

Ripped off, mixed up (and burned out?)

*There is plenty of music available online, from Eminem to Mahler. But no-one wants to pay for it. The ailing record companies have, until recently, wrung their hands but taken little action. A slew of lawsuits in the US against file sharers has signalled their intention to clamp down. By **Adrian Preston***

First the good news for the music business: more music was “consumed” in 2002 than ever before. Now the bad news: sales of CDs are down across the board as more and more listeners use alternative (and mostly illegal) ways of getting hold of the music that they want to listen to.

Traditional piracy involves creating counterfeit copies of CDs and tapes, and this remains a big problem in many parts of the world. The ease with which CDs can be copied from an original using plentiful and cheap technology means that the pirates can create many thousands of copies at very low cost. According to the Recording Industry Commercial Piracy Report 2003, compiled by the International Federation of the Phonographic Industry (IFPI), in Eastern Europe, parts of Asia (including China), Latin America and the Middle East, piracy accounts for more than 50% of all units of recorded music sold, with an estimated value in 2002 of US\$4.6 billion, a 7% increase on 2001. However, pirates’ warehouses can be raided, duplicating machines can be impounded and fake discs destroyed. The record industry faces a potentially far greater and invisible threat in the online, digital world.

The costs of physical piracy are beginning to look small in comparison to the amount of copyrighted material available online, for free, via peer-to-peer networks created using software such as Kazaa and Grokster.

The IFPI estimates that there are now more than one billion copyright infringing music files available online at any one time (more than 14 billion in total), compared to 500 million in June 2002. Kazaa Media Desktop (one of the software tools that allows users to share music and other media files online) is now the most downloaded piece of software ever,

having hit nearly a quarter of a billion downloads worldwide. And there is nothing illegal about the software that creates the ability to share files online. Grokster, another peer to peer software producer, was recently held not to be responsible, by the Supreme Court of California, for the content - and any possible infringement of copyright - that users of its software exchanged.

The music industry’s house of pain

That the music industry is suffering is not a matter of debate. Worldwide, music revenues fell by 7% in 2002 (for example, EMI -11%, Sony Music -5%, Universal -4%, Bertelsmann (music) -6.8%), and in the first half of this year figures show that the US market alone lost 9% of the previous year’s revenues.

Financial performance of the big five record companies does not make pretty reading. Can their declines in profitability really be due entirely to the file-sharing phenomenon? File sharing started in earnest in the late 90s, when Napster was in full swing. Napster’s technology differed from that used today by the likes of Kazaa in that users logged on to central servers. Though Napster was shut down by the courts in the US, if IFPI’s 14 billion figure is correct file sharing has continued to grow at a phenomenal rate.

Research business NPD Group has carried out extensive investigations into the impact that file sharing has had on the sales of CDs. Their June 2003 survey shows that the impact very much depends on the demographic profile of the file sharer. Those under 25, who tend to be the largest buyers of recorded music according to the research, have abandoned music buying in CD format preferring to download files. Others, the survey found, are as likely to increase their

Music copyright wars

music purchasing according to the amount of music that they download and listen to first.

The music industry's response to the file-sharing phenomenon has until recently been low key. Echoes of a previous campaign that ran in the 1980s urging users to stop home taping because it was "killing music" have been tried, but with little impact. Now, however, the Recording Industry Association of America (RIAA) has launched over 200 lawsuits for copyright infringement against individuals in the US - including one 12 year old girl - who it claims have repeatedly made copyrighted material online to others for free.

The action has received a predictably mixed response. Many argue that high profile legal action against your customers is not, perhaps, the best way to create a long term and loyal relationship. However, some research suggests that the threat of winding up in court may cause some serial offenders to have second thoughts. According to Forrester Research, the groups most likely to be downloading copyrighted material (ie 13-19 years olds) said that they would stop downloading material if they felt that "there was a serious risk that I would go to jail or have to pay a fine".

