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The end of the CD as we know it...

Shifting consumer behavior and changing business models in the music industry

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According to the music industry, Napster, Kazaa, Gnutella and other P2P-filesharing services have been responsible for a worldwide decline in CD-sales since the end of the nineties. According to the industry downloading music is not only illegal and un-ethical; it is also harmful for the economy and artists. It takes away the incentive to be creative and therefore it is a threat to cultural diversity. In this paper the validity of these economic and cultural claims will be questioned. It will be argued that there is little evidence that local musical cultures are becoming less diverse. Although it is not contested that the music industry suffers from declining CD-sales and that P2P-filesharing could be partly responsible, it will be argued that this does not mean that music is becoming less important or even that people spend less money on music. Music itself is still popular - but buying CDs is not. It will also be argued that the traditional business model with its focus on CD-sales is no longer the core model; shifts in consumer behavior make the traditional music industry less important in the manufacturing and distribution of music. Artists will switch to other business models and can gain more autonomy, and other (non-music) firms are getting more opportunities.

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Digitalization seems to have hit the music industry harder than other media businesses. Flat-rate high bandwidth Internet connections, multi-media computers, compression techniques, P2P-filesharing, and portable MP3-players have changed the way music is distributed and experienced. When the Internet as we know it was introduced more than ten years ago, few people would have envisaged that this medium could develop into a 'global jukebox' where you could access almost every song you wanted to hear. Also, hardly anybody foresaw that people would store and play their music from their own computer at home, or walk or drive around with little portable devices that could contain more than 10,000 songs. Science Fiction came to life. For the music industry this scenario soon developed into a nightmare. The

Compact Disc, their cash cow, almost overnight changed into an endangered animal. The music industry launched a ferocious attack on P2P-software developers and users of these services, protected their CDs with technologies to prevent 'ripping', and asked legislators for stricter copyright protection.

In many respects the music industry was in 2003 in a worse position than four years earlier when Napster was shut down as result of a lawsuit by the music industry (McCourt & Burkart, 2003). CD-sales were still dropping and downloading music seemed even more popular than before. Protective technologies have been remarkably unsuccessful. Legal digital downloads have been made next to impossible (before in introduction of iTunes in the US) because of an elaborate system of Digital Rights Management (Oksanen, 2002; Fetscherin, 2002). New legislation is not an easy option in the international Internet environment. The only thing that seemed to work was the threat to individual downloaders and people who make music available on the Internet that they will be sued if they don't end their 'illegal' practices.

Perhaps most threatening to the music industry is that other non-music firms have entered the market. This is most visible in the hardware market where Apple, Dell, Nike/Philips, Rio, Nomad, Creative and many others have launched their MP3-players. As of September 2003, Apple sold more than a million iPods; in the beginning of January 2004 this amount had already doubled (Over Two Million iPods Sold, 2004). Distribution is no longer controlled by the music industry; Microsoft and Dell are about to enter this market, Apple sells individual tracks (for 99c per song) and complete albums (mostly for \$9.99) to consumers. Many other services for digital downloads have been launched, some of them even ask lower prices (79c for a track at Wal-Mart) or charge users only for used bandwidth like the Russian AllofMP3-site or the Spanish Weblisten service.

In this paper first the introduction of the mp3-format and the impact on the music industry is roughly sketched. Second, the strategies used by the music industry to protect their market and their product are analyzed. The emphasis is on the validity of their claims about the economic and cultural dangers of downloading music from the Internet. Finally, the changing behavior of the music consuming public and artists in the post-Napster area is analyzed.

