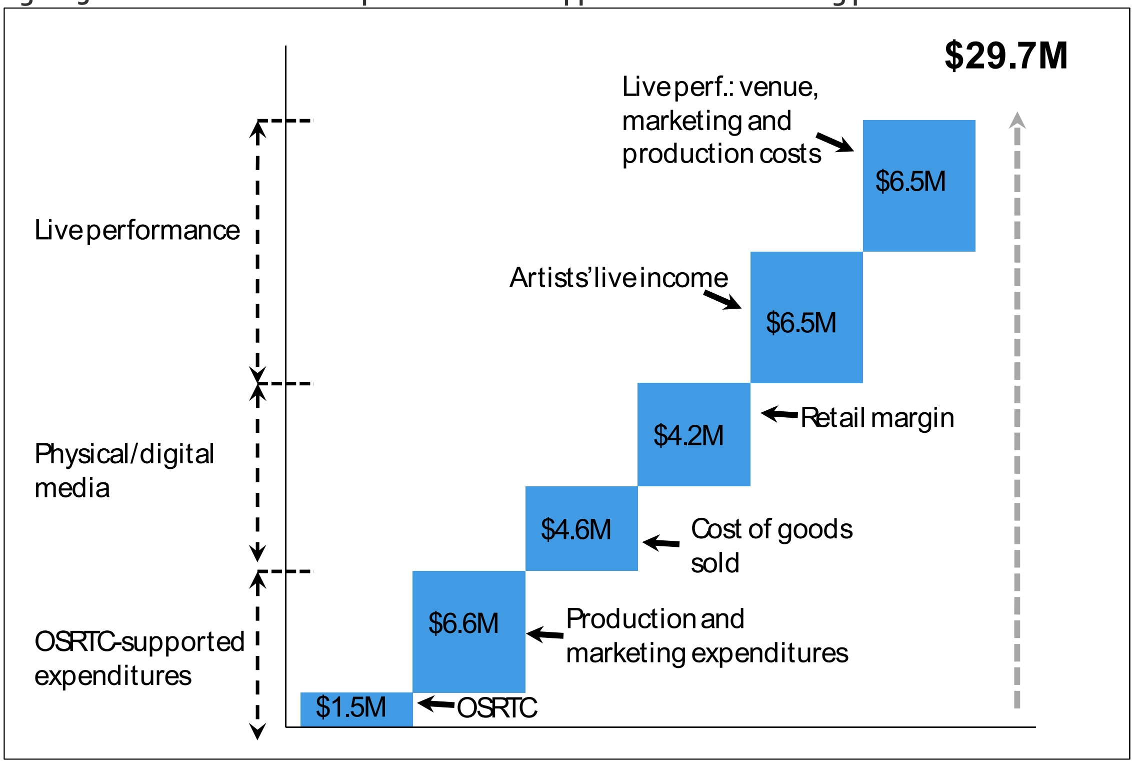
In this section, we present an analysis of the economic impact of the OSRTC on the Ontario economy. We begin by estimating the revenues generated by the OSRTC across the music value chain. We convert these value chain revenues into estimates of GDP, wages and employment in Ontario. On the basis of the incremental economic impact of the OSRTC, we also prepare a cost-benefit analysis, which compares the Province's annual OSRTC outlays to its incremental tax revenue.

### 6.1 Value chain impact

#### 6.1.1 Overall worldwide impact

Figure 31 traces the overall value-chain impact of a single year[28] of OSRTC-supported sound recording production. In 2009-10, the OSRTC provided $1.5 million in financial support to sound recording production. This financial support stimulated an additional $6.6 million in production and marketing expenditures. The total value of OSRTC-supported projects was, therefore, $8.1 million.

**Figure 31 Overall value chain impact of OSRTC-supported sound recording production**




Source: Nordicity analysis.

The manufacture and distribution of the physical and digital media generated an additional $4.6 million in costs of goods sold (COGS), which includes packaging of physical media and distributors' fees. Retailers earned an estimated $4.2 million from the sales of sound recordings. There was also an

[28] Throughout our analysis, we analyze and quantify the economic impact of a typical single year of OSRTC-supported production activity. We take OSRTC activity in 2009-10 as most representative of a typical single year. We choose 2009-10 because we consider the five-year average to be distorted upward by the large volume of sound recording activity associated with the OSRTC certificates issued in 2008-09.

estimated $13.0 million in live performance revenues associated with these releases. This live performance revenue was split 50-50 between artists, and promoters and venues. In total, therefore, the OSRTC financial support of $1.5 million led to worldwide revenues of $29.7 million across the music value chain – from production through live performance.

In the remainder of this sub-section, we discuss in more detail how we derived the estimates of the worldwide value chain impact.

*OSRTC-supported expenditures*

According to OMDC, in 2009-10, the OSRTC provided $1.5 million in financial support to 102 sound recording projects. This financial support stimulated additional production and marketing expenditures totalling $6.6 million.

*Cost of goods sold*

In our analysis of the value chain impact of the OSRTC, COGS includes all of the incremental costs of manufacturing and distributing the physical and digital media associated with sound recording. It includes the costs of pressing physical media and distributing physical and digital media – two costs not eligible for the OSRTC. To estimate the COGS we combined data from a variety of sources, including IFPI, the online survey and Vogel 2007.

First, we determined that the average unit price for a physical media sound recording in Canada in 2009 was $12.80 (Table 11).

**Table 11 Calculation of average unit price of sound recording physical media**

| Line | Item | Amount |
|---|---|---|
| A | Total value of retail sales of sound recordings in Canada, 2009 | $594.7M |
| B | Share of sales from physical media in Canada, 2009 | 65% |
| C | Retail value of physical media sales in Canada, 2009 [A÷B –1] | $386.6M |
| D | Number of physical media units sold | 30,200,000 |
| E | Average retail price per unit [D×(1+C)] | $12.80 |

Source: IFPI, *Recording Industry in Numbers, 2010,* pp.16 and 28, and Nordicity estimates.

We then allocated this average unit price to the retail margin, certain components of COGS and the music label's gross income (Table 12).

**Table 12 Allocation of average unit price**

| Item | Share of retail value | Amount ($) |
|---|---|---|
| Retail value | 100% | 12.80 |
| Retail margin | 25% | 3.20 |
| Distributor's fee | 15% | 1.92 |
| Musicians' fee | 1% | 0.06 |
| Mechanical licence | 4% | 0.48 |
| Artists royalty | 5% | 0.66 |
| Producers royalty | 2% | 0.22 |
| Free goods | 11% | 1.44 |
| Duplication/packaging | 6% | 0.80 |
| Subtotal | 69% | 5.58 |
| Music label's gross income | 31% | 4.02 |
| Grand total | 100% | 12.80 |

Source: Nordicity estimates based on data from Harold L. Vogel, *Entertainment Industry Economics: A Guide for Financial Analysis* (7th ed.), 2007.

Following that, we summed the components for inclusion in COGS – distributor fees, free goods, and duplication/packaging – to arrive at an estimate of per-unit COGS of $4.16 (Table 13).

**Table 13 Calculation of average per-unit COGS**

| Item | Amount ($) |
|---|---|
| Distributor's fee | 1.92 |
| Free goods | 1.44 |
| Duplication/packaging | 0.80 |
| Total | 4.16 |

Source: Nordicity estimates based on data from Harold L. Vogel, *Entertainment Industry Economics: A Guide for Financial Analysis* ($7^{th}$ ed.), 2007.

From there we had to develop an estimate for the number of shipped units associated with OSRTC-supported production. From the survey data we calculated that the median sales level for an OSRTC-supported sound recording during the 2005-to-2009 period was $83,000. Given that there were 102 OSRTC-supported projects in 2009-10, we estimated that music labels' total revenues from OSRTC-supported sound recordings were $8.4 million in 2009-10. We then used our calculation of the music labels' average revenue per unit to estimate the number of units associated with OSRTC-supported projects. Based on this approach, we estimated that OSRTC-supported projects generated a total of 1.1 million units (Table 14).

**Table 14 Estimate of music labels' revenues and shipped units from OSRTC-supported projects**

| Line | Item | Amount |
|---|---|---|
| A | Median sales for each OSRTC-supported sound recording | $83,000 |
| B | Number of OSRTC-supported sound recordings in 2009-10 | 102 |
| C | Estimate of music labels' revenues [A×B] | $8,466,000 |
| D | Music labels' average revenue per unit | $7.68 |
| E | Estimated number of units generated by OSRTC-supported projects [C÷D] | 1,102,358 |

Source: Nordicity estimates base don data from OMDC and Nordicity survey.

We then multiplied the estimated number of shipped units by the average per-unit COGS of $4.16 (seeTable 13) to arrive at an estimate of overall COGS of $4.6 million for all OSRTC-supported projects. This amount included the manufacturing costs and distributors' fees associated with the sale of sound recordings supported by the OSRTC.

**Table 15 Estimate of total COGS for OSRTC-supported sound recordings**

| Line | Item | Amount |
|---|---|---|
| A | Estimated number of units generated by OSRTC-supported projects | 1,102,358 |
| B | Average COGS per unit | $4.16 |
| C | Total COGS for OSRTC-supported projects [A×B] | $4,585,750 |

Source: Nordicity estimates.

*Retail margin*

The retail margin represents the incremental revenue earned by retailers from the sale of physical and digital media. We used an average retail margin of 32% of the wholesale trade value of the sound recordings. This average retail margin assumption was derived from statistics published by IFPI. We applied this average retail margin to the total wholesale trade value of OSRTC-supported recordings of $13.1 million to arrive at a retail margin estimate of $4.2 million (Table 16).

**Table 16 Calculation of retail margin**

| Line | Item | Amount |
|---|---|---|
| A | Total value of retail sales of sound recordings in Canada, 2009 | $594.7M |
| B | Trade value of sound recordings in Canada (income of distributors and music labels), 2009 | $451.3M |
| C | Implied retail margin [A÷B –1] | 32% |
| D | Trade value of OSRTC-supported sound recordings, 2009-10 | $13.1M |
| E | Total worldwide retail margin [D×(1+C)] | $4.2M |

Source: IFPI, *Recording Industry in Numbers, 2010,* p.16, and Nordicity estimates.

*Live performance revenues*

The live performance revenues represent the total value of tickets sold at live performances. To derive total live performance revenues, we used the ratio of global live performance and retail revenues reported by IFPI. According to IFPI, the global live music sector earned total revenues of $19.8 million in 2009; this was equal to 75% of the total retail value of worldwide music sales of $25.4 million in 2009 (Table 17). We split the total live performance revenues 50/50 between artists, and promoters and venues, on the basis of research reported in Hyatt 2008.[29]

**Table 17 Calculation of total live performance revenues**

| Line | Item | Amount |
|---|---|---|
| A | Worldwide live performance revenues, 2009 (US$) | $19.1M |
| B | Total value of worldwide retail sales of sound recordings, 2009 | $25.4M |
| C | Ratio of live performance revenues to retail revenues [A÷B] | 75% |
| D | Total retail value of OSRTC-supported sound recordings, 2009-10* | $17.2M |
| E | Estimated total live performance revenues [D×C] | $12.9M |

Source: IFPI, *Recording Industry in Numbers, 2010,* p.24, and Nordicity estimates.
* Sum of OSRTC support ($1.5M), OSRTC-supported production and marketing expenditures ($6.6M), COGS ($4.6M) and retail margin ($4.2M).

