

# **THE EFFECT OF DIGITAL MUSIC IN THE UK RECORDING INDUSTRY**

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## **Abstract**

The paper analyses how the digital downloading affected the music industry in the U.K as a new distribution medium. Additionally, while the study focuses on the U.K music industry, the progression of the U.S music industry is also discussed as compared to those in the U.K.

The study is based on the arguments that although the enforcement on law and technology are important to fight music piracy, their result is not satisfactory in preventing music piracy. Hence, supplementary solutions have to be complemented by more innovative approaches such as education on consumer and industry cooperation with relevant factors in preventing this negative phenomenon.

The findings indicate that record industry in the U.K should implemented the same methods applied in the U.S although the negative PR effects. The integration between 'infomediaries' could increase in the future to maximise online market he success

## **1.0 Introduction**

The music industry, since its existence, has always had to deal with piracy: from cassette copying to bootlegging and CD burning - but the biggest blow to music producers and artists does not need a solid medium. It is readily available all over the world, at any time and in the best of quality: Presenting the fully digital copy of music, or in short, the MP3.

More than a decade ago, digital technology brought a revolutionary increase in the quality and durability of sound recordings, which, at the same time initiated a huge drop in music industry profits due to illegal downloading sites such as LimeWire, eDonkey, BitTorrent or Kazaa. While the new technology, for a lot of industries, has been considered as a strength of their businesses, unlike, in music industry it has been

considered as a threat, through inability to protect its copyrights. However, in recent years, with legalization of various on-line sites, music industry has seen online selling as a new opportunity to increase revenue. It has been sad that this huge drop in industry profits has been as a result of the non effectiveness of music industries to react towards the online networks as a new way of music business.

The aim of this research is to identify and analyze the causes and consequences of digital downloading to music industry and new artists in the U.K. Additionally, the study will look into what steps and measures are being taken in the U.S compared to those in the U.K

The U.K is one of the global leaders in the music industry, alongside the U.S, being one of the largest music exporters globally (IFPI 2005). The industry collaboration between both countries is superior, with artists having a high presence on both sides.

### **1.1. Objectives**

Nowadays, there are a large number of record labels that operate in the U.K market, but most eminent labels, known internationally, are EMI, BMG, Sony Music, Universal and Time Warner. These companies represent by far the biggest market share in the music industry worldwide.

Although the aim of this study is mainly focused in examining the U.K's music industry, it is important to highlight that the music industry is increasingly globalised, and therefore considerably correlated to the rest of the international recording industry.

#### **The objectives of this research paper are:**

- To determine the causes and consequences of illegal digital music downloading in the U.K
- To research and analyse, as how the U.K music industry should move forward and adapt to the challenges caused by digital technology. Considering successful strategies adopted by the music industry in the US.

To accomplish this, a thorough analysis of the market will lay the groundwork for this dissertation and a well-planned methodology will help overcome obstacles during the research phase.

### **3.0 Research Methodology**

This paper has the following objectives:

- To determine the causes and consequences of illegal digital music downloading in the U.K
- To research and analyse, as how the U.K music industry should move forward and adapt to the challenges caused by digital technology. Considering successful strategies adopted by the music industry in the US.

The research of this paper is based only on the secondary research. It was decided to focus on textbooks as well as journal materials available on the subject and decision was made to not do any primary research. Objectives of the research are of analytical character and include qualitative, secondary data research approach.

Due to the fact that digital downloading is a recent innovative technology within recording industry, the existing academic textbooks and theories on the subject are very limited. However, the literature on Intellectual Property Law (e.g. Bentley and Sherman, 2004), Social and ethical (e.g. Baase, 2003), Business of Music (e.g. Krasilovsky and Shemel) are some of which helped to accomplish the paper objectives. In addition, a variety data used in this paper are from academic Journals and online newspapers articles (e.g. BBC News, The Time, Guardian and Financial Times).

A majority of these journals has been viewed via journal databases such as Emerald. The annual reports (2000-2006) of International Federation for Phonographic Industry (IFPI), available at the London Metropolitan University Library, were used as well as two video tapes. The internet sources were also used in order to provide the latest developments on the subject, this includes; IFPI.org, BPI.co.uk. Research sources (Forrest Research) were sometimes used in order to gather more qualitative information's, but a large number of these information's are available only commercially. Additionally, taking into consideration the limit of the academic books, the use of some sources are not necessarily proven as academic quality.

The data collection was compiled from March 2007 up until December 2007. All data gathered from journal articles and newspapers were assembled in a research diary and were filed in a chronological order. This played a vital part in analysing recording industry, taking into consideration significant changes that were being introduced continuously. This also made it possible to have an overall view of the past as well as assessing ongoing developments. Assuming that U.S. often leads UK in terms of technology inventions, particular consideration was made on developments in U.S, in order to establish project developments in the UK.

After looking at these issues, highlighted in the Literature Review, a number of key factors were identified. The purpose of these key factors is to reveal that, both internal and external factors of the music industry alongside elements of marketing mix most of the times are incorporated or crossed over.

The key areas of study are: Legal, Social and Ethical, Technological, P.R, Pricing, Product, Distribution and Marketing Strategies.