The MP3 revolution

Downloading music was possible from the beginning of the Internet. But it would take hours to send a 20 or 30 MB CD-track to another computer. And, the average computer wouldn't be able to store the file or play it after downloading. Technological innovations made transferring music not only possible but also very easy. MP3 (MPEG layer 3) is the most used compression-technique. "By using MPEG audio coding, you may shrink down the original sound data from a CD by a factor of 12, without losing sound quality" according to the developers of MP3, the German Fraunhofer Institute (Fraunhofer Gesellschaft, 1998-2001). A compressed music file has a lower quality, but this cannot be heard on PC-speakers. It would take more than five hours to transmit a CD-track to another computer with a 14.4 modem. The MP3-file of the same track could be send within 20 seconds with ADSL or cable. 'Flat rate'-access, fast modems (56 KB), ISDN-connections and cable, ADSL or direct lines (T1) made downloading music possible. The first PC's had a small hard disk (20 MB) and no soundcard or speakers. Modern hard disks can store thousands of MP3s while a soundcard, speakers, CD-players (and burner) are no longer an exception. MP3-files are not only smaller. Making MP3's (ripping CDs), playing MP3s, finding MP3s, downloading MP3s and storing them is also very easy. After Napster many alternatives (Gnutella, Kazaa, AudioGalaxy, Morpheus) became available (Carey & Wall, 2001). The last innovation is the rapid introduction and penetration of the portable MP3-player.

Because of the variety in platforms it is hard to tell how many people actually use P2P-services but figures are nevertheless impressive. In October/November 2002 3,5 to 4 million users were online on the Kazaa network, a year later this figure has only dropped a few percent (contrary to claims of the music industry). According to the IFPI (2002): "In May 2002 there were approximately three million users and 500 million files available for copying at any one time on all of the peer-to-peer services worldwide. There are approximately 200,000 Web and FTP sites hosting or linking to some 100 million unauthorised recorded music files." It should however be noted that a figure like '500 million files' does not mean that there are 500 different songs available. Not every file is a music file, not every music file is copyrighted, a lot of files are impossible to download and most important: there are many many duplicates –popular songs can be found on more than 100 different computers (Bakker, 2003a).

It comes as no surprise that the music industry blames the Internet for a decline in CD-sales, although the economic recession is also mentioned as a possible contributing factor. For the

first time since the introduction of the compact disk in 1982, worldwide sales of CDs have dropped according to the industry ((RIAA, 2000a; see also NVPI, 2002). In 2001 the industry faced a decline of 5 percent in value (IFPI, 2002), and in 2002 sales of recorded music fell by 7 percent (IFPI, 2003). In an interview in the *Financial Times* (March 24, 2003) Sony chairman Andy Lack said he expects a 13 to 15% decline in 2003. Figures for the US market illustrate this development (table 1). Growth slowed down in 2000 and developed into a decline in 2001. An earlier decline (1996-1997) can however not be attributed to music downloads on the internet. The year 2003 will also show a decline according to the industry: “Shipments of music products to retail outlets declined nearly 10 percent in the first half of 2003, representing a nine percent drop in dollar value compared with the first six months of 2002.” (www.riaa.com). Market research firm Nielsen Soundscan however stated that there was only a 0.8% decline in units sold in 2003 (album and single sales declined, internet sales and digital tracks sales went up). The fourth quarter of 2003 showed a recovery compared to 2002 (Businesswire, 2002). The dollar value of CD-sales in the USA was almost the same as the year before (-0.8%) (in Reijnders, 2003).

Table 1: revenues (millions \$) and sold units (millions) CDs in the US

	<i>units CDs</i>	<i>+ / - %</i>	<i>revenue CDs</i>	<i>+ / - %</i>
1991	333		4.338	
1992	408	23%	5.327	23%
1993	495	21%	6.511	22%
1994	662	34%	8.465	30%
1995	723	9%	9.378	11%
1996	779	8%	9.935	6%
1997	753	-3%	9.915	0%
1998	847	12%	11.417	15%
1999	939	11%	12.816	12%
2000	943	0%	13.215	3%
2001	882	-6%	12.909	-2%
2002	803	-9%	12.044	-7%

Source: RIAA website 2000 -2003 (Yearend Statistics)

In the Netherlands CD-sales showed a different pattern (table 2). In the mid-nineties the market already saw a drop in sales (see Rutten, 1995) while there was a temporary recovery in 2000. This makes it difficult to show the influence of file sharing.