### 6.1.2 Impact in Ontario

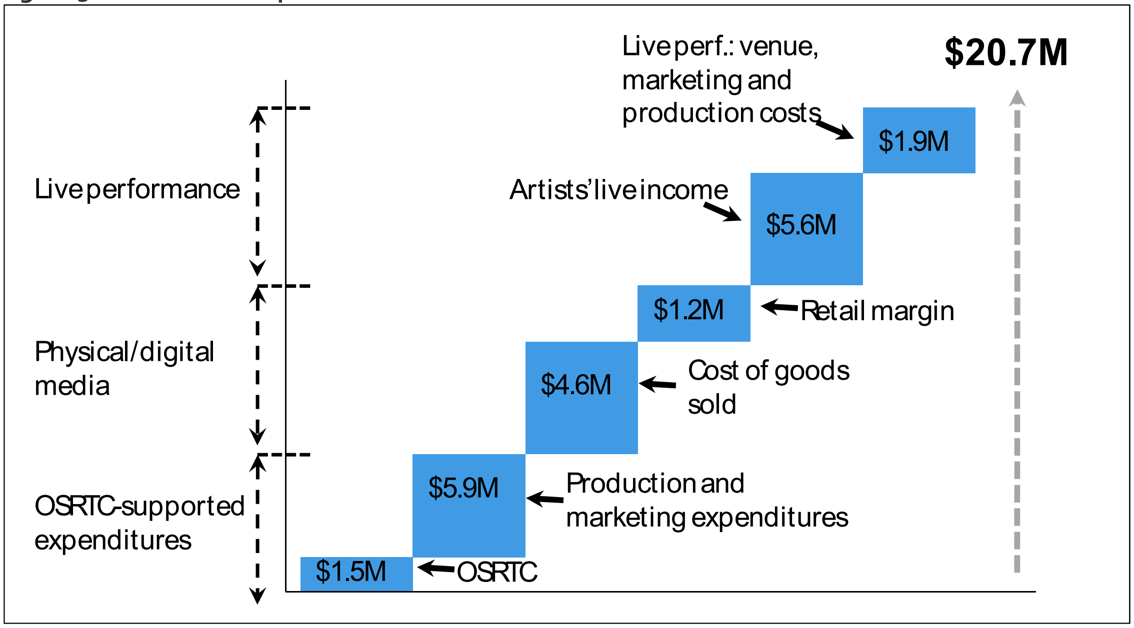
In the previous sub-section, we outlined how we derived the estimate of the overall worldwide value chain impact of a single year of OSRTC-supported production. Not all of this worldwide value impact is captured by the Ontario economy, however. For example, for retail sales outside of the province, the retail margin and its associated economic impact occur outside of the province and are not captured by the Ontario economy. The same principle applies to live performances outside of Ontario. For example, the revenues of promoters and venues for performances outside the province and their economic impact remain outside the province. In this sub-section, we estimate the portion of the worldwide value chain impact that does remain inside Ontario.

After accounting for value chain revenues that remain outside of Ontario, we estimated that the total value chain impact of OSRTC-supported production was $20.7 million (Figure 32) in 2009-10. In other words, approximately 70% of the worldwide value chain impact actually stayed within the province in terms of revenues and income for Ontario businesses and residents.

In the remainder of this section, we describe the adjustments we made to the worldwide value chain impact, in order to derive the Ontario impact.

[29] Douglas Hyatt, *An Overview of the Financial Impact of the Canadian Music Industry*, 2008, p. 26.

Figure 32 Value chain impact in Ontario




Source: Nordicity analysis.

*Out-of-province marketing expenditures*

On the basis of data from OMDC, we removed out-of-province marketing expenditures from the overall value of OSRTC-supported projects. According to OMDC, OSRTC applicants reported that out-of-province marketing expenditures on OSRTC projects totalled $0.7 million in 2009-10. As such, we reduced the value of OSRTC-supported production and marketing expenditures from $6.6 million to $5.9 million.

*Cost of goods sold*

We assumed that 100% of COGS remained in Ontario. We believe this is a reasonable assumption because Ontario is home to all of the major foreign and domestic music distributors. As well, given that CINRAM – a leading physical-media manufacturing company – is based in Ontario, we assumed 100% of physical-media manufacturing expenditures occurred in Ontario.

*Retail margin*

From the online survey, we obtained data on music labels' revenues from outside of Canada; they reported that Canada accounted for 78% of revenues. We multiplied this 78% Canadian share by Ontario's share of Canada's GDP (38%), to arrive at an estimate of Ontario's share of music sales (30%).

Ontario's share of music sales = (share of revenues from Canada) × (Ontario's share of national GDP)
= 78% × 38%
= 30%

We then multiplied the worldwide retail margin of $4.2 million by 30% to arrive at an estimate of the retail margin captured within Ontario (Table 18).

**Table 18 Calculation of retail margin within Ontario**

| Line | Item | Amount |
|---|---|---|
| A | Worldwide retail margin | $4.2M |
| B | Ontario's share of worldwide retail sales | 30% |
| C | Ontario's share of retail margin [A×B] | $1.2M |

Source: Nordicity estimates based on data from Statistics Canada and Nordicity online survey.

*Artists' live performance income*

We reduced artists live performance income, by assuming that 20% of the income they earned outside of the province was also spent outside of the province on travel and tour costs (Table 19). We also assumed that live performance income was earned in proportion to sound recording sales. Accordingly, we assumed that 70% of touring income was earned outside of Ontario given that 30% of sound recording sales occurred in Ontario and 70% occurred outside of Ontario. Based on these assumptions, we reduced artists total worldwide live performance income of $6.5 million by $0.9 million to account for their expenditures outside the province. As a result, we estimated that Ontario artists repatriated $5.6 million in live performance income.

**Table 19 Estimate of artists' live performance income repatriated to Ontario**

| Line | Item | Amount |
|---|---|---|
| A | Artists worldwide live performance income | $6.5M |
| B | Share of live performance income earned outside of Ontario | 70% |
| C | Live performance income earned outside of Ontario [A×B] | $4.6M |
| D | Share of artists' live performance income spent outside of Ontario | 20% |
| E | Artists' live performance income spent outside of Ontario[C×D] | $0.9M |
| F | Artists' live performance income repatriated to Ontario [A–E] | $5.6M |

Source: Nordicity estimates based on data from Statistics Canada and Nordicity online survey.

*Live performance: venue and promotion*

Given that Ontario accounted for 30% of total live performance revenues, we included 30% of total venue and promotion revenues ($6.5 million) in the economic impact for Ontario (Table 20).

**Table 20 Estimate of Ontario's share of venue and promotion revenues from live performances**

| Line | Item | Amount |
|---|---|---|
| A | Total venue and promotion revenues from live performances | $6.5M |
| B | Share of live performance income earned inside of Ontario | 30% |
| C | Venue and promotion revenues from live performances in Ontario [A×B] | $1.9M |

Source: Nordicity estimates based on data from Statistics Canada and Nordicity online survey.

## 6.2 Long-term impact of emerging-artist development

In Section 6.1, we determined the immediate impact that the OSRTC had on the production and marketing of emerging artists' sound recordings, and the subsequent effect these activities had on revenues in the music value chain. However, the impact of the OSRTC is not confined to this immediate impact. The OSRTC also helps create successful established artists who generate revenues and economic benefits in the future. In this regard, the OSRTC has a *dynamic effect*. It can be viewed as an investment that has the potential to yield future benefits.

The dynamic, or long-term, impact of the emerging-artist development stimulated by the OSRTC occurs when an emerging artist *breaks out* to become an established artist. When an emerging artist does graduate to become an established artist, a sound recording company is no longer able to claim OSRTC support on that artist. Nevertheless, the artist continues to generate an economic impact through future releases of sound recordings.

To quantify the long-term impact of the OSRTC, we first needed to ascertain what percentage of emerging artists would break out to become established artists – i.e., an artist who achieves gold album status in the U.S., Canada (sales of 40,000 units), U.K., France, Germany, Asia or Latin America.[30] Statistics Canada reports that Canadian and foreign labels released 568 sound recordings featuring Canadian artists in 2008. Data published by the Canadian Recording Industry Association (CRIA) indicates that 113 sound recordings achieved gold-album status in that year. Of that amount, 35 were sound recordings made by Canadian artists.

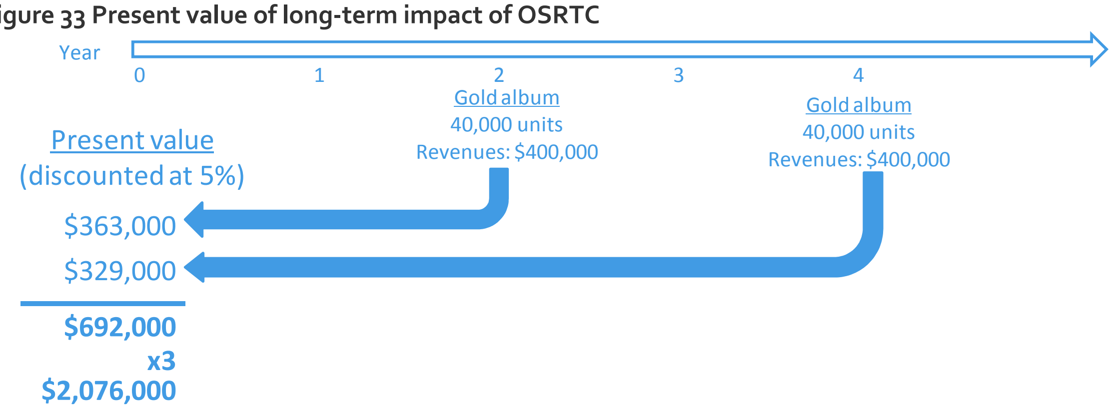
**Table 21 Estimate of gold album success rate for Canadian artists in Canada**

| Item | Amount |
|---|---:|
| Total number of Canadian artists' releases in Canada, 2008 | 568 |
| Number of gold albums in Canada by Canadian artists, 2008 | 35 |
| Percentage success rate | 6.2% |

Source: Number of releases from Statistics Canada, *Service Bulletin: Sound Recording and Music Publishing*, catalogue no. 87F0008X, 2008; number of gold albums tabulation by Nordicity based on data published by the Canadian Recording Industry Association (CRIA) at www.cria.ca.

A comparison of the number of Canadian artists with gold albums in Canada to the total number of releases in Canada suggests that approximately 6% of Canadian artists achieved gold album status in 2008 (Table 21). Recognizing that this overall average reflected not only emerging artists but also established artists who achieved gold album status in Canada, we assumed that 3% (half of the overall average rate) of emerging artists would achieve gold album status in Canada and thereby break out as established artists. When this 3% success rate is multiplied by the 102 OSRTC projects produced in 2009-10, it suggests that a total of three artists from the class of 2009-10 should have broken out in some manner from their emerging artist status.

**Figure 33 Present value of long-term impact of OSRTC**




A gold album in Canada corresponds with unit sales of at least 40,000. So, if each of these break-out artists generates a second gold album in Canada in two years time and a third in four years time, then each artist will generate revenues of at least $400,000 in years two and four. When these future revenues of $800,000 are discounted at 5%, the present value per artist is $692,000. We multiply this present value by the assumption of three break-out artists to yield a total present value of $2,076,000 derived from future revenues from gold albums. This present value of $2.1 million is in addition to the static short-term impact of $20.7 million, generated by each OSRTC project.

[30] The number of unit sales required to meet gold album status in selected countries outside of Canada are: U.S., 500,000; U.K., 100,000; Germany, 100,000.

In turn, the in additional $2.1 million in sales stimulates a further $1.6 million in live performance revenues (Table 22). In total, the long-term impact adds $3.7 million to the worldwide value chain impact. This $3.7million in worldwide value chain revenues translates into $2.7 million in revenues within Ontario.