## **4.0 Findings**

### **4.1 Legal Issues**

The music industry, particularly in the U.S, is more and more targeting a large number of illegal file-sharers with lawsuits. By September 2003 the RIAA (Recording Industry Association of America) had secured more than 250 settlements against people, accused of illegally making copyrights material from file sharing programs such as KaZaA. (Burkart et al 2006). P2p sites can and have argued effectively that p2p technology has legitimate uses (point 1 of the fair-use doctrine-see below). Yet p2p site providers cannot deny that their service is primarily used for illegal rather than legal sharing. A legitimate use does not automatically mean that it has to be used in a legitimate way. An example from recent history seems valid: a UK-based man created a website called <http://tv-links.co.uk> providing links not downloads, of movies. This service was offered to consumers at free of charge and he

had no financial gains, yet he was arrested under section 92 of the Trade Mark Act, which states:

*"A person does not commit an offence under this section unless-  
(a) the goods are goods in respect of which the trade mark is registered,  
or (b) the trade mark has a reputation in the United Kingdom and the  
use of the sign takes or would take unfair advantage of, or is or would be  
detrimental to, the distinctive character or the repute of the trade mark."*

(Sheriff [online<sup>1</sup>] 2007)

Here is an example, on how legislation is counterproductive, showing that it does not fully understand what copyright infringements, trade mark violations and for that matter what music piracy is.

The recording industry increasingly has had success in forcing ISP's to disclose the identities of illegal downloaders. The RIAA had forced the ISP division of the company Verizon to reveal the identity of customers using p2p networks (Burkart et al 2006). There are indications of greater cooperation between ISP's and record companies and trade association in terms of that, ISP's can be held liable if they do not stop providing internet service to known violators (Baase 2002). However, it is not always in the interest of ISP's revealing the identities of illegal downloaders, if a large proportion of their subscribers use these services. Competitively (and with ethics aside) it hardly makes sense to expose the customers to legal actions unless all other ISP's are doing the same, or unless they are only seeking to prosecute serial downloaders.

Consumer surveys indicate that legal action is having a massive effect in terms of educating and raising the awareness of consumers towards the illegitimacy of p2p networks. In the U.S, a survey carried out in 2005 showed that 86% of 802 people surveyed, aged over 10, had knowledge that it is illegal to make music available for others or to download music illegally on the internet, which is up by 37% when compared to a survey carried out in 2002.

Furthermore, one study by 'Pew Internet and American Life Project' showed a massive 50% drop in p2p file-swapping, cited as the

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<sup>1</sup>Available from: [http://www.theregister.co.uk/2007/10/23/tv\\_links\\_trademark\\_law/](http://www.theregister.co.uk/2007/10/23/tv_links_trademark_law/)

result of RIAA legal actions (although this survey was based on a sample of 1,358 Internet users only) (Madden, et al [online<sup>2</sup>] 2004)

Whilst the RIAA's UK equivalent the BPI has been more reluctant to use litigation against individuals, it has targeted large scale offenders, most notably EasyInternet (the café chain owned by Easy mogul Stelios Hajo-Ioannou). The BPI successfully prosecuted EasyInternet after it allowed its cafe consumers to download copyright protected material and burn it onto CD's (Gibson [online] 2003)

According to Taylor Nelson Sofres (TNS) survey, the overall percentage of consumers downloading illegal music is declining every year, from 17.8 percent in 2003, it went down to 16 percent in 2004 and 15.4 percent in 2005. (BPI [online<sup>3</sup>] 2006) A possible reason for this is that most people who have just started downloading music in the Internet are now taking the legal path. 56 percent of those who have begun to download music (during the period of sep-2005 to march-2006) used legal services, compared to just 41 percent for those who have been downloading music for more than a year. (IFPI [online<sup>4</sup>] 2006) It is relatively easier to attract new consumers to download music legally than converting those who are already making use of illegal file sharing. According to IFPI, only 1 out of 10 downloaders have migrated from illegal to legal music downloading in the Internet. (IFPI [online] 2006).

#### **4.2. Fair Use Doctrine**

The legal background to digital downloading is rooted in issues of copyright law.

There are numerous key cases in the U.S that form the background of the current situation. These cases date back from 1976 U.S copyright law 'fair-use doctrine', which relates to fair-uses of copyrighted materials. "The four factors to consider in determining... fair use are:

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<sup>2</sup> [accessed on 27/09/07]

<sup>3</sup> Available from: [http://www.bpi.co.uk/pdf/Illegal\\_Filesharing\\_Factsheet.pdf](http://www.bpi.co.uk/pdf/Illegal_Filesharing_Factsheet.pdf) [accessed on 30/11/07]

<sup>4</sup> Available from: <http://www.ifpi.org/content/library/piracy-report2006.pdf> [accessed on 30/11/07]

1. The purpose and nature of the use, including whether it is for commercial purposes or non-profit educational purposes. (Copying for commercial purposes is less likely to be fair use).
2. The nature of the copyrighted work. (Creative work, such as a novel, has more protection than factual work.)
3. The amount and significance of the portion used.
4. The effect of the use on the potential market for or value of the copyrighted work. (Uses that reduce sales of the original work are less likely to be considered fair.)”

