

Sound Recordings

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Canada

1990-1991

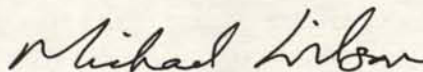
INDUSTRY, SCIENCE AND
TECHNOLOGY CANADA
LIBRARY**SOUND RECORDINGS**

DEC 16 1991

BIBLIOTHÈQUE
INDUSTRIE, SCIENCES ET
TECHNOLOGIE CANADA**FOREWORD**

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to growth and prosperity. Promoting improved performance by Canadian firms in the global marketplace is a central element of the mandates of Industry, Science and Technology Canada and International Trade Canada. This Industry Profile is one of a series of papers in which Industry, Science and Technology Canada assesses, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological, human resource and other critical factors. Industry, Science and Technology Canada and International Trade Canada assess the most recent changes in access to markets, including the implications of the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the profiles.

Ensuring that Canada remains prosperous over the next decade and into the next century is a challenge that affects us all. These profiles are intended to be informative and to serve as a basis for discussion of industrial prospects, strategic directions and the need for new approaches. This 1990-1991 series represents an updating and revision of the series published in 1988-1989. The Government will continue to update the series on a regular basis.



Michael H. Wilson
Minister of Industry, Science and Technology
and Minister for International Trade

Structure and Performance**Structure**

The Canadian sound recording industry comprises companies that produce and manufacture prerecorded discs (singles, LPs/albums and compact discs) and prerecorded audio tapes. Production establishments are generally responsible for engaging artists and selecting compositions, renting recording-studio facilities, arranging for the manufacture of sound recordings and, finally, marketing the artists and their products. The larger production companies are also engaged in the physical distribution of sound recordings. Manufacturing plants press discs and duplicate tapes for production companies. Excluded from this profile are other activities of producers, artists and musicians outside the area of producing sound recordings. Also excluded are the activities of the recording studios themselves as well as of wholesalers

and retailers of sound recordings, although their impact on producers will be reviewed where appropriate.

In 1989, the Canadian industry comprised roughly 200 companies, of which only a few were engaged in manufacturing. It employed about 2 100 people full time, 800 of whom were in manufacturing and 1 300 in production; another 400 people were employed on a part-time basis. In addition, the industry provides significant employment opportunities for free-lancers (primarily musicians hired on a project-by-project basis).

The industry's shipments of all sound recordings totalled roughly \$475 million (at the distributors' net selling price) in 1989. Entertainment sound recordings accounted for about 90 percent of industry shipments in dollar terms. The balance was composed essentially of educational and religious products. English-language sound recordings accounted for about 80 percent of the value of all shipments. With regard to product configuration, tapes accounted for roughly 55 percent of

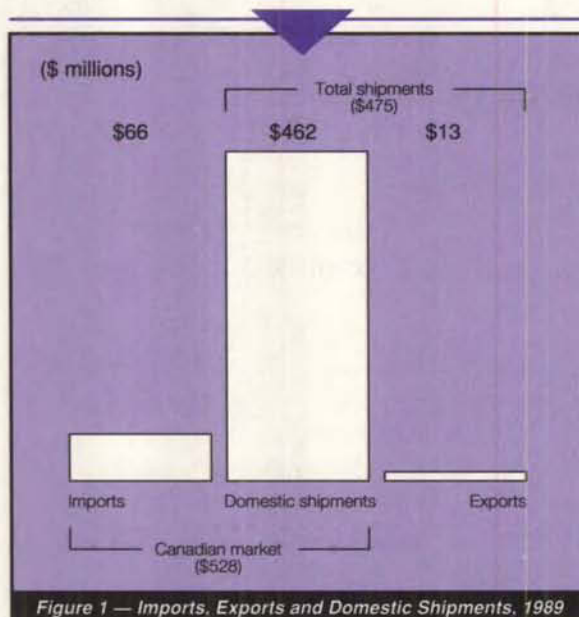


Figure 1 — Imports, Exports and Domestic Shipments, 1989

the value of total shipments, followed by compact discs (about 35 percent), record albums (close to 8 percent) and singles (less than 2 percent).

Only about 15 percent of the sound recordings shipped by the industry in 1989 contained Canadian music. The remaining releases were manufactured in Canada from imported masters (copies of original tapes used in the pressing and duplicating of sound recordings). These imported masters originated primarily from the United States, although the recording artists are from many other countries, most notably the United Kingdom.