We added the long-term impact to the immediate impact first estimated in Section 6.2.2 to arrive at an estimate of the total impact of the OSRTC (Table 23).

**Table 22 Long-term impact by value chain segment**

| Item | Worldwide impact | Ontario impact |
|---|---|---|
| Sound recording production and marketing | $1.0M | $1.0M |
| Retail sales | $1.1M | $0.8M |
| Live performance | $1.6M | $0.9M |
| **Total** | **$3.7M** | **$2.7M** |

Source: Nordicity estimates.

**Table 23 Sum of immediate and long-term impact of OSRTC**

| | Immediate impact | Long-term impact | Total impact |
|---|---|---|---|
| Sound recording production and marketing | $7.4M | $1.0M | **$8.4M** |
| Retail sales | $5.8M | $0.8M | **$6.6M** |
| Live performance | $7.5M | $0.9M | **$8.4M** |
| **Total** | **$20.7M** | **$2.7M** | **$23.4M** |

Source: Nordicity estimates.

## 6.3 Economic impact of OSRTC-supported production

Utilizing Statistics Canada's industry surveys and 2005 input-output tables (for Ontario), we allocated the total value chain impact expenditures in each segment to wages and indirect expenditures on goods and services in other industries. We then used Statistics Canada's 2005 input-output tables to estimate the indirect GDP and wages. The employment estimates were based on dividing our wage estimate in each segment by assumptions regarding annual average FTE (full-time equivalent jobs) costs.

Our induced-economic-impact multiplier was derived from the Conference Board of Canada report, *Valuing Culture 2008*. We combined the estimates for the indirect and induced-economic impacts to calculate the spin-off economic impact. We summed the direct economic impact and spin-off economic impact to estimate the total economic impact.

**On an overall basis, OSRTC-supported sound recording expenditures led to a GDP of $21.6 million in the Ontario economy, and generated $16.5 million in wages as well as503 full-time equivalent jobs (FTEs).**

Table 24 Economic impact of OSRTC in Ontario

| Value chain segment | Revenues | | Direct economic impact | Spin-off economic impact (indirect + induced)[††††] | Total economic impact |
|---|---|---|---|---|---|
| Sound recording production and marketing | 8.4 | → | **GDP:** $0.9M<br>**Wages:** $0.9M<br>**Jobs**[†]:25 | **GDP:** $6.0M<br>**Wages:** $3.5M<br>**Jobs:**97 | **GDP:** $6.9M<br>**Wages:** $4.4M<br>**Jobs:**122 |
| Retail sales | 6.6 | → | **GDP:** $4.0M<br>**Wages:** $3.3M<br>**Jobs**[††]:112 | **GDP:** $2.6M<br>**Wages:** $1.3M<br>**Jobs:**40 | **GDP:** $6.6M<br>**Wages:** $4.6M<br>**Jobs:**152 |
| Live performance | 8.4 | → | **GDP:** $7.0M<br>**Wages:** $7.0M<br>**Jobs**[†††]:215 | **GDP:** $1.1M<br>**Wages:** $0.5M<br>**Jobs:**14 | **GDP:** $8.1M<br>**Wages:** $7.5M<br>**Jobs:**229 |
| **Total** | 23.4 | → | **GDP:** $11.9M<br>**Wages:** $11.2M<br>**Jobs:** 352 | **GDP:** $9.7M<br>**Wages:** $5.3M<br>**Jobs:**151 | **GDP:** $21.6M<br>**Wages:** $16.5M<br>**Jobs:**503 |

Source: Nordicity analysis based on data from Statistics Canada and Conference Board of Canada.

Notes:

† Based on an average annual full-time salary of $36,000.

†† Based on an average annual full-time salary of $27,000.

††† Based on an average annual salary of $36,000 (artists income) and $29,000 (venues/promoters).

†††† All job estimates based on an annual average salary of $36,000.

## 6.4 Incremental economic impact of OSRTC

In order to prepare a cost-benefit analysis of the OSRTC, we first needed to assess the *incrementality* of the OSRTC: the portion of sound recordings that would have been produced anyway.

Based on the survey data, we estimated an incrementality rate of 33%. In other words, two-thirds of OSRTC-supported sound recording projects would have been produced regardless of the availability of the tax credit. However, the incrementality analysis also had to consider two other factors.

i. The OSRTC assists music companies in expanding their marketing and promotion. This can lead to higher sales for the artists that companies would have produced anyway.

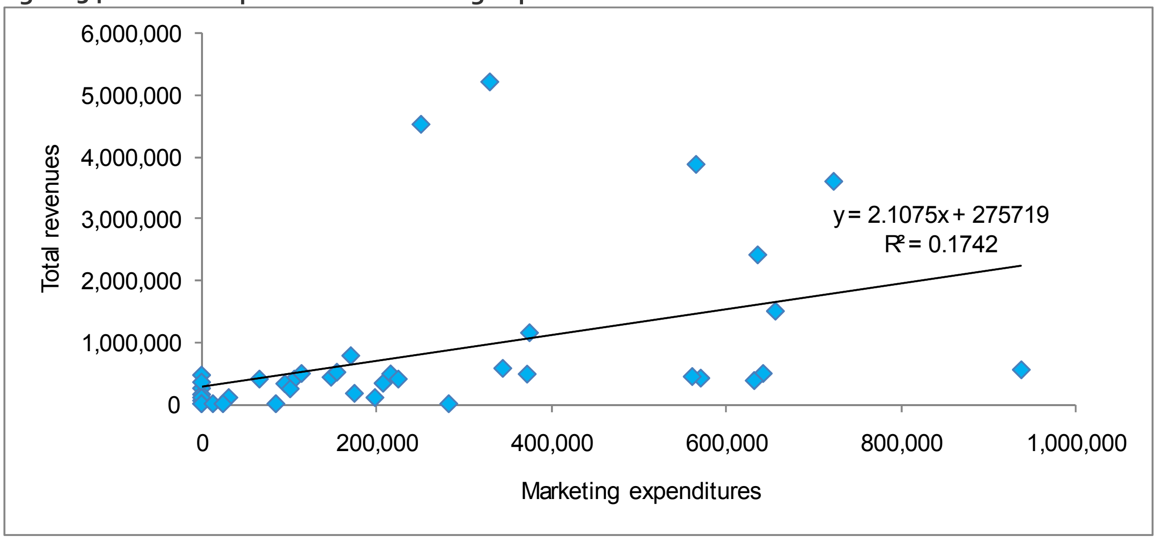
ii. The OSRTC attracts entrepreneurs and artists from outside the province. Without the OSRTC, projects would indeed proceed anyway, but generating income in another province. [31]

In order to quantify the first factor, we used data from the survey to estimate the relationship between marketing expenditures and sales. We compared each respondent's level of marketing expenditures on OSRTC projects to its total company revenue. This comparison indicated that a 2:1 relationship existed. That is, a one dollar increase in marketing expenditures (on OSRTC-supported projects) led to a two dollar increase in the music labels' total revenues (Figure 34).

[31] The interview research indicates that, over the long-term, the OSRTC has attracted music-industry entrepreneurs seeking to establish independent music labels to relocate to Ontario from other provinces.

If music labels allocate 50% of their OSRTC refund – or 10% of their project value – to marketing their revenues should increase by 20%, given the 2:1 ratio. In other words, the sales of the *other* two-thirds of projects that are not incremental would increase by 20%. The marketing and sales effect, therefore, adds another 10% to 13% to the incrementality (20% of 67%). This raises the overall rate of incrementality to 46%.

**Figure 34 Relationship between marketing expenditures and total revenues**




Source: Nordicity analysis of survey data.

While we did not quantify the second factor, we determined from the interviews that it was reasonable to add another four percentage points to the incrementality rate of 46% on account of the music labels that are drawn from other provinces. This adjustment increased the overall incrementality rate to 50%.

**A 50% incrementality rate implies that the annual OSRTC assistance of $1.5 million led to a GDP of $10.8 million, wages of $8.2 million and 251 new FTEs in the Ontario economy on an annual basis** (Table 25).

**Table 25 Incremental economic impact of OSRTC in Ontario**

| Value chain segment | Revenues | Direct economic impact | Spin-off economic impact (indirect + induced) †††† | Total economic impact |
|---|---|---|---|---|
| Sound recording production and marketing | 4.2 | **GDP:** \$0.4M **Wages:** \$0.4M **Jobs**†:12 | **GDP:** \$3.0M **Wages:** \$1.8M **Jobs:**49 | **GDP:** \$3.5M **Wages:** \$2.2M **Jobs:**61 |
| Retail sales | 3.3 | **GDP:** \$2.0M **Wages:** \$1.7M **Jobs**††:56 | **GDP:** \$1.3M **Wages:** \$0.7M **Jobs:**20 | **GDP:** \$3.3M **Wages:** \$2.3M **Jobs:**76 |
| Live performance | 4.2 | **GDP:** \$3.5M **Wages:** \$3.5M **Jobs**†††:107 | **GDP:** \$0.5M **Wages:** \$0.2M **Jobs:**7 | **GDP:** \$4.0M **Wages:** \$3.7M **Jobs:**114 |
| **Total** | 11.7 | **GDP:** \$5.9M **Wages:** \$5.6M **Jobs:** 176 | **GDP:** \$4.9M **Wages:** \$2.6M **Jobs:**76 | **GDP:** \$10.8M **Wages:** \$8.2M **Jobs:**251 |

Source: Nordicity analysis based on data from Statistics Canada and Conference Board of Canada.
Notes:
† Based on an average annual full-time salary of \$36,000.
†† Based on an average annual full-time salary of \$27,000.
††† Based on an average annual salary of \$36,000 (artists income) and \$29,000 (venues/promoters).
†††† All job estimates based on an annual average salary of \$36,000.

## 6.5 Fiscal cost-benefit analysis

On the basis of the results of the economic impact analysis, Nordicity also prepared estimates of the incremental Ontario government tax revenues that can be attributed to OSRTC-supported sound recordings. Nordicity prepared these estimates of provincial-government tax revenue by applying economy-wide effective tax rates derived from Statistics Canada data.[32]

The jobs and wages generated by the OSRTC generated an estimated \$970,000 in income taxes for the Ontario government. Incremental corporation taxes totalled \$173,000 and general retail sales taxes (RST) totalled \$443,000. The Ontario government also collected \$232,000 in RST on the sales of OSRTC-supported sound recordings within Ontario and \$164,000 in RST on sales of live performance tickets.

In total, the Ontario government collected an estimated \$1,981,700 in taxes from the incremental economic impact of OSRTC-supported sound recordings. When this tax revenue is compared to the Ontario government's annual OSRTC outlays of \$1.5 million, the result is an annual fiscal benefit of \$405,400. In other words, **for every dollar the Province invests in the Ontario sound recording industry through the OSRTC, it receives \$1.27 in tax revenue** (Table 26).

[32] Personal income taxes, social insurance payments, and payroll taxes were estimated at a rate of 10.9% of total wages and supplementary labour income. Corporation income taxes were estimated at a rate of 1.6% of provincial GDP. Sales taxes were estimated at a rate of 4.1% of GDP.