(Baase 2003 p.241-242)

In her book ‘A Gift of Fire’, Baase (2003) discusses the most relevant cases in some detail. The first is the case of Sony against Universal city studios. In summary, two film studios took legal action against Sony because, they claimed that Sony was contributing to copyright infringements since people were using its Betamax video machines to record copyrighted music broadcasted on TV. The main principle at stake was whether makers of copying equipment could be sued, as users can use this equipment to make illegal copies. The court ruled in favour of Sony because the copying was a private for non-commercial use, which presented no realistic harm to the copyright holder. It was unlikely to affect sales of the original work and in other words it is a ‘fair-use’. This case has been cited in many subsequent cases against p2p networks who claim that they cannot be held responsible for what their users do with a service that has substantial legitimate uses.

Napster was sued in 1999 by eighteen record companies for copyright infringement and lost, largely because it was concluded that the large scale copying on Napster had a serious adverse affect on the market for the physical CD sales. As Baase points out, the fact that in 1999 Napster had 50 million users highlights how peoples attitudes to the illegality of illegal downloading was entirely ambivalent. Baase (2003) argues that this ruling indicated that the legal system could still make a major impact at a time when many thought we were seeing the end of copyright as a concept.

Further attempts to shut down the p2p sites that followed Napster (Gnutella, Morpheus) proved more difficult, as these sites do not use a central server, they are vast networks linked computers (Baase 2003). Operators of illegal services will frequently set up in countries that don't honour U.S or U.K copyright laws. However, commercial p2p sites popular in the U.S frequently have U.S companies advertising on their sites that litigators can target (Parloff [online] 2003).

Though, it is worth to mention that illegal downloading/sharing of copyrighted material is likely to drive growth in the market for Internet policing technologies and services. Now is the era of the 'Cybercop' (Guardian 2003)

#### **4.3. Social and Ethical issues**

Since p2p file sharing existence, a large number of people who have used such websites argue that either there is nothing wrong in doing so or that it is wrong but not so wrong as to deter them from doing it. Control over intellectual copyright is a highly contentious issue. It is clearly wrong for thousands of people to receive music for free if the copyright holder is not to receive a fair economic reward for their time and effort. At the same time, isn't it unfair for the copyright holder to exercise monopolistic control over the consumer by charging excessive prices for the work?

In this context, it is important to emphasize a brief discussion of the ethics of intellectual copyright. According to natural rights theorists, the copyright protection is not granted because people think the public will benefit from copyright, but it is granted because it is right to recognize the property right, which derive from the mind of an author. (Bently et al 2004) McFarland (1999) in his paper 'Intellectual Property, Information, and the Common Good', discusses the theory of natural law. This law, dates back from Aristotle's Nichomachean Ethics, argues that the good in something is in the fulfilment of its purpose.

As a result, McFarland argues that the purpose of intellectual work lies in them being communicated or shared. He says that ethical policies for the use and distribution of information must take into account the



social nature of information. By protecting the authors right to benefit economically from their ideas, you encourage people to invest in new ideas. McFarland makes the point that the nature and purpose of information should be taken into account terms of rights and property. For example; a scientific paper containing information of a new medical breakthrough is arguably greater benefit to society than Britney Spears new single, even if the importance of the arts in civilised society is also important. The most important point that McFarland makes though, is that the interests of the producer of information must be balanced with the interests of the rest of society.

*“For many users, paying for online music would appear irrational because so much free music is still available... users feel a need to ‘oppose’ music companies”* (Walsh at al [online<sup>5</sup>] 2003)

The ethics of intellectual copyright in the context of the music recording industry is not as abstract as it may at first appear. It has important effects for the major record labels when they consider their relationship with their consumers and the willingness of people to use illegal p2p networks. For example, it is a fact that the recording industry has, in the past, abused its control of intellectual copyright by setting unfairly high prices for recordings for many years. This has contributed toward increase in negative PR for the industry that, it could be argued, has lowered peoples desire to behave ethically towards the industry.

Baase (2002 pp.253) considers the ethical arguments usually made by file-sharers in support of personal copying and for each offers a counterpoint. These included:

*“I cannot afford to buy the product-...Not being able to afford something is not an excuse for taking it”*

*“Everyone does it. You would be foolish not to...The number of people doing it does not determine whether it is right.”*