Reflecting the combined effects of freight and tariff barriers and the nature of the products, international trade in this field involves either selling sound recordings or licensing masters. Canadian exports of sound recordings reached \$13 million in 1989, while imports into Canada totalled \$66 million (Figure 1). Imports of sound recordings consist mostly of deleted products (goods no longer in popular demand that are sold at substantially reduced prices) and new products for which the demand does not justify local manufacturing from imported masters. In 1988 (the latest year for which reliable estimates are available), the Canadian industry generated about \$5 million from the licensing of masters to foreign accounts. In contrast, payments to foreigners for the use of their masters exceeded \$70 million. Canadian licence fee revenues and payments relate predominantly to transactions with the United States; however, Canada's international trade in sound recordings does extend to other countries as well.

The sound recordings industry is heavily concentrated in Central Canada, especially in the Toronto and Montreal metropolitan areas. There are no major barriers to entry for small-scale production operations.

The industry is dominated by a small number of foreign-owned firms. In 1989, about 5 percent of the companies were foreign-owned. Together, these firms accounted for about 80 percent of industry employment and 85 percent of industry shipments of sound recordings. Most of these recordings were derived from masters licensed by their parent organizations. Production of Canadian talent accounted for only 5 percent of these firms' total shipments.

The majority of Canadian-owned firms are small. The small firms usually release Canadian music only. However, many of the larger Canadian-owned firms also act as agents for foreign companies. Agency business accounted for about 50 percent of total sales by Canadian-owned firms in 1989. In addition to being an important source of cash flow that can be used to finance the production of Canadian music, agency business provides the additional volume required for establishing and sustaining marketing and support functions.

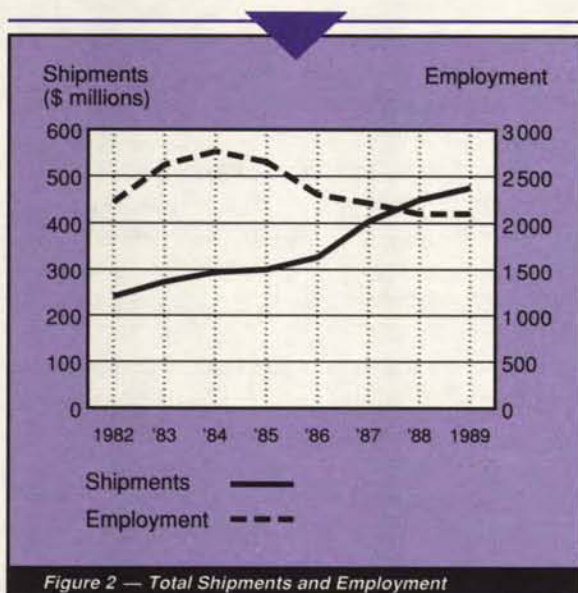
There are 50 firms producing predominantly French-language sound recordings in Canada, with combined shipments estimated at between \$15 million and \$25 million. Average company size in the French-language segment is smaller than in the English-language segment. However, French-language firms do not rely as much on imported masters as a source of revenue, and they concentrate less on rock music than do their English-language counterparts.

The United States is the world's largest producer and exporter of music, notwithstanding the fact that the majority of its largest sound recording companies are now controlled by foreign interests. Even in countries such as the United Kingdom and France, which have large internal markets, the presence of U.S. music is significant, albeit less pervasive than it is in Canada. As in Canada, these sound recordings are generally manufactured locally from imported masters.

Performance

The Canadian industry's volume and value of shipments between 1982 and 1989 expanded at average annual growth rates of 3 percent and 10.4 percent, respectively (Figure 2). The market for sound recordings has been eroded by home taping and rentals. Pirating (the illegal duplication and sale of products), while not as common in Canada as in some other countries, has also adversely affected legitimate sales.

Between 1982 and 1989, in response to consumer preferences and available new technology, there was a significant shift in the nature of the industry's output from vinyl discs to prerecorded audio tapes and compact discs. During this



period, audio tapes increased their share of total shipment from 32 percent to an estimated 55 percent in dollar terms and from 29 percent to an estimated 60 percent in unit terms. While commercial production of compact discs in Canada began only in mid-1986, in 1989 they accounted for about 35 percent of industry shipments in dollar terms and roughly 17 percent in unit terms.