Table 2: revenues (millions Euro's) and sold units (millions) CDs in the Netherlands

	units CDs	+ / - %	revenue CDs	+ / - %
1991	39,2	12%	529	
1992	33,2	-15%	477	-10%
1993	34,6	4%	479	0%
1994	34,6	0%	474	-1%
1995	35,0	1%	471	-1%
1996	34,4	-2%	454	-4%
1997	36,9	7%	492	8%
1998	34,2	-7%	469	-5%
1999	33,5	-2%	458	-2%
2000	34,1	2%	466	2%
2001	32,4	-5%	461	-1%
2002	28,3	-14%	406	-12%

Source: www.nvpi.nl

Declining CD-sales have not hit every country. France saw CD-sales rising in 2001 (Bressand, 2002), in the UK CD-sales increased in 2000 and 2003 (Downing, 2003).

Discourses

It is however possible that there is a relation between downloading music and not buying CDs. This could mean a loss of income for the music industry and related sectors. But the argument of the music industry does not stop there. Downloading music is seen as illegal, un-ethical, and harmful for the economy. In addition, it is seen as a threat to the music culture as well, because loss of income by artists will take away the incentive for artists to create new music. The music industry argues as follows: downloading music is illegal (infringement of copyrights) and un-ethical (stealing), it is hurting the industry and artists, and it takes away the incentive for creativity, the supply of music will become less diverse, and it is therefore harmful for national music cultures. In this argument four different discourses are combined.

The *legal discourse* concentrates on copyright infringements: “The very first Article of the Constitution empowered Congress, ‘...to promote the progress of science and the useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.’ Even back then, copyright was all about improving society by protecting the economic incentive for people to come up with brilliant ideas and inventions.” (RIAA, 2002b; see also Soundbyting, 2002; see Vaudhyanathan (2001), Rimmer (2003), May (2003) and Negativeland (2003) for a critical analysis on copyrights and creativity).

The *ethical discourse* is about stealing: “Today’s pirates operate not on the high seas but on the Internet” (RIAA, 2002b). In an educational campaign Britney Spears asks her fans:

“Would you go into a CD store and steal a CD? It’s the same thing, so why do it?” (Rocha, 2002). The Dutch joint anti-piracy program BREIN (2002, p. 2) states: “Uploading without permission is theft and downloading is receiving stolen goods.” (see also www.nvpi.nl; *ifpnetwork*, 2002; IFPI, 2002).

The *economic discourse* is about money: “Each year, the industry loses about \$4.2 billion to piracy worldwide – we estimate we lose millions of dollars a day to all forms of piracy.” (RIAA, 2002b). “It is estimated that such illegal product costs the music industry more than 300 million dollars a year domestically.” (RIAA, 2002b). Employment is another element in this discourse; the copyright industry “employs hundreds of thousand of people worldwide - 600,000 in Europe alone” (Berman, 2002).

The *cultural discourse* states that a loss of income will take away the incentive to create music. “Copyright provides a financial incentive (...) for individuals to share ideas and inventions” (RIAA, 2002b). According to the IFPI (2002): “consumers (...) get less diversity and less choice.” Speaking about the situation in Russia, the IFPI newsletter *ifpinetwork* stated “piracy kills culture (...) there is a real danger for national culture and artists who could be forced out of the market” (Pozhitkov, 2002, pp. 10-11; see also *IFPI European Excom...*, 2002).

Deconstructing discourses

The industry supports the claim that music downloads are hurting the industry and artists by pointing to declining sales, the amount of blank CDs sold, counterfeiting, and reported behaviour of consumers. In reports from the industry all sorts of illegal activities like piracy (compilations), counterfeiting (exact copies), home copying, bootlegging (recording and selling live or broadcasted performances) and downloading tracks from the Internet are often taken together. This strengthens the argument of the music industry that all kinds of illegal activities are harmful, but it fails to reveal how much downloading contributes to the decline in music sales (see also Freedman, 2002). High counterfeiting and piracy rates do occur in countries where the penetration of PCs with CD-burners is relatively low (Hogenbirk & Van Kranenburg, 2001). Data from consumer surveys are also confusing, some surveys suggest the opposite: people who download music buy more music (Forrester Research, 2000; Shachtman, 2002; Ipsos-Reid, 2002).