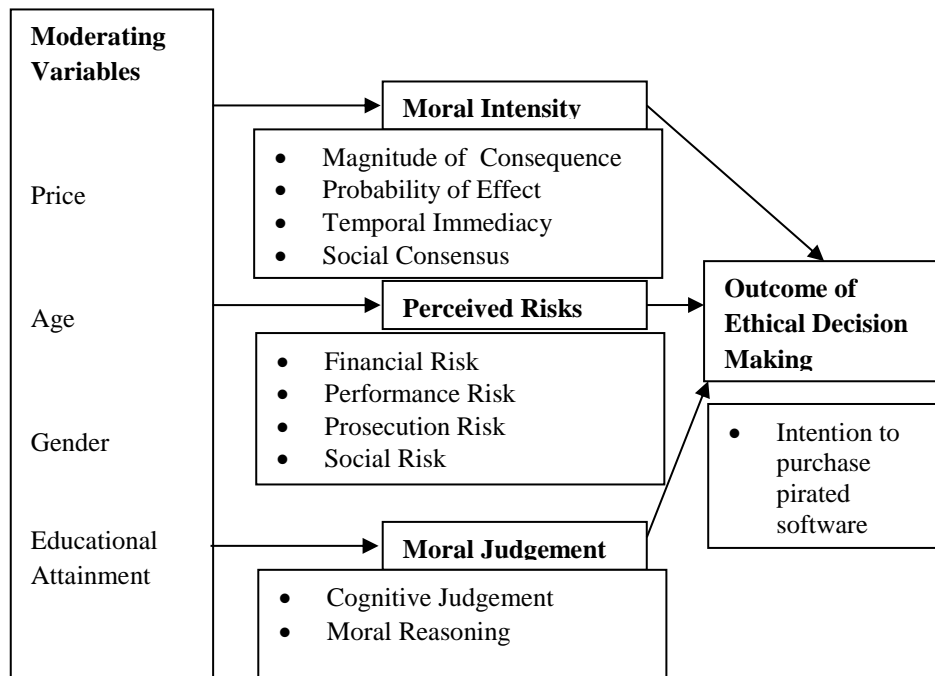
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<sup>5</sup> Available from:

<http://0www.emeraldinsight.com.emu.londonmet.ac.uk/Insight/ViewContentServlet?Filename=Published/EmeraldFullTextArticle/Articles/0200210505.html> [accessed on 05/06/07]

There are several studies trying to identify the consumer's attitudes towards digital music piracy. In his study ' Understanding consumer ethical decision making with respect to purchase of pirated software' Tan (2002) presents an integrated model (see figure 1 below), that offers a method to explain the process of consumers' decision-making when they purchase pirated software, which has many similarities with the process identified by other authors.

When we consider the factors involved in terms of Tan's model, it is clearer why so many people choose to download music illegally. Regarding moral intensity, the consumer will most likely feel the magnitude of consequence and probability of effect is low. Your average teenage digital downloader will disassociate their actions from having any tangible effect on the music industry at all. This is due to the impersonal and detached nature of digital downloading. Social consensus has a low influence on consumers buying intention. The perceived risks of consumers are relatively low. There is a possible virus infected file while downloading, but is a small chance. Financial and prosecution risks may now be perceived to be higher, particularly in the U.S due to legal threats, but the risk of a small volume downloader being prosecuted is still low. In social context, there is no risk at all, no one will be socially banned for downloading as it is perceived to be such a soft crime and besides, music downloaders are 'invisible' in the eyes of society. As far as moral judgement concerns, many people see that the record industry has self inflicted the damage due to years of CD pricing.



**Fig1.** An issue-risk-judgement (IRJ) model of ethical decision making

It is very important for industry to understand and identify the consumer ethical behaviour in order to develop effective PR strategies and marketing communication; such as promoting legitimate download enterprises.

#### 4.4. Technological Issues

The internet recently became a major device to download music. In 2000, online distribution was not considered as a main factor in music business studies. Nevertheless, the increasing access to broadband delivery in homes and offices, this attitude changed very quickly.

Based on National Statistics (2007), the number of U.K Internet users at home between 2002 and 2007 increased from 46 per cent to 61

per cent. (National Statistics [online<sup>6</sup>] 2007) The speed of broadband has been increasing continuously and adults obtaining broadband Internet access at home increased from 40 per cent in 2006 to 51 per cent in 2007. As a result of these innovations, burning a CD or DVD today is no longer expensive peripherals; many now come as standard in home pc packages.

The combination of this impressive increase in penetration of technologies and the invention of MP3 and p2p technologies result in a quicker distribution channel, and more efficient than anything seen before.

A large number of recording companies that have begun to sell recordings online have used technical protection which is known as “Digital Rights Management” (DRM). This system enable record companies “to limit the ways in which consumer can use those recordings” (Fisher 2004 pp. 156). For example, it restrict the number of copies that you make from an original MP3 file or even introduce a life span to the product after which it will electronically expire. This offers content owners greater flexibility and control in how they offer their product. They can, for example, offer an infinitely ‘copy-able’ file for a premium price, limited ‘copy-able’ files for a cheaper price and play once offerings are free. This introduction of flexible contracts or licenses could be very advantageous to the consumer depending on the degree of purchasing options available to them. Some attempts to introduce DRM technologies are made without consumer content, which is inevitably unpopular. (Thompson [online] 2004)

Consumers do not react well to enforced restrictive technologies, believing that once they have purchased a track, then they should have greater freedom with what they can do with it in terms of personal use (e.g. making a CD’s for a friend etc).