**Table 26 Fiscal cost-benefit analysis**

| Category of Ontario government revenue | Calculation | Amount |
|---|---|---|
| Income taxes | 10.9% of wages ($8.2M) | $893,800 |
| Corporation taxes | 1.6% of GDP ($10.8M) | $172,800 |
| Retail sales taxes (RST) | 4.1% of GDP ($10.8M) | $442,800 |
| RST on sales of sound recordings | 8.0% × $2,895,000 (retail value of sales in Ontario) | $232,000 |
| RST on live performances | 8.0% × $2,044,000 (live perf. revenues in Ontario) | $164,000 |
| | **Total Ontario government revenues** | **$1,905,400** |
| | OSRTC outlays | $1,500,000 |
| | **Net fiscal benefit/(cost)** | **$405,400** |

Source: Nordicity calculations based on data from Statistics Canada, CANSIM tables 384-0001, 384-0002, and 385-0002.

# 7. Policy Options

In this section we identify policy options regarding possible changes to the OSRTC and its guidelines, and provide a preliminary commentary on each. We also provide an economic assessment of one of the policy options—a rate increase from 20% to 30% for the OSRTC--although this is not a full evaluation.

## 7.1 Options for changes to OSRTC

The options for improving the effectiveness of the tax credit range from increasing the credit across the board to the inclusion of expense categories that are currently ineligible or restricted, as described below

*1. Increase the tax credit rate so that it corresponds with tax credit rates for the other creative sectors*

At 20%, the OSRTC's statutory rate is lower than the statutory rates on all of other tax credits administered by OMDC, with the exception of the Ontario Computer Animation and Special Effects Tax Credit, which is also 20%. The OMDC administers four tax credit programs where the rates are higher than the OSRTC rate of 20%: Ontario Production Services Tax Credit (25%), Ontario Book Publishing Tax Credit (30%), Ontario Film and Television Tax Credit (35%) and Ontario Interactive Digital Media Tax Credit (40%)[33]. Given that the OSRTC has the lowest tax credit, and given that the fiscal cost-benefit analysis in Section 6.5 shows that at a 20% rate, the OSRTC provides a net positive return to the Province, there should be ample scope to increase the tax credit and continue to provide a net economic benefit to the province. Increasing the OSRTC rate from 20% to a rate between 30% and 40%, with no change in the list of eligible expenditures, would bring it in line with rates for many of the other tax credits administered by OMDC..

Increasing the OSRTC rate would lead sound recording companies to invest more in practices that offer greater returns. Based on findings from the interviews, any increased funds would be reinvested in the marketing and development of new and emerging talent. This change would also encourage sound recording companies to increase the number of emerging artist projects they would take on. As demonstrated in Section 5, there is a positive relationship between the OSRTC at its present level and various KPIs of industry development. Increasing the tax credit by a measurable amount such as 10 or 20 percentage points would have a compounding effect on the greater Ontario music industry.

*2. Increase the eligibility of international marketing expenditures to match the domestic rate of 100% eligibility*

Increasing the eligibility of international marketing expenditures from 50% to 100% would provide significant support to the expansion and diversification of company sales to both international and domestic markets. The emphasis on international marketing is widely recognized as a need by the industry as it continues to adapt to international markets. The new subscription-model services that are slated to challenge the supremacy of iTunes (and even its business model) include industry heavyweights such as Sony and successful start-ups such as Spotify and We7. Marketing to those aggregator/retailers in addition to international touring will be critical to the long-term prosperity of Ontario's music industry and therefore, this option could have an invigorating and timely impact.

*3. Expand eligible expenditures to include strategic costs such as touring, manufacturing, rights tracking and social media.*

Expanding the list of eligible expenditures to reflect new costs introduced to the ever-evolving music industry will help *future-proof* the OSRTC supports to ensure that they remain relevant and effective for both traditional and emerging business models. The additional expenditure categories proposed below

[33] The 40% OIDMTC rate is applicable to qualifying expenditures in one of four streams; all other eligible qualifying expenditures are set at 35 per cent.

address the two leading trends in the evolution of the music industry business cycle: (i) a shift towards live performance-related revenues, and (ii) the emergence of digital (and social) media.

**Touring** has always been part of the music industry, although it has become especially important as a revenue source since the decline of physical-media sales and the advent of social networking as a way to promote fans' interest in musical acts prior to their public concert appearances. While there has been some prior reticence to include touring expenses because of a possible risk of adverse publicity – which might arise if touring expenditures are diverted to business-entertainment purposes (e.g., purchases of alcohol) – the likelihood for such diversions is greatly diminished by artists' increasing business approach to their work. The risk of adverse publicity associated with business-entertainment expenses could be mitigated by limiting eligible expenditures to those incurred pre-tour. This would restrict the costs eligible for tax credit support to those incurred during the preparation phase such as bookings for flights, vans and hotels.

**Manufacturing** is another possible category for inclusion among OSRTC-eligible expenses. Although sales of physical media represent a declining portion of the music industry's overall revenue profile, they are still a vital component of revenues. Given the increasing reliance upon revenues associated with live performances and touring, namely the revenues derived from merchandise sales, the cost of manufacturing has been more critical to the viability of emerging artists. Furthermore, the inclusion of manufacturing and distribution expenses would align the OSRTC with Quebec's CIPES.

**Rights-tracking** is an emerging expenditure item for artists and labels, and is something that deserves consideration for inclusion among OSRTC-eligible expenses. Although sound recording companies may be unable to separate rights by project, they could outsource rights tracking to a service agency, which could be charged back on a rights basis or reasonably amortized by project.

**Social media** is an emerging expenditure item that is not currently defined in the OSRTC guidelines. While this expense is not currently listed as either eligible or ineligible, OSRTC users might stand to benefit from the inclusion of a definition of and guidelines for social media costs. Based on survey and interview data, some companies claim social media costs as a general OSRTC-eligible marketing expense. However, other companies do not claim social media costs because they believe they are ineligible or because the guidelines are not clear.

Expanding eligible expenses to include touring, manufacturing and distribution, rights-tracking and social media will support businesses' investment in the practices that will obtain the most benefit. However, the disadvantage of this option is that new expense categories add more complexity to compliance, definition, and tracking activities associated with OSRTC administration.

*4. Provide some form of collateral or guarantee on OSRTC, to facilitate cash flow financing*

Providing a form of collateral or guarantee on OSRTC tax credits can alleviate some of the crippling pressures of very long receivables that become idle capital on sound recording companies' balance sheets. The cash-flow financing of tax credits would help sound recording companies deploy some of this capital to artist development or marketing. More cash flow financing is a desirable objective, across the board, for Ontario's greater creative sector, so there may be across-the-board solutions. For example, the Province could offer loan guarantees so that the commercial banking sector can deliver cash within a timeframe that corresponds to the expenditure cycle.

*5. Provide advances on tax credits to established companies*

The provision of an advance on OSRTC claims to recipients would help companies improve cash flow and enable the tax credit returns to be directly reinvested in artist development. If commercial financial institutions are not prepared to underwrite guaranteed tax credits, where the business volumes are low, an alternative option would be for OMDC to advance some portion of the OSRTC claim to recipients before CRA completes its review of the file. This option is another potential across-the-board financing solution for Ontario's creative sector. Again, the music industry could act as a test case, so that the Province could identify and resolve the administrative issues associated with advances on tax credits. Issues that would require resolution include risk management regarding possible label bankruptcies before a proper filing, or the reclaiming funds that were advanced for expenses that are ultimately deemed ineligible.

*6. Reduce any real or perceived administrative burdens with the OSRTC application process*

Three-quarters of OSRTC non-users reported that their primary reason for non-use of the OSRTC was due to the real or perceived administrative burden associated with it. Users and non-users both reported that the OSRTC application form used by OMDC and CRA was much more complicated than the application form for FACTOR, as an example.

It is suggested that OMDC, the Ministry of Finance and stakeholders work together to address the real or perceived administrative barriers relating to the tax credit application process.

## 7.2 Economic impact of changes to OSRTC

In this sub-section we model the economic impact of one of the proposed options for changing the OSRTC: an increase in the OSRTC rate of 10 to 20 percentage points. We describe in detail how we model the impact of a ten percentage point increase, and then summarize the results of our modelling of 15 and 20 percentage point increases.

If the OSRTC rate was increased from 20% to 30%, tax credit payments would increase by at least 50% from $1.5 million per annum to $2.25 million per annum. The value of the increase would be $750,000. If we assume that sound recording companies channel two-thirds of this new money, $500,000, into marketing and promotion, then the observed relationship between marketing expenditures and revenues can be used to derive the economic impact (see Section 6.4).

According to the statistical relationship presented in Figure 34, music labels' revenues increase by a ratio of 2:1 with each dollar of marketing. Therefore, music labels' revenues should increase by $1 million, if they were to increase their marketing expenditures by $500,000. Given that music labels' revenues comprise approximately 50% of the total retail value of OSRTC-supported sound recording productions, this increase in music labels' revenues entails that overall retail sales would go up by $2 million. Live performance revenues could also be expected to rise by $1.5 million ($2 million × 75%), as a function of the 0.75:1.00 relationship between live performance revenues and retail sales.

**Table 27 Impact of a ten percentage point increase in OSRTC rate on revenues in the music value chain**

| | Base case impact | Incremental impact of tax credit change | Incremental impact in Ontario |
|---|---|---|---|
| Sound recording production and marketing | $4.2M | $0.8M | $0.8M |
| Retail sales | $3.3M | $1.2M† | $0.8M |
| Live performance | $4.2M | $1.5M | $0.8M |
| **Total** | $11.7M | **$3.5M** | **$2.4M** |

Source: Nordicity estimates.

† Equal to total increase in sales of $2 million less value of increase in tax credit monies of $750,000.

The $2.4 million incremental revenue increase as a result of a 10% increase in the OSRTC rate would translate into an increase in GDP of $2.2 million and an increase of $1.7 million in wages (Table 28). The ten percentage point OSRTC subsidy rate increase would also generate 52 new jobs in the Ontario economy.

**Table 28 Incremental economic impact of a ten percentage point increase in OSRTC rate**

| Value chain segment | Revenues | | Direct economic impact | Spin-off economic impact (indirect + induced) | Total economic impact |
|---|---|---|---|---|---|
| **Incremental impact** | 2.4M | ➡ | **GDP:** $1.2M<br>**Wages:** $1.2M<br>**Jobs:**36 | **GDP:** $1.0M<br>**Wages:** $0.5M<br>**Jobs:**15 | **GDP:** $2.2M<br>**Wages:** $1.7M<br>**Jobs:**52 |

Source: Nordicity analysis based on data from Statistics Canada and Conference Board of Canada.

Given that value chain revenues would increase by $2.4 million, or 21%, we estimate that the Province's revenues should also increase by 20%, from $1.9 million to $2.3 million. This $400,000 increase in provincial tax revenue is approximately one-half of the increase in OSRTC outlays of $750,000, which would suggest that the increase in the tax credit rate would be accompanied by a fiscal shortfall. However, our calculations indicate that even with the 10 percentage point increase, the Province will still generate an annual surplus of $55,400 from its investment in the Ontario music industry.

**Table 29 Cost-benefit analysis of a ten percentage point increase in OSRTC rate (30% rate)**

| Item | Amount |
|---|---|
| Government revenues before increase in tax credit rate | $1,905,400 |
| Increase in government revenue | $400,000 |
| Government revenues after 10 point increase in tax credit rate | $2,305,400 |
| Total OSRTC outlays after 10 point increase in tax credit rate | $2,250,000 |
| **Net fiscal benefit/(cost)** | **$55,400** |

Source: Nordicity estimates.