Cultural diversity

Do national music cultures suffer from a drop in sales that can be attributed to downloading music from the Internet and are they becoming less diverse? National music cultures in most European countries have flourished in the last years. It is claimed by the music industry that local and national artists are more affected by a decline in CD sales. There is however no empirical evidence to prove this. Some information indicates very clearly that local artists flourish in almost every European country. The most remarkable example is France where in 2001 the amount of CDs has not only rising but also mostly because of a diverse national supply of music.

“Last year, the total amount invested reached a peak of 84.8 million Euros (38. 8 of which was for new talent). The French music sector is also extremely diverse: for example, France has a rap scene, a techno scene, and a world music scene. In the past, the French music market was largely a ‘traditional’ one, with repertoire predominantly made up of French songs. Today, by contrast there is a greater variety of artists, originating from far and wide. Music consumers benefit because of the greater choice.” (Bressand, 2002, p. 1)

Also in the Netherlands, national product is becoming more popular. In 2001 the two best selling albums were from Dutch artists, both sold more than 400.000 copies. The same goes for 2002; three of the six best selling albums were national products (Bakker & Scholten, 2003). CD-sales in the Netherlands are dropping since 1998. How much of this decline can be attributed to downloading music is not clear, as the decline began before file sharing services were introduced.

In almost every European country national produced material is still very popular and this popularity is growing. This is also true for countries with a relatively high degree of piracy (for instance Greece, Italy and Spain).

A decline in diversity (if demonstrated) could also be attributed to other influences. High concentration in the music industry and corporate control could have negative effects on diversity (Negus, 1996, pp. 36-65; Visser, 1999). An other possible influence is the music diversity on radio stations and music television, because these function as mediators for the public (Hendy, 2000). Thirty major recording artists complained to the FCC about further radio deregulation because this could reduce programming diversity (*Artists fight radio deregulation*, 2003).

Consumer behavior & business models

MP3-files have been around at least since 1997 (Bakker, 2003b). After six years the main question is no longer *if* downloading MP3s is hurting CD-sales but much more *how* MP3s have changed the way music is experienced. Internet penetration is still rising in every Western country, computers are replaced every three to five years and every new computer is equipped with all features needed to make, find, store, play and burn MP3-files. Cable and (A)DSL-connections are replacing telephone connections. There are many different sorts of MP3-players available, but MP3s can also be played on (portable) CD-players, MD-players and almost every DVD-system. Using your computer as a radio or CD-player is not unusual. All this means that experiencing music (MP3) is by no means inferior to buying music (CDs). Music is what you listen to, and you 'own' this music as much as you own a CD (see also Bull, 2001). Downloading or buying music from the Internet is nothing special anymore. This explains not only the success of portable MP3-players and legal download services like the Apple Music Store but means also that the traditional music industry with its emphasis on the CD is losing ground and that this process is most likely irreversible.

The format that is definitely on its way down is the CD-single. In the US this format reached its peak in 1997 when 67 million units were sold, in 2002 this figure dropped to five million units; dollar value dropped in the same period from 273 million US dollar to 20 million (RIAA Yearend Statistics). Digital tracks are taking the place of the traditional single, 19.2 million tracks have been sold in the second half of 2003. A possible explanation is that the price of a digital download is much lower (79 to 99c) than the CD-single, the price difference between a full CD and the same CD-download is smaller. There is still an increase of traditional CDs sold online, 18.1 million units in 2002, 21.7 million in 2003 (Businesswire, 2002). This could be a consequence of pricing, CDs sold on the Internet are less expensive than CDs sold in record shops. DVD-sales (including music -DVDs) are also rising fast.

Artists themselves furthermore threaten the position of the traditional music industry. They have long found out that the CD-based business model has its flaws. Relying on the CD-model made you a hostage of your music label. Artists usually get an advance on their royalties, so they are in fact in debt. Many artists have turned to a more performance oriented business model. Concert prices are rising while the income from these concerts are impressive. Bruce Springsteen sold 1.6 million tickets in 2003 in the USA only (47 shows in 230 cities) at an average price of \$71. Celine Dion tickets have an average price of \$136, the Rolling Stones tickets were the most expensive in 2003: \$158 (Pollstar, 2003).