Hardware manufacturers are also introducing DRM systems built into their machines. Hewlett-Packard for example is one such

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<sup>6</sup> Available from: <http://www.statistics.gov.uk/pdfdir/inta0807.pdf>. [accessed on 15/10/07]

manufacturer that is committed to installing DRM software in every one of its consumer devices, encrypting any recorded content stored on its systems so that they cannot be transferred to other computers or players. (Thompson [online] 2004)

DRM systems are protected by law; in particular the European Union Copyright Directive and US Digital Millennium Copyright Act that make it illegal to break or ‘hack’ DRM technologies if their purpose is solely to protect copyrighted material. (Thompson [online] 2004)

Thompson (2004<sup>7</sup>) argues whilst there is nothing wrong with DRM technology per se, it is being used by content holders and their affiliates to exert greater control over the consumer. He says that DRM technologies are being used to manage copyrighted material in a way that “maximises revenue, not creatively or enjoyment”.

Thompson suggests that hardware manufacturers such as Hewlett-Packard (but also Intel, Microsoft and others) are bowing to pressure from the entertainment cartel, by which he means the RIAA. Baase (2003) also makes the point that DRM technologies are unpopular with consumers and can also prevent ‘fair-uses’ as well as infringement uses. (See 4.2 Social/Ethical Issues)

#### **4.5 Public Relation**

While the recording industry is trying to combat the illegal file sharing, the significant factor that makes the industry to be aware is the Public Relation in consideration with costumers. It has been argued that media plays a major role in creating an effective relationship with consumers. Peter Jamieson, executive Chairman of the BPI said that “currently we are dead and buried in the press perception of our industry. Perception is reality and needs a huge effort from all of us to change our current stereotype” (Jamison [online<sup>8</sup>] 2003)

During the speech, given at the BPI general meeting on July 2003, Jamison referred to the P.R problems that music industry is facing. He argues the music industry has to ensure that business model needs to be

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<sup>7</sup> Available from: <http://news.bbc.co.uk/1/hi/technology/3383253.stm> [accessed on 24/08/07]

<sup>8</sup> Available from: <http://www.pro-music.org/viewpoints/speech03703.htm>. [accessed on 22/06/07]

improved, fair and transparent in order to avoid the ‘public vendettas’ of the past. He accused the press of being ‘locked into a time warp of music industry stereotypes’ in particular such as resording companies have the excessive profits, Prices are too high, all record companies problems are self-profited etc.

In addition, He states these views of the music industry help and encourage people to become more ‘anarchist’ in order to avoid paying for music. He also refers to the industries failure to honour a very public commitment in the 1980’s to pass back reductions in CD manufacturing prices as and when they occurred and points out that in 2003, CD prices have never been cheaper (although plenty of evidence suggests that recent price reductions have been forced by the consumers willingness to adopt illegal file sharing). He argues that the industry actually stands for honesty (referring to its ‘honest recoupment mechanism’) when compared with likes of Kazaa. Jamieson then comments on the RIAA’s legal campaign against illegal downloaders in the U.S and compares the P.R effect of that strategy to being dangerously ‘shock and awe’ as opposed to (more preferably) ‘hearts and minds’. Furthermore, Jamieson concludes by claiming that the industry’s problems, with the Internet, can be solved by educational campaigns of which he cites ‘education’ as being the most important factor.

Regarding the PR effects in the U.S, the RIAA’s legal campaigns have been significant. One of the industry spokesman said “When you fish with a net, you are going to catch a few dolphins” (Roberts [online]<sup>9</sup> 2003). This refers to music industry lawsuits the U.S that have targeted amongst others a twelve-year old girl and. ‘Put simply, suing people does not make you popular with your customers’. (Grossman [online] 2003) The record industry does not only carry the baggage of negative PR with the consumer and the press, but also the artists, who are frequently heard bad-mouthing their record labels. This compounds negative perceptions amongst consumers who Grossman argues will not

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<sup>9</sup> Available from: <http://www.newsweek.com/id/60140> [accessed on 20/09/07]

feel bad for ripping off the 'suit' that has been ripping off their favourite artist. Even when the record industry has got its artist onside, PR disasters have not been away.

#### **4.6 Distribution**

Since the use of the Internet as a new distribution channel within the recording industry, the industry's market structure has drastically changed. In the electronic marketplace, the removal of traditional intermediaries such as physical distributors and bricks and mortars retailers is known as 'disintermediation' (Chaffey et al 2001) ( see appendix xxx page xxx). In the place of traditional intermediaries are 'infomediaries' or 'cybermediaries' (see appendix xx, xx page xx). These include the ISP's, search engines and operating systems and the e-retailers (such as iTunes) that act as retailer, distributor and wholesaler.

In other words, many of the costs associated with the traditional physical channel (physical production of disks, transportation of disks to warehouses, shipments to retail stores and in-store promotion of music) are no longer borne solely by the record company.

Meisel et al (2002) argue that this new distribution structure would seem to be potentially huge economic advantage (as yet not fully recognised) to be the industry.

Mergers have also contributed to the changing shape of the market structure. This is predominantly vertical integration, as record companies look to gain access to electronic markets through alliances with infomediaries and download sites. Music download sites are increasingly integrating with on-line distribution networks (search engines, ISP's) and/or hardware (MP3 players) for added online 'reach'. (Meisel et al 2002). One such example is the alliance between Pressplay (the download site developed by Vivendi Universal and Sony) and Yahoo!, who distributes Pressplay's catalogue via its portal (Meisel et al 2002).