We can apply a similar, very conservative modelling approach to estimate the fiscal cost-benefit of 15 and 20 percentage point increases in the OSRTC rate. A 15 percentage point increase would bring the OSRTC rate to 35% and in line with the Ontario Film and Television Tax Credit. We estimate that a 15 percentage point increase in the OSRTC would increase sound recording sales by $1.5 million (Table 30). Total industry revenues would thus increase to $15.3 million. This level of industry revenues would yield $14.1 million in GDP and $10.8 million in wages in Ontario. It would also generate a total of 329 FTEs within the Ontario economy. This economic activity would generate an estimated $2,504,800 in provincial government revenues, which would offset the Province's tax credit payments of $2,625,000, and yield a net cost of only $120,200 for the Province.

A 20 percentage point increase in the OSRTC rate would bring it to 40%.. We estimate that a 20 percentage point increase would increase sound recording sales by $2.0 million (Table 30). Total industry revenues would thus increase to $16.5 million and yield $15.2 million in GDP, $11.6 million in wages and 355 FTEs within the Ontario economy. The economic activity associated with a 40% tax credit would generate an estimated $2,704,600 in provincial government revenues and offset part of the Province's tax credit payments of $3,000,000, yielding a net cost of $295,400 for the Province.

The results of the modelling of increases in the OSRTC rate show that while the net benefit to the Province does narrow at a 30% rate and turns slightly negative at 35% , it is virtually breakeven from the Province's perspective. It is only at a 40% rate that the Province's net cost increases to a point where it is equivalent to approximately 10% of its annual OSRTC payments.

**Table 30 Cost-benefit analysis of OSRTC tax credit rates (all amounts in dollars except jobs)**

| | **35% tax credit rate** | **40% tax credit rate** |
|---|---|---|
| Tax credit payment | $2,625,000 | $3,000,000 |
| Increase in marketing | 750,000 | 1,000,000 |
| Increase in sales | 1,500,000 | 2,000,000 |
| **Music industry revenues in Ontario** | | |
| Sound recording production and marketing | 5.4M | $5.8M |
| Retail sales | 4.5M | $4.9M |
| Live performance | 5.4M | $5.8M |
| Total revenues | 15.3M | $16.5M |
| GDP | 14.1M | $15.2M |
| Wages | 10.8M | $11.6M |
| Jobs | 329 | 355 |
| Government revenues | $2,504,800 | $2,704,600 |
| Total OSRTC outlays | $2,625,000 | $3,000,000 |
| **Net fiscal benefit/(cost)** | **($120,200)** | **($295,400)** |

Source: Nordicity estimates.

# 8. Summary of Key Findings and Policy Options

## 8.1 Competitive position of Ontario's music industry

Despite the pressures brought on by digital technologies, the music industry remains an important part of the Canadian economy and, in particular, Ontario's economy. As the location for the global majors' Canadian operations, and home to Canada's premier cluster of indie labels, Ontario accounted for 81% of Canada's total sound recording revenues in 2008 (the most recent year of published statistics).

Digital distribution of recorded music – to computers and mobile devices – is growing. As recently as 2005, digital distribution accounted for only 6% of global end-user spending on recorded music. By 2009, it comprised 31% of global sales, and is expected to surpass physical distribution as early as 2012.[34] However, digital revenues will not compensate for the overall declines in recorded music revenues. In Canada, sales of sound recordings dropped from $765 million in 2005 to $619 million in 2008, despite growing digital revenues. To compensate for falling revenues for recorded music, music labels are turning to other revenue sources; music publishing (i.e., the licensing of music for use in other media), live performances and merchandising (which typically takes place at live performance venues) are becoming more central to music industry business models.

Ontario's indie labels are adapting their business models and pursuing these new revenue streams as vigorously as their international counterparts. However, their corporate development is not free of complication. Cash flow pressures and the challenge of growing international sales remain the two most prominent top-of-mind issues for Ontario's indie labels.

Without a rolling portfolio of projects, Ontario's indie labels can easily experience cash flow shortages. Unfortunately, the OSRTC process can often exacerbate such cash flow pressures, as the tax credit receipt can develop into a two-year receivable. Improved cash flow can have a real impact on music companies' competitive position and financial performance. Delays in signing an artist could cause Ontario's indie labels to lose the artist to an out-of-province indie label or a global major. This outcome means that the economic benefits associated with that artist are lost to the Ontario music labels and the provincial economy. As little as an additional $20,000 can often mean the difference between the signing and not signing an artist by an indie label.

Out-of-province (international) marketing is essential for the development of an emerging artist and their audience base. An unexpected advantage of international marketing channels is the reach to both domestic and international markets. For example, Internet marketing is usually U.S.-based, and therefore reaches both American and Canadian consumers. The market dominance of U.S. and international media, such as television, magazines and web sites (e.g., MTV, NME and Pitchfork), often requires that these marketing channels be exploited simply to reach audiences within Canada. As such, Ontario-originated advertisements are often less effective than those from U.S. or international media. This issue is two-sided: resulting in increased marketing costs for Canadian businesses, and extending the market-reach to the much larger and more lucrative U.S. and international markets.

## 8.2 Economic rationale for the OSRTC

The economic rationale for the Province's financial support of the music industry, and the OSRTC in particular, is warranted primarily by the industry's economic importance. The music industry is not only important in terms of the economic activity it generates in and of itself, but also because of the vital role it plays in Ontario's world-class entertainment and creative cluster. However, the case for government intervention is further warranted by two types of market failure that beset Ontario's music industry.

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[34] PwC, *Global Entertainment and Media Outlook 2008-2012*, June 2008, p. 304.

The importance of music industry's role in the Ontario economy has already been established. Sound recording and music publishing in Ontario generated $499 million in revenues in 2008, or 80 cents of every dollar of music-industry revenues in Canada. Together, indie labels and the global majors employed an estimated 1,900 Ontarians in a wide range of technical, creative, managerial and administrative professions. But the broader economic importance of the music industry is not limited to sound recording and music publishing. Using international as a reliable indication, the broader music industry in Ontario – which includes radio broadcasting, live performance, merchandising, physical-media manufacturing and instrument sales – could in fact be closer to $2.0 billion in revenues[35] and employ well over 5,000 Ontarians.

Ontario's music industry not only contributes revenues, wages and jobs to the Ontario economy, but also bolsters the province's vibrant entertainment and creative cluster. Indeed, within the entertainment and creative cluster, the music industry is perhaps the most interrelated and commercially collaborative. Music is a product unto itself, but it is also an integral element of film and television programming. Moreover, it is increasingly seen as an active component of interactive digital media (e.g., in electronic games) and as part of the growing use of video on the Internet.

The characteristics of the music industry are such that a relatively small country such as Canada – or smaller jurisdiction such as Ontario – faces a significant risk of oligopoly and not having a vibrant enough ecosystem of music labels. The high level of risk, uncertainty of demand and the need to move quickly in response to audiences' ever-changing tastes lends advantage to companies that possess economies of scale and scope and that are vertically integrated. Canadian music labels are not able to achieve the required levels of size and vertical integration. Government intervention can remedy this disadvantage, ensuring that an ecosystem of music labels and supporting companies can continue to play a key role in Ontario's entertainment and creative cluster.

Sound recording production is, in essence, the R&D of the music industry, particularly concerning emerging artists. Indeed, the development of emerging artists shares many of the characteristics of scientific R&D and is consequently subject to significant economic spillovers. However, independent labels risk losing out on most of the economic returns from developing emerging artists, which are more easily captured by distributors and major labels. This situation can also lead to a market failure that calls for intervention.

## 8.3 OSRTC activity

Program statistics show that use of the OSRTC has been relatively consistent over the last four years. With the exception of 2008-09, the tax credit has typically supplied around $1.5 million in annual financial assistance to roughly 100 projects with total expenditures reaching a value of $8 million. Participation among Ontario music labels has also been relatively consistent – with the exception of 2008-09. Approximately one-quarter of Ontario's 64 music labels use the OSRTC. For those three-quarters that do not use the OSRTC, most report that the legal and administrative burden associated with the tax credit was the primary reason they did not seek assistance from it.

Program statistics as well as the results of the survey show that marketing – and out-of-province marketing, in particular – is growing in importance. The share of OSRTC expenditures comprised by marketing activities rose from 47% to 59% between 2006-07 and 2009-10. This is not surprising since 69% of survey respondents reported that they use their tax credit to increase their marketing.

The number of projects with out-of-province marketing expenditures jumped to 43% in 2009-10 from 11% in 2006-07 (see Figure 20 in Section 4.4). Interviewees commented that the OSRTC guidelines

[35] Ontario Music Industry Council, *The Music Industry in Ontario*, August 2009, p. 4.

regarding out-of-province marketing do not have a strong influence on their marketing decisions. Music labels are seeking to maximize the value of the product they create. This often requires labels to hire foreign public-relations and radio-relations professionals to help them promote their sound recordings internationally.

## 8.4 Key performance indicators

The success of the OSRTC was evaluated in terms of the impact it has on the long-term development of Ontario's sound recording industry. The OSRTC leads directly to the creation and marketing of new sound recordings, and thereby, generates impacts on the Ontario economy when the production and marketing budgets are spent in Ontario. However, for the OSRTC to have a positive impact on the sound recording industry in the long-run, it must affect sound recording companies' ability to grow their revenues, diversify their revenues away from slow-growth segments, lead to more artist signings and foster greater exports.

On this basis, we used a quartiles analysis to assess the impact that OSRTC use intensity has had on six KPIs:

- Revenue growth;
- Digital revenues (share of revenues from digital-platform sales);
- Revenue diversification (share of revenues from sources alternative to physical and digital sales);
- International revenues (share of sound recording revenues from outside of Canada);
- Rate of artist signings (annual number of new artists signed); and,
- International promotion (number of international touring dates).

More intensive users of the OSRTC had higher rates of revenue growth, a larger share of revenues from digital platforms and better revenue diversification across lines of business. With respect to the input KPIs, more intensive use of the OSRTC was also associated with higher rates of artist signings and higher rates of international touring. However, despite this higher rate of international touring, there was no positive relationship between OSRTC use intensity and international revenues (share of total revenues from outside of Canada).

The absence of a correlation between OSRTC use intensity and international sales may be related to out-of-province marketing and promotion expenditures being discounted by 50% in the OSRTC guidelines. While Ontario sound recording companies can reach a large share of Canadian audiences through Ontario-based marketing campaigns, they require out-of-country marketing support and extensive touring to reach international audiences. With a tax credit design that excludes tour costs and may discourage out-of-country marketing, Ontario sound recording companies may not have the resources or incentives to build international audiences.

## 8.5 Economic impact of the OSRTC

The economic impact of the OSRTC reaches well beyond the production and marketing expenditures it supports. The OSRTC stimulates the creation and release of sound recordings that generate retail sales and live performance revenues for artists, venues and promoters. Tracing the effect of the OSRTC through the whole music value chain reveals that $1.5 million in financial support from the OSRTC-generates global revenues of $29.7 million.

Of this $29.7 million, $20.7 million, or 70% is captured by Ontario residents (artists and other workers) and businesses. In the long-term, this $20.7 million is supplemented by an additional $2.0 million in value chain revenues, which can be attributed to emerging artists who eventually breakout and achieve gold record status. Without the benefit of the OSRTC, these successful artists may not have been discovered and subsequently signed to produce a break-out production.

Taking into account both the immediate and the potential long-term impact of the OSRTC, we find that it leads to a $21.6 million increase in Ontario's GDP (on an annual basis), $16.5 million in additional wage income for Ontario and the creation of 503 new jobs in the Ontario economy.