Overall, the total sales of sound recordings with actual Canadian musical content have fluctuated from a high of about 17 percent of the industry's shipments in 1982 to a low of about 10 percent in 1986.

From 1982 to 1989, Canadian exports of sound recordings grew at a slower rate than total industry shipments; their share has fluctuated from 6.1 percent to 2.6 percent. In contrast, imports expanded at a faster rate than domestic shipments, with their share of the Canadian market increasing from 11.1 percent to 12.5 percent. The trade deficit in sound recordings in current dollars increased from \$16 million in 1982 to \$53 million in 1989. The annual trade deficit in licence fees for masters has fluctuated between \$60 million and \$70 million.

Average profitability and return on investment in the sound recording industry, worldwide, have customarily been very volatile. Rapid product obsolescence and constantly changing consumer preferences make investment in sound recording production a high-risk undertaking. Only one in 10 recordings recovers its costs; however, those that do succeed can earn very high rates of return.

In 1988, the latest year for which statistics are available, the foreign-controlled producers of sound recordings in

Canada reported an average after-tax profit on total revenues of about 10 percent, compared to less than 1 percent for the Canadian-controlled producers.

Strengths and Weaknesses

Structural Factors

Competitiveness in the production segment of the industry depends largely on the ability to discover, develop and market artists and their music. There is a significant disparity in the capability of Canadian and U.S. sound recording producers to successfully develop and market their respective talent pools on a sustained basis. Most weaknesses of Canadian firms derive from the relatively small size of the Canadian market.

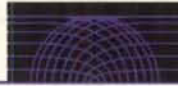
Because of their large market base and, hence, inherent economic advantages, the multinationals and their subsidiaries in Canada are able to engage the most popular and most promising musical artists. By representing a great number of artists, the large companies spread their risks. In addition, they are able to mount extensive marketing campaigns.

Overall, the Canadian-owned production segment of the industry is subject to the weaknesses usually associated with small scale. Most companies suffer chronic underfinancing. They lack the necessary human and financial resources to take full advantage of market opportunities at home and abroad. The size of most companies restricts the extent to which full-fledged management and technical groups can be financially sustained. Finally, many Canadian-owned firms cannot afford to distribute their own products in Canada and must rely on foreign-owned companies for distribution.

In the manufacturing segment of the industry, raw materials, wages and transportation represent the major costs. On a currency-adjusted basis, prices for most raw materials used by manufacturers of sound recordings in 1989 were somewhat higher in Canada than in the United States.

In 1989, average hourly earnings, after currency adjustment, were marginally higher in the Canadian manufacturing segment than in its U.S. counterpart. However, labour productivity was about 30 percent (currency-adjusted) higher in the United States. The difference in labour productivity levels reflects the fact that, as a group, the large U.S. manufacturers achieve greater economies of scale. In addition, the shorter manufacturing runs in Canada, due to the segmentation of an already small market into two linguistic groups, militate against the realization of such economies.

Manufacturing of sound recordings is usually done as close to the major consuming markets as possible, in order



to limit transportation costs and allow companies to respond quickly to demand. For Canadian firms, these are the Toronto and Montreal metropolitan areas. However, they face competition from several large manufacturing plants just across the U.S. border.

Trade-Related Factors

Canada, like the United States, the European Community (EC) and Japan, provides duty-free entry to sound recordings with an educational, scientific or cultural content. Compact discs for entertainment were subject to a Most Favoured Nation tariff rate of 9.5 percent in 1989, while other discs were dutiable at 13.7 percent and prerecorded audio tapes at 11.3 percent. Masters were dutiable at 10.3 percent in 1989. However, in the case of masters, the tariff is computed only on their duplication costs. Therefore, in practice, the impact of this tariff is negligible.

In the United States, the tariff rates in 1989 were 9.7 cents U.S. per square metre of recording surface for prerecorded audio tapes and compact discs and 3.7 percent for other discs. The United States provided duty-free entry to masters. In comparison, tariff rates in the EC were 5.1 percent for masters and audio tapes, and 4.9 percent for discs. In Japan, masters, audio tapes and compact discs were subject to a tariff rate of 1.7 percent; singles were dutiable at 6.4 yen each, and albums at 15.6 yen each.¹

The Canadian musical-content regulation for radio stations is considered a non-tariff barrier by the United States. Some European countries also have minimum requirements in terms of the domestic musical content or language for radio stations, offering some form of protection to their local recording industries. The United States does not have these types of measures.