Bertlesmann has surprised many by embracing the major labels former archenemy Napster in a strategic bid to access the massive Napster on-line community (Meisel et al 2002). Alliance has also formed between infomediaries and download sites not necessarily backed by the

record labels: In Europe, OD2 has agreed a distribution deal with Microsoft via its msn.com website, which will make them serious competition for Apple when they launch iTunes in Europe.

But why haven't the major labels sought direct distribution. To date this has not really happened. A number of factors could explain this:

- A key success factor in both legal and illegal sites is the availability and size of catalogue. It is therefore unfeasible from a marketing perspective for, record companies to distribute solely their own content on their own websites. Direct distribution would require the big five labels to work closely together on a collaborative website whilst avoiding anti-trust/ anti-monopoly legislation: 'Antitrust laws made it difficult for the labels to collaborate and it didn't help that they couldn't agree to license their music for pay services'. (Robert [online] 2003) <http://www.newsweek.com/id/60140> [accessed on 20/09/07]

- In the electronic channel, information processing based competencies plays a very important role not traditionally the competencies of the recording industry.

- Meisel et al (2002) suggest that record companies have been waiting for online custom to reach a 'critical mass' before they start to cut out their retailers as the major part of the market as a whole is still the physical market.

- Whilst waiting for this critical mass to occur, sites such as iTunes and Kazaa have built up string customer base and formidable brand awareness.

- Record labels have been slow to accept the validity of the electronic channel per se, often choosing to fight it rather than embrace it. Their relationships with many Internet firms were historically antagonistic.

#### **4.7 Pricing**

A U.K study conducted by Jupiter Research in August 2005 suggested that consumers are willing to pay to download music online. Their findings, based on a sample of 2,40 demonstrate price expectations amongst the sample.



**Fig 2. Price Expectations of Digital Music**

Price of Digital Song	0.01	0.50	0.99	1.40	1.99
% of Market Reached	89%	82%	74%	42%	39%
Potential Revenue*	N/A	992.20	1,772.89	1,512.44	1,878.16
Price of Digital album	0.01	5.00	9.00	12.00	16.00
% of Market Reached	87%	72%	36%	12%	2%
Potential Revenue*	N/A	9,129.60	8,216.64	3,651.84	811.52

\*Revenue calculated by multiplying the % of market reached by the survey sample and, in turn, by the unit price.

Jupiter Research ( 2003)

This data casts doubt over whether the 0.99 single track model is the most profitable- at 1.99 per track reaching 39% of the market generates higher potential revenue within the sample. Perhaps more notable overall through, is that this data suggests that consumers are only willing to buy music on-line at far lower prices than in the physical market.

In the U.S, as a result of the success of iTunes, a '0.99 per single' model had begun to take root. December 2003 however, industry executives have been questioning whether this pricing model makes financial sense. The argument goes that although sites such as iTunes have good sales figures, they are not generating any significant income at this point, due to current pricing models. Garrity (2003) demonstrates that currently, all parties have thin margins:

In fact, even the U.S industry success story Apple iTunes is said to be as yet only profitable because it increases sales of its iPod mp3 players (Milne 2003)

The nature of the downloading industry structure suggests that by cutting out traditional intermediaries the recording industry should be able to increase its margins. Gosain and Lee (2001<sup>10</sup>) argue that prices will be lower in electronic marketplaces for the following reasons:

- Electronic markets reduce transaction costs resulting in efficiency gains.
- Electronic markets reduce information asymmetries for buyers or in other words facilitate greater cost transparencies. This is due to the lower search costs compared to the bricks-and-mortar market.
- Low market entry costs increase potential or actual competition –leading to more efficient pricing.

(Gosain and Lee 2001)

Gosain and Lee also point to the increased fluidity of price dynamics in electronics markets. This, they argue, is the result of reduced menu costs in electronic markets: It is easier for to change prices in electronic markets due to the support of flexible information systems. This, they posit and immature nature of the e-market (high numbers of new entrant retailer) will lead to a higher rate of change in prices in e-market than in physical markets. This author argues that this will have implications for the strategic marketing of the recording industry i.e. how suitable are price promotions in the long term considering the volatile of pricing models in the emerging market?

There are currently two main differences in pricing models at the retail stage of the e-market place for music. One is the a la carte model (iTunes) where customers can download tracks when they like as discrete transaction. The other is the subscription model where a (usually) monthly subscription fee to retailer allows the consumer to download a set number of tracks per-month; how many tracks often depends on the ‘copyability’ of the track. For example, some sites allocate you a number of ‘credits’ depending on your subscription. Fully copyable tracks cost a premium, limited copy tracks (limited transferable

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<sup>10</sup> Available from: <http://www.ingentaconnect.com> [accessed on 22/10/07]

to MP3 players for example) are cheaper and streamable only tracks (listen once) are the cheapest or are free.