Artists with a business model based on CD-sales will suffer the most if downloading music does affect music sales. Artists with a business model based on live performances, and direct (Internet) sales will not suffer as much, in fact, they could profit from the Internet. Even when fans do put their music on file sharing services, it will not affect them as much because they did not rely on music sales in the first place, maybe it will even serve as a marketing tool. The fact that these acts do indeed offer free music themselves is an indication of this development. UK-artist George Michael announced in March 2004 that he would altogether stop making CDs, fans can download his music from his website in the near future.

The possibility of marketing music via Internet and selling CDs (and merchandize) without any record company or retailer is a real option. The once famous artist Janis Ian did not sell enough CDs according to her record company for a new recording contract. She now sells her own CDs via Internet (www.janisian.com). In the pre-Internet days it would be next to impossible to distribute CDs on more than a local basis (except for CDs sold at live performances). And artist can make money (Ian, 2002):

My site (www.janisian.com) gets an average of 75,000 hits a year. Not bad for someone whose last hit record was in 1975. When Napster was running full-tilt, we received about 100 hits a month from people who'd downloaded Society's Child or At Seventeen for free, then decided they wanted more information. Of those 100 people (and these are only the ones who let us know how they'd found the site), 15 bought CDs. Not huge sales, right? No record company is interested in 180 extra sales a year. But... that translates into \$2700, which is a lot of money in my book. And that doesn't include the ones who bought the CDs in stores, or who came to my shows.

Tuomola (2004) demonstrated how two artists – Aimee Mann and Murrillion – made money and gained more independence from traditional music industries by adopting a business model that relied much more on Internet sales and promotion (including participation of fans) than on traditional retail CD-sales. In both instances record companies played a significant role, but mainly as distributors of CDs.

In the Netherlands the amount of live performances and big festivals has not only risen, also the price for tickets has risen (in four years time a ticket for a Rolling Stones concert in the Netherlands almost tripled). In 1979 12% of the population went to jazz or popular music performances, this percentage rose to 22% in 1995 (De Haan & Knulst, 2000, p. 220). This means not only that artists (and booking agencies) have earned more money but is also an indication that the public is not spending less on music - although they may very well be

spending less on CDs. KPMG Special Services (2002) analyzed the economies of the Dutch dance scene and estimated that there was a cash flow of almost 500 million Euros yearly but only 8% of this was spent on CDs, vinyl and DVDs (Table 3).

Table 3: Cash flows in the Dutch dance scene

	Millions of Euro's	Percentage
DJ's & VJ's	147	30%
Clubs & disco's	221	45%
Sponsoring events	2	0%
Dance events	80	16%
Carriers (CD, DVD, LP)	39	8%
Total	488	

Source: KPMG, 2002

People – notably young people - spend money on entertainment like movies, DVDs, festivals, concerts, hardware, games, mobile phones, and CDs; but this last category is not as important as is used to be.

Conclusion

As noted above, the theory that there is a direct relation between downloading and declining CD sales is a chain of weak links. Evidence is lacking or circumstantial. Problematic is the claim of the record industry that all kinds of copyright infringements (downloading, piracy, bootlegging, copying and counterfeiting) are related. It puts people who play downloaded music from their PC in the same category as organized criminals and it fails to unveil the true nature and effects of downloading.

The theory of the music industry is based on the premise that record companies are essential for the public, for artists, and for the innovation of the music culture. A business model that relies on CD-sales and copyrights, and sees touring only as a way to promote CD-sales is part of this premise. There is however much evidence that this business model is becoming less dominant.

The most important development is the revolution in music and entertainment experience. Digital 'virtual' music and mobile content are more accepted, while music experience in stead of physical 'ownership' is becoming more important. It is likely that these shifts in consumer behavior have had profound effects on market conditions and have radically altered the

environment where the music industry is operating. Not the Internet but the consumer is causing the big changes the industry is facing.

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