Under the Canada-U.S. Free Trade Agreement (FTA), all tariffs on sound recordings will be phased out by 1 January 1998. The sound recording industry, as one of the cultural industries, has been excluded from the investment provisions of the FTA. The other government measures in place to assist the Canadian industry are not affected by the FTA.

Technological Factors

The sound recording industry generally relies on suppliers of machinery and equipment to originate technological developments. The existence of two recording technologies (analogue and digital) and several products, particularly compact discs and audio tapes, stimulates competition

among suppliers and, as a result, generates extensive ongoing research and development (R&D) programs. Most R&D work is conducted outside Canada. A notable exception is Cinram, the largest manufacturer of sound recordings in Canada, which has its own R&D department. Manufacturing technologies developed by suppliers of machinery and equipment are usually made available on a worldwide basis. The Canadian industry has generally kept pace with its counterparts elsewhere in the world in modernizing its manufacturing facilities.

At the product level, the most significant development in the past decade has been the introduction of digital compact discs. The sound quality of the compact disc vastly surpasses that of other existing sound recording formats. This disc and its player were developed jointly by Philips of the Netherlands and Sony of Japan, two leading manufacturers of consumer electronics. Commercial manufacturing of compact discs started in 1982 in West Germany and Japan. In Canada, full-scale manufacturing began in mid-1986.

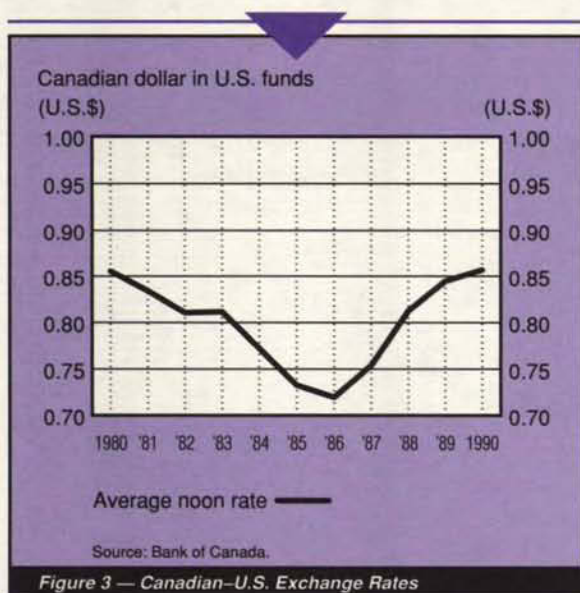
In 1987, Sony unveiled a digital audio tape that offers a sound quality comparable to that available on a compact disc. In 1988, Tandy Corp., a major U.S. manufacturer of consumer electronic products, unveiled the first prototype of a recordable, erasable compact disc. The potential impact of these new products is hard to evaluate at this time.

Other Factors

The manufacturing processes used in the sound recording industry are not directly linked to serious pollution or occupational problems related to health and safety. Nonetheless, the industry in Canada and the United States has had to comply with increasingly stringent governmental regulations concerning clean air, waste disposal and worker safety.

Governments in most developed countries, with the notable exception of the United States and the United Kingdom, have established measures to protect and assist their domestic sound recordings industries. Government involvement in the Canadian sound recording field is relatively modest. Some provincial governments, notably Quebec, support special promotional projects, chiefly through subsidies to companies and trade associations for marketing, promotion and production. The prime objective of federal assistance has been to support the development of Canadian culture by providing a medium in which Canadian musical talent can flourish.

¹In December 1989, one yen equalled about C\$0.01.



The principal measure in place relates to the use of Canadian music on radio. The Canadian Radio-television and Telecommunications Commission requires that Canadian music occupy at least 30 percent of broadcast time by AM stations or network operators between 6 a.m. and midnight. For FM stations, the percentage of required Canadian content is currently 7 percent for classical music (to be increased to 10 percent in September 1991), 20 percent for popular music (to be increased to 30 percent in September 1991) and 30 percent for country music. Some radio stations meet the content requirements by playing old hits and through heavy exposure of new songs by well-established artists. Radio airplay remains the most influential factor in a consumer's decision to purchase a sound recording, although music videos are becoming an important means of exposure for popular music.

