

iTunes - When the Recording Industry Sang the Blues, Apple Sang a Different Tune

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About two years ago, the recording industry erupted in chaos and fury as the illegal distribution of digital music proliferated, with the major studios (hereafter, majors) fighting to protect their traditional distribution channels. Could a different strategy on behalf of the recording labels have expedited their turnaround from a three-year slump or, even, have prevented it? Will Apple iTunes, the current leader in digital downloading, prove to have the winning long run strategy?

Providers of illegal music downloads initially flourished, but were eventually rebuffed by a powerful legal onslaught. However, the recording industry's effort to identify and prosecute perpetrators has fallen short, as illegal downloads from file sharing escalate in the peer-to-peer channel. But the stigma and penalties associated with piracy have given significant momentum to a preference for legal downloads. The majors' succeeded in that regard, but their oblivion to the need for an effective offensive game plan to flank and complement their defensive measures has resulted in a lost opportunity.

Preoccupied with the Status Quo: Majors Miss an Opportunity

To sum up, the recording industry chose to maintain the status quo rather than exploit a potential competitive advantage. It viewed the new digital channel as a misguided use of technology rather than a robust value proposition offering customers what they wanted when they wanted it. It also failed to appreciate the opportunities a digital channel offered for reduced operating costs, new product bundles, increased revenues, and wider audience appeal.

The majors' fixation with traditional distribution channels and their all-out effort to protect that pipeline represented the rejection of a potentially fruitful marketing strategy, especially, the creation of a source of substantive differentiation. But this was nothing new. A decade earlier the recording industry had stifled the growth of emergent legitimate in-store downloads by limiting access to titles and, ultimately, by halting sales to these channels once they proved popular with the public. The market eventually found a way, albeit illegal, to fill the void.

Ironically, when the majors finally developed industry alliances to develop digital offerings, it attracted Justice Department scrutiny, which gave new entrants more time to strengthen their competitive position. Although the Justice Department ruled in favor of the recording industry in December 2003, the market ruled against the majors' in-house Internet ventures: their offerings were rebuffed, because the music couldn't be burned to CD's or MP3 players and the songs offered were limited in scope.

Apple Seizes the Day

In the interim, Apple emerged as the leader in the digital audio realm. It launched Windows iTunes, selling 14 million downloads two months prior to the US Federal Appellate Courts' December 2003 decision to reject the

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recording industries petition compelling ISP's to divulge subscribers suspected of illegal on-line music swapping.

By launching iTunes, Apple preempted even Microsoft. And it has since broadened its market appeal by establishing allowance accounts for teens without credit cards, streamlining the sign-up process for 25 million AOL subscribers, and developing Airport Express to enable users to beam downloaded music to their home stereos. Most significant, it has sold 95 million songs since the early 2002 launch.

Apple's strategy clearly emphasizes a simple value proposition: seamless access to as many musical selections, in the most straightforward manner possible, at a competitive price. But the playing field is rapidly changing and iTunes now has to contend with credible new entrants such as Real Player. The latter offers more user-friendly features that enable users to download with fewer clicks. Real Player also offers higher quality downloads but sacrifices storage space to do so.

Critical Next Steps in Audio Revolution

Doubtless, all of this evidences a revolution in the audio market. Sony once owned the portable music market with its Walk-Man brand, but relinquished potential leadership in the download market because of its dislike for hard disk technology. In many ways, Sony demonstrated a strategic and technological myopia that hurt the recording industry as well. Albeit late, Sony is about to introduce an iPod that will play music downloads in several formats, but not music from the iTunes site.

Clearly, the incompatibility of downloads with iPod players is a key hurdle to be surmounted. The proprietary nature of the existing download limits consumers to playing music using only one type iPod device. Will Apple out-position Real Player by leveraging its hardware competency? Or will the jukebox software supplied by Real Player, which plays all major copy-protected formats, pose a disadvantage for Apple similar to that posed by the Microsoft Windows operating system, even though Apple cleared the Microsoft hurdle with its iTunes Windows Version?

Future Battles

As the recording labels have continued to sign new agreements and loosen their grip on distribution channels, the hope for revitalization of the majors that might have occurred with the appropriate strategic alliances has faded.

The degree to which the legitimate market cannibalizes the illegitimate market depends on how user-friendly current legitimate user options are perceived to be. Moreover, the battle grows as competitors orchestrate strategies to give the market the optimal interplay of download methodology, jukebox software, and player

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capability.

The stakes are increasing and competition is heating up as the coveted turf for this war—in particular, your living space—expands. Apple has expended much effort disputing Sony's claim of superiority for its new iPod. Industry experts, moreover, have cited potential security risks posed to businesses by iPods and have warned of the implications to the video industry, which, ironically, is the new choice of pirates who have benefited from increasingly speedy internet connections!

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