Our research indicates that the rate of incrementality is 33%. In other words, one-third of OSRTC-supported projects would not proceed without OSRTC financial support. Furthermore, our analysis indicates that the tax credit helps companies expand their marketing expenditures and sales. We found that each dollar of marketing expenditure leads to two more dollars of music label revenue. This marketing effect suggests that the incrementality rate should in fact be higher, justifying an incrementality of 50%. On the basis of a 50% incrementality rate, the OSRTC assistance of $1.5 million led to a GDP of $10.8 million, wages of $8.2 million and 251 new jobs in the Ontario economy on an annual basis.

The Ontario government collected $1.27 in revenues for every dollar it invested in the music industry through the OSRTC. As such, there appears to be room to increase the tax credit and maintain a fiscal breakeven position for the Province, regardless of the existence of any knock-on effect from a tax credit rate increase.

## 8.6 Policy options

Through our research (interviews, survey, background research), we identified six potential options for changes to the tax credit, which have the potential to improve its effectiveness. These six options include:

1. Increase the tax credit rate so that it corresponds with the tax credit rates for the other creative sectors.
2. Increase the eligibility of international marketing expenditures to match domestic expenditures (i.e., 100% eligible).
3. Include other specific costs as eligible expenditures, e.g. touring, manufacturing, and rights tracking.
4. Provide some form of collateral or guarantee on OSRTC, to facilitate cash flow financing.
5. Provide advances on tax credits to established companies.
6. Reduce any real or perceived administrative burdens with the OSRTC application process.

While the scope of this study did not call for an assessment of policy options, we conducted an analysis of the economic and fiscal impact of Option#1, an increase in the OSRTC rate. In particular, we modelled the impact of increasing the OSRTC rate to 30%, 35% or 40%, so that it would be in line with the tax credit rates for the other creative sectors.

The results of this conservative analysis indicate that if music labels channel two-thirds of the additional monies available as a result of a ten-point rate increase to marketing and promotion activities, their revenues could increase by $1 million (Table 31). At the same time, overall retail revenues could increase by $2 million and live performance revenues could rise by $1.5 million.

As revenues increase through the value chain – and in particular the Ontario value chain – Ontario's GDP would increase by $2.2 million, Ontario residents' wages would rise by $1.7 million, and 52 new jobs would be generated in the Ontario economy.

While the cost to the Province of this rate increase would be $750,000, our analysis indicates that a large share of this cost would be offset by $400,000 in incremental tax revenue for the provincial government. What is more, the Province's overall fiscal position with respect to the OSRTC would remain positive at $55,400; total costs of $2,250,000 would be offset by incremental revenues of $2,305,400.

Similar modelling for 15 and 20 percentage increases indicate that as the OSRTC rate rises above 30%, the net fiscal benefit to the Province narrows and turns slightly negative. An OSRTC rate of 35% would generate an estimated net cost of $120,200 for the Province. At an OSRTC rate of 40%, we estimate that the net fiscal cost to the Province would be $295,400.

**Table 31 Summary of cost-benefit analysis of OSRTC rates (all amounts in dollars except jobs)**

| | **Status quo 20%** | **30% tax credit rate** | **35% tax credit rate** | **40% tax credit rate** |
|---|---|---|---|---|
| Tax credit payment | $1,500,000 | $2,250,000 | $2,625,000 | $3,000,000 |
| Increase in marketing | -- | $500,000 | 750,000 | 1,000,000 |
| Increase in sales | -- | $1,000,000 | 1,500,000 | 2,000,000 |
| **Music industry revenues in Ontario** | | | | |
| Sound recording production and marketing | 4.2M | 5.0M | 5.4M | $5.8M |
| Retail sales | 3.3M | 4.1M | 4.5M | $4.9M |
| Live performance | 4.2M | 5.0M | 5.4M | $5.8M |
| Total revenues | 11.7M | 14.1M | 15.3M | $16.5M |
| GDP | 10.8M | 13.0M | 14.1M | $15.2M |
| Wages | 8.2M | 9.9M | 10.8M | $11.6M |
| Jobs (FTEs) | 251 | 303 | 329 | 355 |
| Government revenues | 1,905,400 | 2,305,000 | $2,504,800 | $2,704,600 |
| Total OSRTC outlays | 1,500,000 | 2,250,000 | $2,625,000 | $3,000,000 |
| **Net fiscal benefit/(cost)** | **$405,400** | **$55,400** | **($120,200)** | **($295,400)** |

Source: Nordicity estimates.

The results of the modelling of increases in the OSRTC rate show that while the net benefit to the Province does narrow at a 30% rate and turns slightly negative at 35% , it is arguably breakeven from the Province's perspective. It is only at a 40% rate that the Province's net cost increases to a point where it is equivalent to approximately 10% of its annual OSRTC payments.

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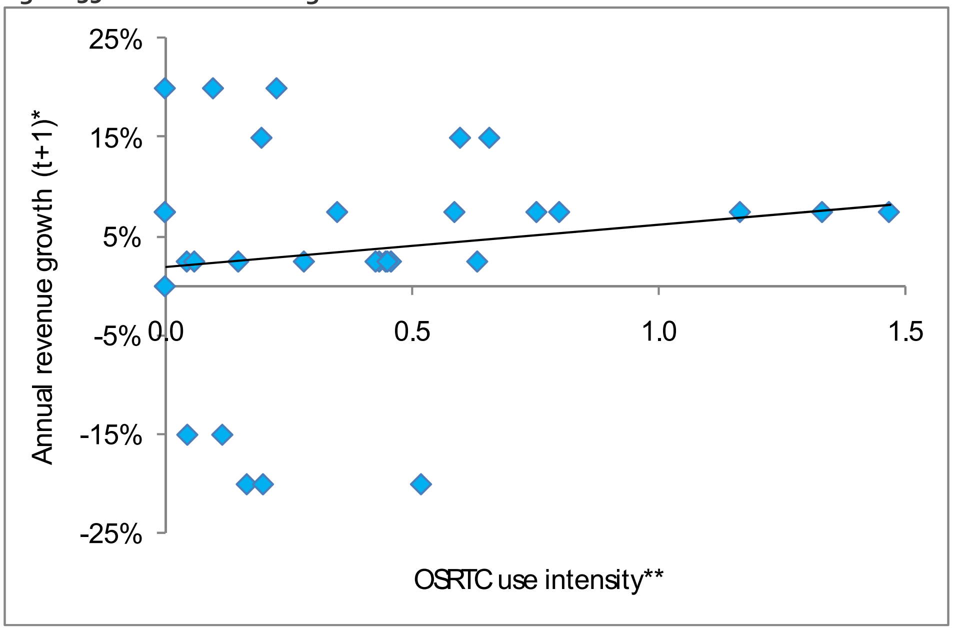
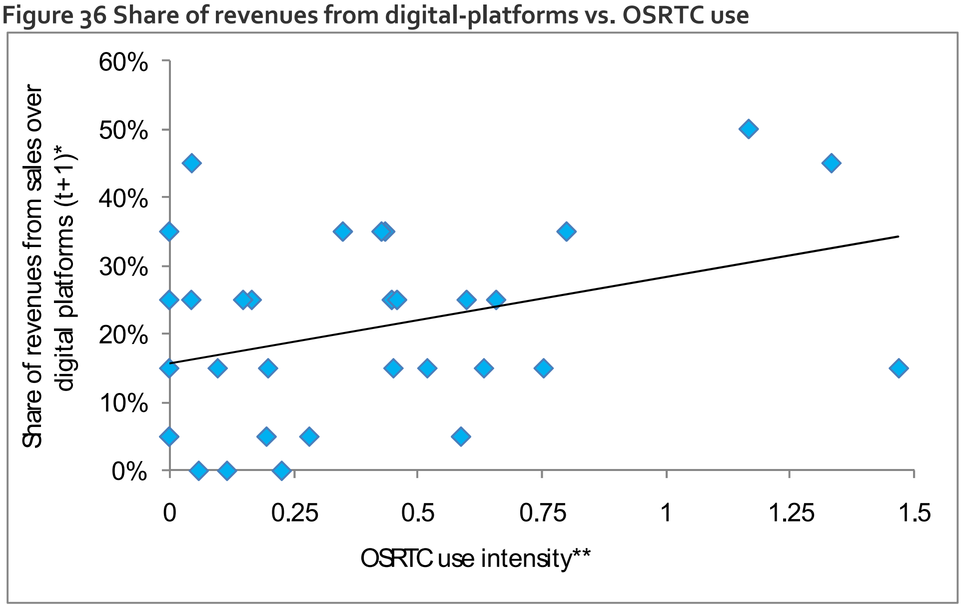
## Appendix A: Additional data analysis

**Figure 35 Annual revenues growth vs. OSRTC use**



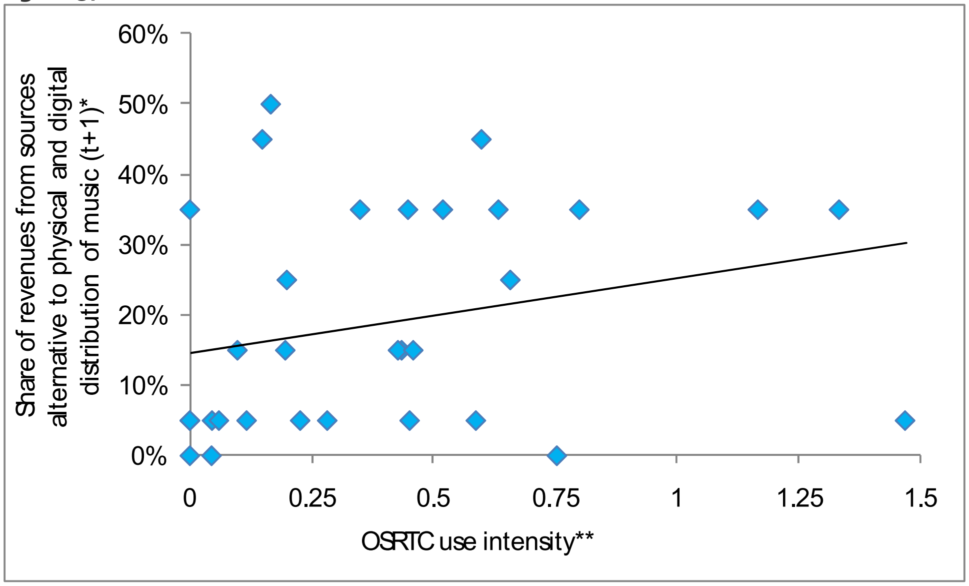

Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32
* (t+1) measured one period after the measurement of OSRTC use intensity
** OSRTC use intensity = OSRTC-supported expenditures$_t$ / Estimated revenues$_t$

**Figure 36 Share of revenues from digital-platforms vs. OSRTC use**



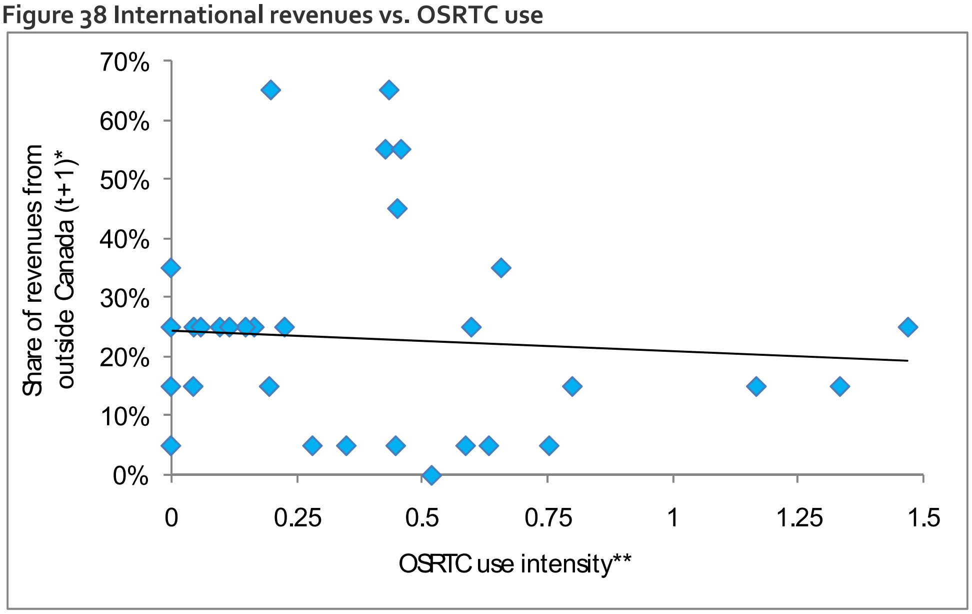

Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32
* (t+1) measured one period after the measurement of OSRTC use intensity
** OSRTC use intensity = OSRTC-supported expenditures$_t$ / Estimated revenues$_t$