But legal action is expensive, and as Grokster's CEO Wayne Rosso said in an interview for Fox News: "I frankly don't think that the music industry can afford to sue 57 million American downloaders." Aside from the expense, litigation is attempting to stop a problem for the industry that is already so established - and so widespread - that it is beyond the point of no return. Many argue that the music industry's response is too late, and may in reality be too little, to prevent a major shift in power to those who have created and embraced new channels to market. Responding to the RIAA suits against downloaders, senior counsel for the Electronic Frontier Foundation (a not-for-profit body that argues the case for file sharing and online distribution) said at a news conference: "It's plain that the dinosaurs of the recording industry have completely lost touch with reality. It's time to get artists paid and make file sharing legal. EFF calls on Congress to hold hearings immediately on compulsory licensing as an alternative to the RIAA's litigation campaign against the American consumer." Grokster's Wayne Grasso, agrees that it is the music industry's attitudes to date that have made a problem out of file sharing. He told Fox News: "If the music industry would turn around and start coming out of their fog and talk to guys like us, we are dying to work with them."

Licensing arrangements for recorded music are far from straightforward. A complex chain

of agreements links the copyright owner to the music buyer, and encompasses the musicians themselves, the record companies and music publishers. International arrangements add considerable complexity. Getting agreements that suit all parties has proven to be a major stumbling block to creating the kind of online offerings that would provide the consumer with sufficient choice and flexibility to dissuade them from sharing illegal copies and switch to paying for content. Larry Kenswil, president of Universal Music e-labs - the online division of one of the largest record businesses in the world - said in a speech to the Jupiter Plug-in conference in New York this summer: "The battles between music labels and music publishers are incomprehensible to anyone outside of the music business and to many inside it. Over half of the publishers' revenues come from sales of pre-recorded music. Frankly, almost all of their revenue is derived from the labels' great artists recording their great songs. But I can't tell you how many business models we can't pursue because of issues in the Byzantine world of music publishing rights."

You say you want a revolution

The arrival of Apple Computers's iTunes Music Store has been heralded by some as the embodiment of the revolutionary approach required to put the music industry back on track to profitability.

How did Apple - a computer company - manage to get right what so few in the music business have been able to do to date? Apple has online content for sale from artists with each of the five major record labels (EMI, Sony, Bertelsmann, Warner Music and Universal) - more than 200,000 tracks in total and growing. The iTunes service allows users to download tracks for 99 cents each, burn them onto CD, transfer them to other computers and download them to portable players. Most other online music offerings are far more restricted. Users have to pay a monthly subscription fee, and often can only access music in streaming form - ie as real time, non transferable transmission - via their PC: in effect, the equivalent to radio.

Apple's great advantage say its fans, is the ability to use the downloaded track in the way that the user wants, rather than according to the narrow restrictions imposed by the recording companies and music publishers that typify other legitimate online offerings. But how did Apple manage to persuade the record companies to offer up what they had so long resisted providing to others? One clue lies in the charisma and market pull of the company's chief executive Steve Jobs. Though Apple

The BBC's Creative Archive - content, online, for free, for everyone

The UK's publicly-funded broadcasting organisation, the BBC, recently announced that it was going to make as much of its back catalogue of television and radio programming available to anyone who wanted to see or listen to it anywhere in the world, free of charge.

Announcing the BBC Creative Archive, the Corporation's director general Greg Dyke said: "I believe that we are about to move into a second phase of the digital revolution, a phase which will be more about public than private value; about free, not pay services; about inclusivity not exclusivity." Noble words. But then for Greg Dyke, giving content away is easy - it's already been paid for by the UK population who have to pay for an annual licence to watch television. Try the same words on the average Hollywood producer, and the response is likely to be less magnanimous than Dyke's noble talk of a new digital revolution.

First the soundtrack – now the film: The Matrix, downloaded

The everything-for-free-culture that online music has represented for millions of people using peer-to-peer software to gain access to digital music files stored on others' computers, represents a serious threat to other players in the entertainment industry. Recent blockbuster movies that have been made available, in high resolution versions, on-line include The Matrix Reloaded and the Hulk.