#### **4.8 Product**

*“Whether we like it or not, we’re now in the business of selling tracks”* Paul Vidich, Warner Music’s strategy chief. (Roberts [online<sup>11</sup>] 2003)

Everybody knows that the way in which people are consuming music is changing. The flexibility of digital downloading means that people are able to downloading individual or bundles of tracks rather than the traditional, prescribed album. In December 2003, BBC News Online reported that NPD Group had found that web consumer were downloading only one track from an album, 85% of the time, with the whole album being downloaded only 1% of the time (BBC [online<sup>12</sup>] 2003). In the U.K and U.S, the market for CD singles has collapsed. U.S consumers buy almost twice as many digital singles as CD singles, with around “7.7 million tracks bought and downloaded since the end of June 2003, compared to 4 million CD singles sold” (BBC [online<sup>13</sup>] 2003)

Many forecasters predict the ultimate collapse of the album market. This has serious implications for touring and merchandising revenues, which are based around album releases (Ayres [online] 2004).

#### **4.9 Marketing Strategies**

It is important to recognise that the various online “infomediaries” are not at all necessarily competing simply in terms of making profit from selling music. Illegal entities make their money from there advertisers. Apple’s iTunes sells music online to ‘facilitate’ the sales of

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<sup>11</sup> Available from: <http://www.newsweek.com/id/60140> [accessed on 20/09/07]

<sup>12</sup> Available from: <http://news.bbc.co.uk/1/hi/entertainment/music/3304481.stm> [accessed on 16/06/07]

<sup>13</sup> Available from: <http://news.bbc.co.uk/1/hi/entertainment/music/3237021.stm> [accessed on 22/06/07]

their MP3 players. 'Third party' consumer brands such as Coca-Cola sell online for brand building purposes.

In terms of music services in the U.K, there has been little money available for marketing to support acquisition and awareness-building. (Elkin [online] 2003) The one outstanding exception to this has been Apple iTunes high profile advertising campaign, designed to drive sales of it's iPod before the launch of iTunes later in 2004. Elkin ([online] 2003) emphasises that Apple's marketing and media push is likely to drive awareness for the entire online music industry.

Elkin (2003) cites Lee Black senior analyst at Jupiter research, who underlines two important factors in terms of marketing on-line distribution of music. The first is that as distribution shifts from physical to Internet, the value of Internet brand recognition will be very important. Consequently, he argues that Internet brands like Yahoo!, Amazon, RealNetworks and Napster (repositioned from 'free') will thrive. Secondly, he argues that legitimate on-line services will need to emphasise the quality of their services (i.e. free from poorly encoded downloads, low bandwidth and junk software) within their marketing communications. Elkin (2003) then cites Josh Bernoff senior analyst at Forrester Research, who predicts a rash of new on-line service launches, accompanied by high profile marketing pushes.

'Labels and digital music executives point to an absence of marketing and merchandising for downloads as a leading culprit in the tepid consumer response to commercial offerings' (Garrity [online]<sup>14</sup> 2003)

Many senior industry commentators were predicting an aggressive marketing push for online music in 2004, arguing that this is what is required to drive downloading forward (Garrity [online] 2003). However this author suggests that the financial state of the industry means that many labels are retailers will look to cross-promotional tie-ins with non-music related companies.

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<sup>14</sup> Available from: <http://www.allbusiness.com/retail-trade/miscellaneous-retail-retail-stores-not/4639729-1.html> [accessed on 21/07/07]

One such example, in the U.K, is that Coca-Cola has recently joined the foray, with its own on-line service Mycokemusic.com. It is leveraging its service with its serious marketing clout, exploiting its considerable existing physical channels. It Mycokemusic.com site offers free downloads via codes found on ring-pulls on cans of Coca-Cola. This is in line with a significant trend in the U.S, that has been major 'third party companies' particularly beverage suppliers using digital music giveaways to establish brand connections between music and their products (Garrity [online] 2003).

Pepsi has also done a tie-in with Apple iTunes offering 200 million downloads in 2004 in the U.S the similar demographics of music downloaders and Pepsi/Coke drinkers offer great potentials for marketing synergies (Garrity [online] 2003).

The drinks companies get the benefits of music association with their brands, which they say 'drives product' (Garrity [online] 2003), whilst the record companies enjoy the promotional platforms beyond their 'traditional' marketing platforms (radio and music video networks).

Napster relaunched in late 2003 as a legitimate service with a \$20 million marketing blitz. Napster's marketing communications notably did not mention that the new Napster actually charges to download tracks. In avoiding the over commercialisation of the brand, they were attempting to cash-in on the freedom-loving spirit of the familiar Napster brand. (Roberts [online] 2003) Perhaps this positioning tactic will retain the original Napster customer base, who will no-doubt be hostile towards the entrance of corporate giants such as Coca-Cola.

Because music online is essentially a commodity (a song by Robbie Williams is be the same at every site), marketing will ultimately play a huge role (Roberts [online] 2003). Roberts (2003) predicts plenty of free trials and alternative methods of payment (prepaid music cards to make sure kids can pay even if they can't use their parent's credit cards). He points to the attempts of downloading services attempts to tap into file-sharers on university campuses by offering exclusive agreements in exchange for discounts.

Steve Johnston (head of licensing at MusicIndie) has criticised the big-five labels for ignoring the fact that delivering a download is a 'really dull experience' (McIntosh 2003). He claims that only Apple iTunes has thus far made downloading 'sexy' by successfully integrating the iTunes website, system software and hardware (the iPod MP3 player). He also points to Amazon as a benchmark for successful Internet retailing and their successful use of peer-recommendation; he suggests that by marrying slick peer-recommendations systems with the ability to download music would be 'the dream service'. Again Apple's iTunes lead the field in this respect having implemented a (simple) peer recommendation feature on their website.