In May 1986, the Department of Communications introduced a series of initiatives to assist the industry, at a cost of \$5 million annually. In particular, the government provides assistance for increasing the production of Canadian-content masters and music videos, for improving the professional skills of employees in the industry and for expanding marketing activities (including tour support) in Canada and abroad.

The industry's products are subject to the provisions of the *Canadian Copyright Act*. Adequate copyright protection is important in order to provide sufficient positive incentive for creative activities to take place. However, the Canadian Act had become obsolete and no longer provided adequate protection to creators, so a first series of major revisions was

made in June 1988. The two most important revisions affecting the sound recording industry pertain to the penalties for infringement of copyright and the mechanical royalties (the fees paid to copyright owners for the mechanical reproduction of musical works). Under the new Act, the penalties for infringement are much tougher, up to \$1 million in fines and five years in jail, compared with a maximum fine of \$200 and two months in jail under the old Act. The two-cent-a-song compulsory mechanical rate was abolished and mechanical royalties are now negotiable at regular intervals; in 1991 the rate is set at 5.9 cents per song. A second series of amendments to the *Canadian Copyright Act* is expected to be introduced in Parliament in the near future.

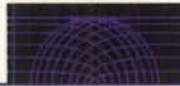
Because international trade in this industry involves both masters and finished products, exchange rates (Figure 3), along with transportation costs and tariff rates, play an important role in determining whether international trade for a given recording will be achieved through selling sound recordings or through licensing the master.

Evolving Environment

At the time of writing, the Canadian and American economies were showing signs of recovering from a recessionary period. During the recession, companies in the industry generally experienced reduced demand for their outputs, in addition to longer-term underlying pressures to adjust. In some cases, the cyclical pressures may have accelerated adjustments and restructuring. With the signs of recovery, though still uneven, the medium-term outlook will correspondingly improve. The overall impact on the industry will depend on the pace of the recovery.

Canadian market demand for sound recordings over the medium term is expected to grow at a moderate rate. This projection reflects slower growth rates for the population and the Canadian economy, the aging of the population and strong competition among leisure products for a share of the consumer's time and money. Compact discs and audio tapes will eventually totally replace vinyl discs.

The FTA could have an adverse effect on the Canadian industry. The elimination of Canadian tariffs could lead to a shift in the nature of imports away from masters to finished products. The shift would affect manufacturing based on imported masters, which accounts for about 85 percent of the Canadian industry's revenues. The extent of the shift would depend on several other factors, including transportation costs and exchange rates. In contrast, the elimination of the relatively low U.S. tariffs would have only limited beneficial effects on the level and nature of Canadian exports. With the



elimination of tariffs, there could be pressure on foreign-controlled multinationals to reconsider the scope of their production, manufacturing or distribution operations in Canada.

Competitiveness Assessment

The majority of Canadian-owned producers and manufacturers of sound recordings are not currently competitive and are not likely to become so in the near future. They suffer significant economic disadvantage from the small size of their operations relative to that of U.S.-owned branch plants located in Canada. Canadian-owned producers are able to survive largely as a result of regulatory and financial government support and by acting as agents for foreign producers of sound recordings. The manufacturing segment in Canada has developed largely by pressing and duplicating sound recordings from imported masters for foreign-owned producers in Canada, primarily as a result of high tariffs.

Although the phasing out of Canadian tariffs under the FTA may adversely affect the Canadian industry, the FTA does not affect the government measures in place to protect and encourage a Canadian cultural presence in sound recording. In addition, U.S. markets are becoming more open to Canadians.

For further information concerning the subject matter contained in this profile, contact

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PRINCIPAL STATISTICS^a

	1982	1983	1984	1985	1986	1987	1988	1989
Companies ^b	118	103	144	106	110	178	194	200 ^d
Employment	2 220	2 620	2 764	2 649	2 300	2 212	2 081	2 100 ^d
Shipments ^c (\$ millions)	241	273	294	300	327	404	450	475 ^d
(million units)	69	78	83	80	79	80	84	84 ^d
Profits after tax (\$ millions)	N/A	10	14	18	21	31	49	N/A
(% of income)	N/A	3.1	4.1	5.0	5.6	6.6	9.0	N/A

^aSICs used: part of 3994 (musical instrument and sound recording industry) and part of 9631 (entertainment production companies and artists). See *Sound Recording*, Statistics Canada Catalogue No. 87-202, annual.