Increasingly, studios rely on DVD sales to boost their profits or simply to recoup the increasingly large investments required to make the movie spectaculars that are mainstream Hollywood's output. Fast broadband connections means that copies of films as well as music are becoming easily available, at no cost, all over the world via peer-to-peer networks. Can the film industry respond to this major challenge in a more creative way than has characterised the approach the music industry has so far adopted?

remains characteristically tight-lipped about the processes that it went through to gain the necessary licensing approval, Jobs' direct appeal to the likes of The Eagles' Don Henley (who had hitherto resisted the overtures of other services to put their music online) made a big impression on the music executives involved and did much to secure for Apple the backing of the mainstream music business.

iTunes - straight in at number one

On its first day of operation, the iTunes store sold more than one million downloads – by early September that number had risen to over 10 million. Apple's service is presently restricted to US customers and, what's more, to Apple PC users only - roughly 5% of the US PC market. But the key to Apple's importance in this market is its reputation as a cool and innovative company. That allowed it to make many artists' back catalogues available with their blessing.

Others, though, remain sceptical of the service's ability to rescue the record industry, suggesting instead that the service at best offers a temporary reprieve from a much more dramatic shift in the way that music rights will be created, marketed and distributed. Early proponents of the internet used the term disintermediation with great frequency. The internet, they argued, cuts out the middleman. And in many ways, that is all that the recording industry is – a group of facilitators that has managed to control the relationship between producers (ie the recording artist) and consumers and to draw off a hefty profit in the process. Complex licensing deals between publishers, recording companies and artists have often left the artist with a very small slice of the royalty cake. Numerous court cases have aired this issue in a very public manner.

Effective licensing?

When Apple launched iTunes music store, they had secured licensing deals from the big five record companies. But a quick look at the site revealed some big gaps in the music provided. Arguably the two most successful rock acts of all time, the Beatles and the Rolling Stones, were not represented, and there were a number of other acts that did not have a presence on the site at all. And the problem with licensing also explains why there is not an iTunes currently available outside the US – Apple will not comment on when the service may be available in Europe or Asia.

Many users of file sharing services like Kazaa argue that it is the record companies, not the pirates, who are to blame for the parlous state that the music business finds itself in. Others, too, believe that the music industry has misread the impact of digital technology. Mp3 players

and the ability to create custom playlists are not replacing traditional CDs – rather they are attacking the traditional hold that radio and particularly commercial radio has had on the listeners' ears.

The record companies may be able, through a mixture of brute force and more gentle persuasion, to prevent so many people from downloading and swapping copyright material, but where they really need to innovate is in the pursuit of a new business model that addresses the desire for customisation of the listening experience that the file-sharing phenomenon has created. Grokster says that its user profile is exactly the market that the record companies have traditionally pursued

Digital rights – the wrong way?

One of the key features of iTunes is that it has managed to persuade the record companies that users can download a track once and then use it in a variety of formats. Other online offerings have been less generous in their licensing. These restrictions, imposed by both the licensing policies of the record companies and the music publishers, are the reason why music lovers are not satisfied with what they get from the internet and why so many will infringe copyright.

New music is abundant online. But music from more established acts, whose back catalogues are often not available online, is harder to find through legal channels. Proponents of file sharing argue that the record companies have inadvertently created the demand for illegal copies of the intellectual property that they control, because they have sought to regulate the release of material to consumers who are no longer happy to wait and do as they are told.

The record companies' traditional business model has been to keep a firm control of the copyright of the material that their signed artists produce and to exploit it in as many different ways as possible. Senator Orrin Hatch once memorably characterised the recording industry standard contract as being akin to a situation whereby the bank still owns the house after the mortgage is paid.

Many recording artists are beginning to demand better terms of ownership of their copyright – and to be able to decide the fate of their back catalogues. Their influence, and the demand from the consumer for accessible and comprehensive music online, further turns the screw on the beleaguered record industry. Without some clear thinking, and an IP strategy to match, the record companies may find that they have protected themselves out of business. ■

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