## **5.0 Conclusion**

Nowadays the music industry is more conscious that Internet is a new source of revenue, whilst in the past was considered as a threat that had to be eliminated. Nevertheless, the huge increase in popularity and availability of p2p file sharing networks has without a doubt had negative impact on U.K music industry revenue. Even today, the main problem for the recording industry remains how to combat the illegitimate downloading sites. However, it seems that legal actions taken by the RIAA in the U.S have been effective in reducing the levels of illegal activities as well as raising consumers' awareness.

Concerning the U.K industry, similar legal actions would undoubtedly have a positive impact on industry, nonetheless it may generate negative PR, as it did occur in the U.S. In this context, undertaking such activities by the industry could create a poor relationship with its customers. Therefore, in order to prevent such publicity, music industries may have to consider to tackle the core of the problem; focusing on taking appropriate legal actions towards serious offenders, p2p sites and non-cooperative ISPs. Moreover, prosecuting illegal download and p2p sites in the U.S has proven to be very difficult.

At the same time, in the U.K, there is legal uncertainty whether ISP's can be forced to disclose the identities of their users.

In social and ethical context, people are still tempted to download music illegally. It is also assumed that illegal digital downloading is being viewed by many as a tool for the consumer to disobey rules of engagements towards the recording industry.

The recording labels will need to take a significant investment and creativity to change the people's perception, the purpose of which should serve towards restoring consumers trust.

An important issue which requires a consideration in the future studies is; How the music industry will achieve to persuade medias from producing negative PR against music industry, which consequently is partially contributing towards consumer illegal downloading.

The head of BPI pointed out that U.K. music industry should take a 'heart and minds' approach rather than 'shock and awe' approach in regards to its legal strategies. As an alternative of investing large amount of monies in marketing campaigns and taking legal actions to try and change consumer's attitude, the industry should focus more resources in making legitimate sites more attractive to the consumer.

With ever increasing penetration of Internet technologies and computing power, there is no doubt that it will drive digital downloading. Therefore the music industry will need to take appropriate steps to protect its copyright material in which DRM technologies will play an important role in achieving this.

However linking back to the industry's already negative P.R image, it must balance the need to protect its copyrights and public perception from preventing being viewed as an industry seeking to control how the public consumes its music. Nonetheless, having such strict measures in place and restrictive technologies, it may push even further consumers towards illegal downloading sites.

Taking into consideration the unhealthy formatting battle which is being created in the U.S, the U.K. music industry must be cautious over which digital formatting will dominate the market as this could have negative impact on the growth of the industry as a whole.

There are of course downsides for increase of download mediums as this could potentially put an end to the existence of the albums.

Nowadays Internet has made it possible for singles to be downloaded individually rather than having to purchase the whole album. Question raises whether the industry will suffer revenue loss and will it be able to support and promote new artists, or will it start concentrating on producing one-hit songs? The downside is closely linked with the fact that this will enable the consumer to pick and choose single tracks.

It is undoubtedly foreseen that the integration between 'infomediaries' will increase in the future in attempt by on-line retailers to maximise on-line market share. However increasing cooperation between online music sellers and other intermediaries such as; ISP's and search engines, will have implications for the record labels marketing communications.

Internet is seen as an ideal medium for the marketers to have more interactive way of communication, but at the same time, how to find solutions to get consumers to visit these websites, can prove to be challenging. The answer to this issue lies with increase of online music channels as it could drive above –the-line marketing activities, as companies seek to generate awareness of their online services.

Over the period of time, the distribution will gradually change its course toward online medium. Therefore, while the Internet provides a great opportunity for record labels and on-line distributors to develop more interactive approach, new marketing strategies need to be developed and all parties involved in this process will have to adapt to these new patterns of the future.

As Apple's iTunes is poised to make its entrance to the U.K market and OD2 links with Microsoft with competing formats, competition in the U.K download market looks set to kick off. Competitors could do worse to look to Apple's iTunes as an industry benchmark, certainly in terms of design and integration of website and MP3 player.

At the same time, for all Apple's iPod driven U.S success, its lack of profit from actual downloads should be a cause for concern for those U.K ventures in terms of pricing models; another area of this paper that warrants further research it is in the area of pricing models. At this point in



time, is there money to be made from on-line music retailing? Possibly not, but that may not be the point at this stage. The entrance of major consumer brands such as Wal-Mart and Pepsi in the U.S and now Coca-Cola and the others in the U.K is as much about cross-marketing as it is about profit making. As these big guns enter the fray and the record labels are forced to relinquish control of the supply chain (certainly in a part a result of anti-competition regulations) we may see the early Internet sellers swallowed up by the marketing muscle of the corporate giants. The record labels may be forced to sit back and concede power to the new 'infomediaries' and the consumer.

Lacking the budget (in the current climate) and perhaps the online expertise, the record labels may have to rely on the promotional resources and creativity of the new intermediaries to drive interest in the online market.

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