**Figure 37 Rate of revenue diversification vs. OSRTC use**



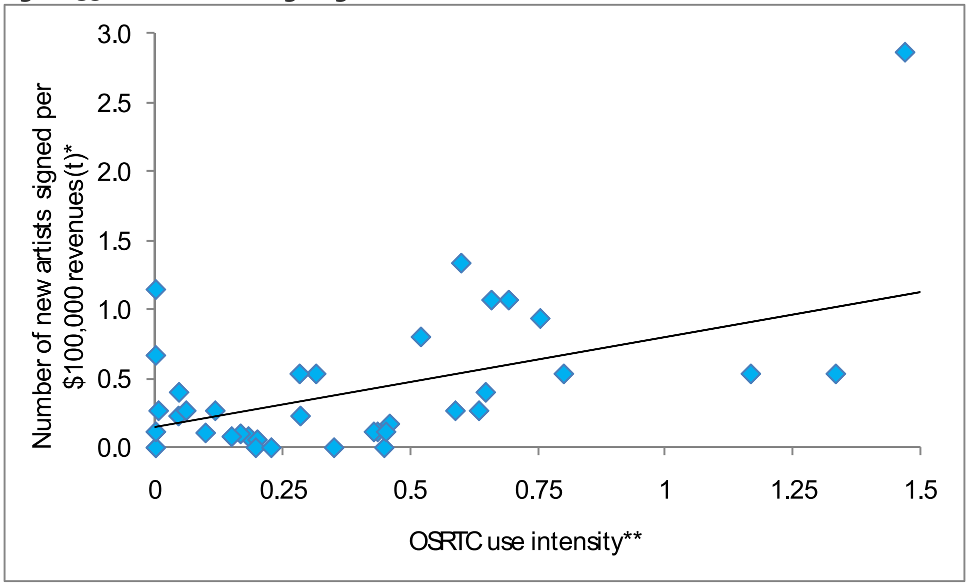

Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32
* (t+1) measured one period after the measurement of OSRTC use intensity
** OSRTC use intensity = OSRTC-supported expenditures$_t$ / Estimated revenues$_t$

**Figure 38 International revenues vs. OSRTC use**



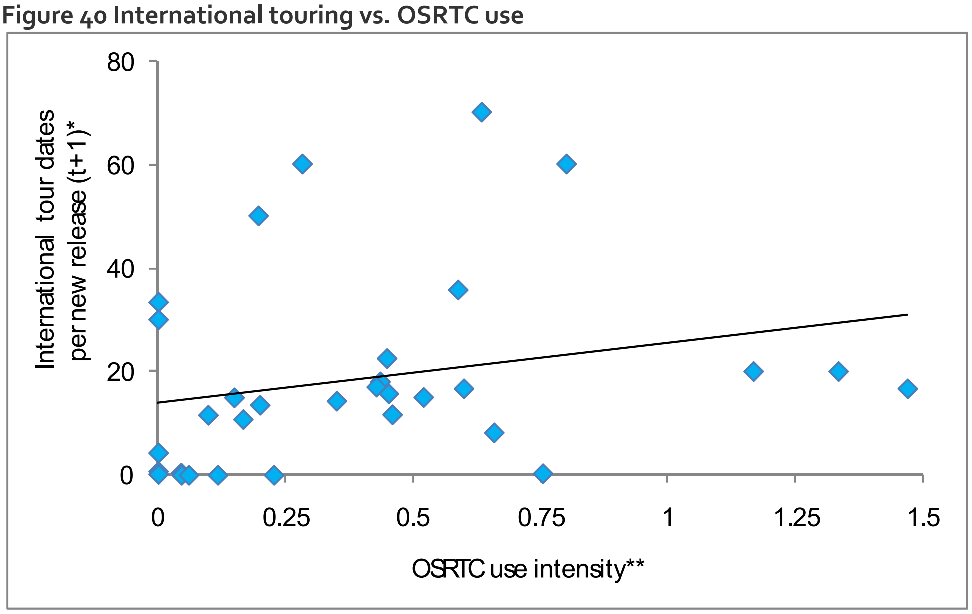

Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32
* (t+1) measured one period after the measurement of OSRTC use intensity
** OSRTC use intensity = OSRTC-supported expenditures$_t$ / Estimated revenues$_t$

**Figure 39 Rate of artist signings vs. OSRTC use**




Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=40
* (t+1) measured one period after the measurement of OSRTC use intensity
** OSRTC use intensity = OSRTC-supported expenditures$_t$ / Estimated revenues$_t$

**Figure 40 International touring vs. OSRTC use**




Source: Nordicity survey of Ontario sound recording companies, November 2010.
n=32
* (t+1) measured one period after the measurement of OSRTC use intensity
** OSRTC use intensity = OSRTC-supported expenditures$_t$ / Estimated revenues$_t$

## Appendix B: Survey Questionnaire

**OSRTC Impact Analysis**
**Online Survey Questionnaire**
**Draft**

**Introduction**

The Canadian Independent Music Association (CIMA) is committed to promoting the Canadian music industry and ensuring that federal and provincial governments have the up-to-date analyses of the impact of industry support programs. CIMA is currently preparing an analysis of the impact of the Ontario Sound Recording Tax Credit (OSRTC) and the overall economic importance of the music industry in Ontario and requires your assistance.

As part of the preparation of this impact analysis, CIMA has engaged Nordicity to assist in the execution of this online survey. The data and information you provide through this survey is vital to CIMA's efforts to present the Ontario government with a rigorous and compelling demonstration of the positive impact that the OSRTC has had on the music industry. This analysis will help CIMA advocate for a modernization of the OSRTC, including a rate increase and guideline changes to include 100% of out-of-province marketing expenditures.

All of the company-specific data that you submit through this online survey will be kept confidential. Survey data will only be published in aggregate form.

In order to accurately complete the survey, you may need to consult with your chief financial officer, comptroller, accountant, or equivalent financial officer within your company. Accuracy of the data is extremely important for the CIMA's ability to lobby effectively on its members' behalf.

If you have any questions about this survey, you may contact: Kristian Roberts, Nordicity Group Ltd., 416-657-2521, Kroberts@nordicity.com.

## A. Company information

A1. Please provide your contact information, in case we need to contact you to validate your responses to this survey.

Company name: ______________________________

Contact person: ______________________________

Email: ______________________________________

Telephone____________________________________

A2. Please indicate the year in which your company started operating in the music industry.

_________

A3. Has your company produced a sound recording that was eligible to receive the OSRTC within the last five (5) years

____ Yes
____ No (Skip to End of Survey)

A4. Please indicate your company's music industry lines of business (mark all that apply).

☐ Music publisher
☐ Music label
☐ Music producer
☐ Artist manager
☐ Artist agent
☐ Artist promoter

A5. Please indicate your company's primary line of business within the music industry (select one).

○ Music publisher
○ Music label
○ Music producer
○ Artist manager
○ Artist agent
○ Artist promoter

A6. Please indicate the total annual music industry revenues earned by your company for the following years.

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| $0 / no operation | ○ | ○ | ○ | ○ | ○ |
| Less than $100,000 | ○ | ○ | ○ | ○ | ○ |
| $100,000 to $249,999 | ○ | ○ | ○ | ○ | ○ |
| $250,000 to $499,999 | ○ | ○ | ○ | ○ | ○ |
| $500,000 to $999,999 | ○ | ○ | ○ | ○ | ○ |
| $1 M to $2.49 M | ○ | ○ | ○ | ○ | ○ |
| $2.5 M to $5.0 M | ○ | ○ | ○ | ○ | ○ |
| Over $5.0 M | ○ | ○ | ○ | ○ | ○ |

## B. OSRTC activity

B1. Please indicate the years in which your company obtained financial support from the OSRTC and the associated value of this support.

| | No | Yes | Number of OSRTC-supported projects | Total value of OSRTC financial support ($) | Sum of OSRTC-eligible project costs ($) |
|---|---|---|---|---|---|
| 2009 | ○ | ○ | _____ | _____ | _____ |
| 2008 | ○ | ○ | _____ | _____ | _____ |
| 2007 | ○ | ○ | _____ | _____ | _____ |
| 2006 | ○ | ○ | _____ | _____ | _____ |
| 2005 | ○ | ○ | _____ | _____ | _____ |

B2. Please **estimate** the percentage of the total sum of your company's OSRTC-eligible project costs in the following expenditure categories.

| | Sound recording production | Music video production | Marketing within Ontario | Marketing elsewhere in Canada | Marketing outside of Canada | Total |
|---|---|---|---|---|---|---|
| 2009 | _____% | _____% | _____% | _____% | _____% | 100% |
| 2008 | _____% | _____% | _____% | _____% | _____% | 100% |
| 2007 | _____% | _____% | _____% | _____% | _____% | 100% |
| 2006 | _____% | _____% | _____% | _____% | _____% | 100% |
| 2005 | _____% | _____% | _____% | _____% | _____% | 100% |

## C. OSRTC impact

C1. Please estimate the revenues earned by your company from the production of OSRTC-supported sound recording projects.

| | Sound recording revenues | Other revenues |
|---|---|---|
| 2009 | $_____,000 | $_____,000 |
| 2008 | $_____,000 | $_____,000 |
| 2007 | $_____,000 | $_____,000 |
| 2006 | $_____,000 | $_____,000 |
| 2005 | $_____,000 | $_____,000 |

C2. For each year in the table below, please estimate the percentage of sound recording projects (supported by the OSRTC) that would have been produced if the OSRTC did not exist (i.e. the percentage of projects that were not contingent on OSRTC financing).

| | |
|---|---|
| 2009 | _____% |
| 2008 | _____% |
| 2007 | _____% |
| 2006 | _____% |
| 2005 | _____% |

## D. Reasons for OSRTC non-use

D1. In the last 5 years, has your company produced any sound recordings that were eligible to receive the OSRTC for which you did **not** claim the tax credit?

____ Yes
____ No (Skip to Section E)

D2. In the instances that your company did not apply for the OSRTC, please rank each of following reasons in terms of its importance to your company's decision **not** to apply

| | 1 (most important) | 2 | 3 | 4 | 5 | 6 (least important) | 0 (Not applicable) |
|---|---|---|---|---|---|---|---|
| No emerging Canadian artists eligible for OSRTC | ○ | ○ | ○ | ○ | ○ | ○ | ○ |
| The absence of any advance ruling / interim financing | ○ | ○ | ○ | ○ | ○ | ○ | ○ |
| The receipt of the OSRTC was too far in the future | ○ | ○ | ○ | ○ | ○ | ○ | ○ |
| Legal and administrative costs of applying for OSRTC too high compared to potential benefit | ○ | ○ | ○ | ○ | ○ | ○ | ○ |
| Potential rate of rebate from OSRTC too small | ○ | ○ | ○ | ○ | ○ | ○ | ○ |
| Unaware of OSRTC | ○ | ○ | ○ | ○ | ○ | ○ | ○ |

## E. Impact on artist signing sound recording releases

E1. For each of the last five years, please indicate the total number of new Canadian artists signed by your company.