^bNumber of establishments is not available.

^cAt distributor's net selling price. Value of shipments at the producer level is not available.

^dISTC estimates.

N/A: not available

TRADE STATISTICS^a

	1982	1983	1984	1985	1986	1987	1988	1989
Exports ^b (\$ millions)	13	8	8	8	12	25	26	13
Domestic shipments (\$ millions)	228	264	286	292	315	379	425	462 ^c
Imports ^b (\$ millions)	29	28	33	35	43	50	57	66 ^c
Canadian market (\$ millions)	257	292	319	327	358	429	481	528 ^c
Exports (% of shipments)	5.4	3.0	2.6	2.8	3.8	6.1	5.7	2.7 ^c
Imports (% of Canadian market)	11.1	9.5	10.3	10.6	12.1	11.7	11.8	12.5 ^c

^aCovers sound recordings only, excludes licence fees associated with the use of masters.

^bSee *Imports by Commodity*, Statistics Canada Catalogue No. 65-007, monthly; *Exports by Commodity*, Statistics Canada Catalogue No. 65-004, monthly.

^cISTC estimates.

SOURCES OF IMPORTS^a (% of total value)

	1982	1983	1984	1985	1986	1987	1988	1989
United States	74.4	65.2	62.2	54.3	54.2	66.8	78.2	77.1
European Community	20.3	29.3	32.0	39.6	39.0	28.0	17.8	19.6
Asia	4.0	3.2	3.4	3.2	4.8	3.6	2.4	2.2
Other	1.3	2.3	2.4	2.9	2.0	1.6	1.6	1.1

^aFluctuations in Canada's international trade in sound recordings reflect, primarily, fluctuations in the minimum level of demand required to justify manufacturing from imported masters, which in turn is caused by factors such as tariff rates, transportation costs and exchange rates. Data are from *Imports by Commodity*, Statistics Canada Catalogue No. 65-007, monthly.



DESTINATIONS OF EXPORTS^a (% of total value)

	1982	1983	1984	1985	1986	1987	1988	1989
United States	59.6	69.3	71.9	46.9	37.3	26.4	44.9	75.5
European Community	12.8	12.4	7.2	6.6	22.3	40.1	31.6	16.9
Asia	0.4	0.1	0.1	0.1	0.5	1.1	1.7	0.8
Other	27.2	18.2	20.8	46.4	39.9	32.4	21.8	6.8

^aFluctuations in Canada's international trade in sound recordings reflect, primarily, fluctuations in the minimum level of demand required to justify manufacturing from imported masters, which in turn is caused by factors such as tariff rates, transportation costs and exchange rates. Data are from *Exports by Commodity*, Statistics Canada Catalogue No. 65-004, monthly.

REGIONAL DISTRIBUTION^a (average over the period 1985 to 1988)

	Atlantic	Quebec	Ontario	Prairies	British Columbia
Companies (% of total)	1	26	65	4	4
Employment (% of total)	1	18	77	2	2
Shipments (% of total)	1	18	79	1	1

^aSee *Sound Recording*, Statistics Canada Catalogue No. 87-202, annual.

MAJOR FIRMS

Name	Country of ownership	Location of head offices or manufacturing plants
A & M Records of Canada Ltd.	Netherlands	Scarborough, Ontario
BMG Music Canada Inc.	Germany	Toronto, Ontario
CBS Records (Canada) Ltd.	Japan	Don Mills, Ontario
Capitol Records - EMI of Canada Ltd.	United Kingdom	Mississauga, Ontario
Cinram Ltd. ^a	Canada	Scarborough, Ontario Montreal, Quebec
MCA Records (Canada) Ltd.	Japan	Willowdale, Ontario
PolyGram Inc.	Netherlands	Saint-Laurent, Quebec
WEA Music of Canada Ltd.	United States	Scarborough, Ontario

^aCinram Ltd. is engaged only in manufacturing.



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