New artists refer to artists newly under the management of your company and not necessarily new to the music industry.

| | All new artists | New artists eligible for project support from OSRTC |
|---|---|---|
| 2009 | _____ | _____ |
| 2008 | _____ | _____ |
| 2007 | _____ | _____ |
| 2006 | _____ | _____ |
| 2005 | _____ | _____ |

E2. For each of the last five years, please estimate the percentage of all OSRTC-supported artists (i.e. "emerging artists) that your company has signed, developed, produced, and/or promoted that would still have been on your roster without the OSRTC.

| | |
|---|---|
| 2009 | _____% |
| 2008 | _____% |
| 2007 | _____% |
| 2006 | _____% |
| 2005 | _____% |

E3. For each year, please indicate the total number of new sound recordings released by your company, which featured Canadian artists.

| | All releases | OSRTC-supported releases |
|---|---|---|
| 2009 | _____ | _____ |
| 2008 | _____ | _____ |
| 2007 | _____ | _____ |
| 2006 | _____ | _____ |
| 2005 | _____ | _____ |

## F. Revenue and international sales impact

F1. Please estimate the average annual growth rate in your company's total operating revenue from music-related businesses during the following years.

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| Decrease of 20.0% or more | ○ | ○ | ○ | ○ | ○ |
| Decrease 10.0% to 19.9% | ○ | ○ | ○ | ○ | ○ |
| Decrease 5.0% to9.9% | ○ | ○ | ○ | ○ | ○ |
| Decrease 0.1% to 4.9% | ○ | ○ | ○ | ○ | ○ |
| No change | ○ | ○ | ○ | ○ | ○ |
| Increase 0.1% to4.9% | ○ | ○ | ○ | ○ | ○ |
| Increase 5.0% to 9.9% | ○ | ○ | ○ | ○ | ○ |
| Increase 10.0% to19.9% | ○ | ○ | ○ | ○ | ○ |
| Increase of 20.0% or more | ○ | ○ | ○ | ○ | ○ |
| Not applicable | ○ | ○ | ○ | ○ | ○ |

F2. Please indicate the portion of your total music-related revenues earned outside of Canada.

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| 0% | ○ | ○ | ○ | ○ | ○ |
| 0.1% to 9.9% | ○ | ○ | ○ | ○ | ○ |
| 10.0% to 19.9% | ○ | ○ | ○ | ○ | ○ |
| 20.0% to 29.9% | ○ | ○ | ○ | ○ | ○ |
| 30.0% to 39.9% | ○ | ○ | ○ | ○ | ○ |
| 40.0% to 49.9% | ○ | ○ | ○ | ○ | ○ |
| 50.0% to 59.9% | ○ | ○ | ○ | ○ | ○ |
| 60.0% to 69.9% | ○ | ○ | ○ | ○ | ○ |
| 70.0% to 79.9% | ○ | ○ | ○ | ○ | ○ |
| 80.0% to 89.9% | ○ | ○ | ○ | ○ | ○ |
| 90.0 to 99.9% | ○ | ○ | ○ | ○ | ○ |
| 100.0% | ○ | ○ | ○ | ○ | ○ |

F3. Please indicate the portion of your total sound recording revenues that can be attributed to sound recordings produced with support of the OSRTC?

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| 0% | ○ | ○ | ○ | ○ | ○ |
| 0.1% to 9.9% | ○ | ○ | ○ | ○ | ○ |
| 10.0% to 19.9% | ○ | ○ | ○ | ○ | ○ |
| 20.0% to 29.9% | ○ | ○ | ○ | ○ | ○ |
| 30.0% to 39.9% | ○ | ○ | ○ | ○ | ○ |
| 40.0% to 49.9% | ○ | ○ | ○ | ○ | ○ |
| 50.0% to 59.9% | ○ | ○ | ○ | ○ | ○ |
| 60.0% to 69.9% | ○ | ○ | ○ | ○ | ○ |
| 70.0% to 79.9% | ○ | ○ | ○ | ○ | ○ |
| 80.0% to 89.9% | ○ | ○ | ○ | ○ | ○ |
| 90.0 to 99.9% | ○ | ○ | ○ | ○ | ○ |
| 100.0% | ○ | ○ | ○ | ○ | ○ |

F4. What portion of the above amount was earned from outside of Canada?

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| 0% | ○ | ○ | ○ | ○ | ○ |
| 0.1% to 9.9% | ○ | ○ | ○ | ○ | ○ |
| 10.0% to 19.9% | ○ | ○ | ○ | ○ | ○ |
| 20.0% to 29.9% | ○ | ○ | ○ | ○ | ○ |
| 30.0% to 39.9% | ○ | ○ | ○ | ○ | ○ |
| 40.0% to 49.9% | ○ | ○ | ○ | ○ | ○ |
| 50.0% to 59.9% | ○ | ○ | ○ | ○ | ○ |
| 60.0% to 69.9% | ○ | ○ | ○ | ○ | ○ |
| 70.0% to 79.9% | ○ | ○ | ○ | ○ | ○ |
| 80.0% to 89.9% | ○ | ○ | ○ | ○ | ○ |
| 90.0 to 99.9% | ○ | ○ | ○ | ○ | ○ |
| 100.0% | ○ | ○ | ○ | ○ | ○ |

## G. Impact on digital platform sales

G1. Please indicate the percentage of your company's revenues earned from sales of sound recordings over digital platforms (e.g. iTunes).

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| 0% | ○ | ○ | ○ | ○ | ○ |
| 0.1% to 2.49% | ○ | ○ | ○ | ○ | ○ |
| 2.5% to 4.9% | ○ | ○ | ○ | ○ | ○ |
| 5.0% to 7.49% | ○ | ○ | ○ | ○ | ○ |
| 7.5% to 9.9% | ○ | ○ | ○ | ○ | ○ |
| 10.0% to 19.9% | ○ | ○ | ○ | ○ | ○ |
| 20.0% to 29.9% | ○ | ○ | ○ | ○ | ○ |
| 30.0% to 39.9% | ○ | ○ | ○ | ○ | ○ |
| 40.0% to 49.9% | ○ | ○ | ○ | ○ | ○ |
| 50.0% or higher | ○ | ○ | ○ | ○ | ○ |

G2. Please indicate any genre or other rankings that sound recordings produced by your company may have attained on iTunes.

| | All releases | OSRTC-supported releases |
|---|---|---|
| 2009 | _____ | _____ |
| 2008 | _____ | _____ |
| 2007 | _____ | _____ |
| 2006 | _____ | _____ |
| 2005 | _____ | _____ |

## H. Impact on revenue diversification

H1. Please indicate the percentage of your company's operating revenues earned from sources alternative to physical and digital platform music sales – e.g. revenues from live performances, sponsorship, or music royalties.

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| 0% | ○ | ○ | ○ | ○ | ○ |
| 0.1% to 2.49% | ○ | ○ | ○ | ○ | ○ |
| 2.5% to 4.9% | ○ | ○ | ○ | ○ | ○ |
| 5.0% to 7.49% | ○ | ○ | ○ | ○ | ○ |
| 7.5% to 9.9% | ○ | ○ | ○ | ○ | ○ |
| 10.0% to 19.9% | ○ | ○ | ○ | ○ | ○ |
| 20.0% to 29.9% | ○ | ○ | ○ | ○ | ○ |
| 30.0% to 39.9% | ○ | ○ | ○ | ○ | ○ |
| 40.0% to 49.9% | ○ | ○ | ○ | ○ | ○ |
| 50.0% or higher | ○ | ○ | ○ | ○ | ○ |

## I. International tour dates

I1. Please indicate the total annual number of international tour performances outside of Canada of your signed Canadian artists.

| | All artists | Emerging artists eligible for project support from OSRTC |
|---|---|---|
| 2009 | _____ | _____ |
| 2008 | _____ | _____ |
| 2007 | _____ | _____ |
| 2006 | _____ | _____ |
| 2005 | _____ | _____ |

## J. Expenditure of OSRTC

J1. Does your company take into account the likelihood of receiving some amount of OSRTC financial support at a future date when planning its expenditures on the production and promotion of a sound recording by an emerging Canadian artist (eligible OSRTC project)?

Yes _______
No ________

J2. When your company has received an OSTRC tax credit claim in the past, did your company increase any of the following types of expenditures / financial distributions?

| | Yes | No | Not applicable |
|---|---|---|---|
| Employee wages | ○ | ○ | ○ |
| Artist development costs | ○ | ○ | ○ |
| Artist remuneration | ○ | ○ | ○ |
| Purchase/rental of studio equipment/technology/software | ○ | ○ | ○ |
| Purchase/rental of other equipment/technology/software | ○ | ○ | ○ |
| Marketing and promotion | ○ | ○ | ○ |
| Music video production | ○ | ○ | ○ |
| Proprietors'/Shareholders' income | ○ | ○ | ○ |

## K. Companies' perception of OSRTC impact

K1. Please rate the impact of the OSRTC on your company's financial and operating performance.

| | 0 No impact | 1 Minor impact | 2 Medium impact | 3 Strong impact | 5 Very strong impact | 0 Not applicable |
|---|---|---|---|---|---|---|
| Led to higher revenues | ○ | ○ | ○ | ○ | ○ | ○ |
| Led to higher profits / shareholders' income | ○ | ○ | ○ | ○ | ○ | ○ |
| Led to an increase in number of signed emerging artists | ○ | ○ | ○ | ○ | ○ | ○ |
| Improved rate of artist retention | ○ | ○ | ○ | ○ | ○ | ○ |
| Led to increase in marketing and artist promotion expenditures | ○ | ○ | ○ | ○ | ○ | ○ |
| Led to increase in <u>international</u> marketing and artist promotion expenditures | ○ | ○ | ○ | ○ | ○ | ○ |

| | 0<br>No impact | 1<br>Minor impact | 2<br>Medium impact | 3<br>Strong impact | 5<br>Very strong impact | 0<br>Not applicable |
|---|---|---|---|---|---|---|
| Led to higher share of revenue from international sources | ○ | ○ | ○ | ○ | ○ | ○ |
| Led to more international tour dates for signed artists | ○ | ○ | ○ | ○ | ○ | ○ |
| Led to higher revenue from online sources | ○ | ○ | ○ | ○ | ○ | ○ |
| Led to higher revenue from sources other than physical or online sales (e.g., live performance, royalties, sponsorship) | ○ | ○ | ○ | ○ | ○ | ○ |

K2. Please rate the below expenditure categories in terms of their relative impact on your operating cash flow.

| | 0<br>No impact | 1<br>Minor impact | 2<br>Medium impact | 3<br>Strong impact | 5<br>Very strong impact | 0<br>Not applicable |
|---|---|---|---|---|---|---|
| Physical Production Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Digital Production Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Mastering/Audio Production Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Artist Development Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Domestic Marketing and Promotional Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| International Marketing and Promotional Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Transportation Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Licensing and Related Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Office and Administrative Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Wages and Staffing Costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Other material (hard) costs | ○ | ○ | ○ | ○ | ○ | ○ |
| Other (Please Specify) | ○ | ○ | ○ | ○ | ○ | ○ |

End of survey