

DIGITAL MUSIC REPORT 2008 - SUMMARY

INTRODUCTION

John Kennedy – making ISP responsibility a reality in 2008

(Excerpts only) A revolution is sweeping the music industry as record companies adapt to a new digital marketplace. But another sea-change is happening – ISP responsibility for protecting content is becoming an accepted idea. Up until now ISPs have allowed copyright theft to run rampant on their networks, causing a massive devaluation of copyrighted music. More than anything else, the Sarkozy agreement in France has changed the mood, but there has been progress among Governments and in courts elsewhere too: in Sweden, Belgium, the UK, the US and Asia.

A turning tide of opinion is one thing – a concrete programme of action is another. The time for action is now – from the EU and other Governments. Revolution and innovation are not going to be enough to secure a healthy future for the music industry. 2007 was the year ISP responsibility started to become an accepted principle. 2008 must be the year it become reality.

SECTION 1 – DIGITAL MUSIC IN KEY FACTS AND FIGURES

- Global digital music sales totalled an estimated US\$3 billion in 2007, a roughly 40% increase on 2006 (US\$2.1 billion)
- Single track downloads, the most popular digital music format, grew by 53% to 1.7 billion (including those on digital albums)
- Digital sales now account for an estimated 15% of the global music market, up from 11% in 2006 and zero in 2003. In the world's biggest digital music market, the US, online and mobile sales now account for 30% of all revenues
- The music industry is more advanced in terms of digital revenues than any other creative or entertainment industry except games. Its digital share is more than twice that of newspapers (7%), films (3%) and books (2%)
- There are more than 500 legitimate digital music services worldwide, offering over 6 million tracks – over four times the stock of a music megastore
- Tens of billions of illegal files were swapped in 2007. The ratio of unlicensed tracks downloaded to legal tracks sold is about 20 to 1

- Lack of interoperability between services and devices, lack of investment in marketing of new services
- The growth rate of around 40% in digital sales did not offset the sharp fall in CD sales globally, meaning that the overall market for the year will be down on 2006. First half 2007 sales dropped 9%.

Top 10 Global Digital Singles 2007

	Artist	Song
1	Avril Lavigne	Girlfriend
2	Utada Hikaru	Flavor of Life
3	Rihanna	Umbrella
4	T-Pain	Buy U A Drank (Shawty Snappin')
5	Akon	Don't Matter
6	Soulja Boy Tell'Em	Crank That
7	Shop Boyz	Party Like a Rock Star
8	Sean Kingston	Beautiful Girls
9	Mims	This is Why I'm Hot
10	Beyonce	Irreplaceable

Reinventing an industry – The digital difference over five years

	2003	2007	
Number of legal services	c30	Over 500	A legal digital music market has been created from scratch over the last five years, with consumers now able to shop around more than 500 legal services.
Licensed tracks	1 million	6 million +	Consumers can now legally access more than six million tracks through legal services.
Value of digital music sales	Around US\$20 million ¹	Around US\$3 billion	Record labels have created a digital music industry worth approximately US\$3 billion in just five years, a rate of growth many industries would envy.

¹ Estimated digital sales, USA, IFPI

Digital as a percentage of overall recorded music sales	0%	15%	Almost a sixth of music sales already come through digital channels just five years after legal options opened up and this figure is set to grow.
Number of formats available per artist release	Less than 10 and dominated by the CD and cassette	Over 100	Today a single artist release can be packaged in multiple formats include video downloads, ringtones or mobile full tracks. Sales of Justin Timberlake's <i>FutureSex/Love Sounds</i> comprised 115 products which sold a total of 19 million units, of which only 20 per cent were in CD format.

Music formats and channels are diversifying.

- Single track downloads, the most popular digital music format, grew by 53% to 1.7 billion (including those on digital albums)
- Sales of mobile full-track downloads were on course to doubling in the year, up to 12% of the digital market in the first half of 2007
- Consumers want to buy album downloads, not just singles – digital album sales were up 40% in the first half of 2007. Consumers usually choose higher-value bundled music products over low-priced ones

Digital music growth varies by country

- Single track sales grew 45% in the US and 48% in the UK
- The digital market is roughly evenly split between online and mobile, with widely varying shares in different countries: for example online sales account for 67% of the US market while over 90% of Japan's digital sales are on mobile
- The UK has Europe's most advanced mobile music market, while South Korea has become the first market where digital sales have overtaken physical music sales
- Digital sales are weak in France due to high levels of unauthorised file-sharing – prompting the Sarkozy plan for action against piracy by ISPs

- China has huge potential, but digital music business is held back by piracy (digital piracy is 99% in China) and poor returns to rights owners in the mobile sector
- *Case Study:* Mobile music has been a notable success in Japan, where leading artists such as GreeeeN and Utada Hikaru are among the world's biggest sellers of mobile downloads. Japan is the one major music market where growth in digital sales have offset the decline in CD sales, producing overall growth

SECTION 2: CHOICE, AVAILABILITY, PORTABILITY

- **Growing availability** of repertoire, more choice and the spread of portable devices have helped drive music demand to an all time high. There are now more than 500 licensed online music sites worldwide, offering over six million tracks. Record labels are continuing to digitise their back catalogue.
- **Music on the go.** There has been an explosion in portable players, led by the iPod and including Zune and Nokia and Ericsson's music phones. With a new generation of devices, there is growing convergence between the mobile phone and portable player – e.g. iPod Touch, iPhone, the new Zune player.
- **Recorded Music Boosts US\$130 billion sector.** Demand for music is at record levels – up 15% in 2007, according to Nielsen SoundScan. This is boosting the entire music supply chain, from hardware manufacturers to broadband suppliers, live music to radio station's advertising revenues. However, record labels are not seeing the benefit of this increased revenue, despite investing heavily in music.

Investing in talent and marketing – the key functions of the record company

Record labels invest up to 20 per cent of their revenues on discovering and nurturing new talent. New digital communication channels and social networks have increased, not diminished, the importance of good A&R and marketing.

Max Hole, Executive Vice President at Universal Music Group International, says many artists want the benefit of working with others who share and match their vision, energy and enthusiasm. "Someone," he says, "who can open a door to the producer/recording engineer/songwriter that they love." In addition, artists do not always have the necessary specialist skills to take care of the business side of their careers – skills which record companies offer.

There are more than 1.2 million rock acts and 1.7 million R&B acts alone clamouring for attention on MySpace. This overwhelming number of new bands and music available to consumers also highlights one of the key roles for record companies in the digital space. The need for filtering, selection, marketing and recommendation is greater than ever.

SECTION 3: EXPLODING FORMATS AND BUSINESS MODELS

Five years ago music distribution formats numbered in single fingers. Today they number in the hundreds.

- **A-la-carte download services** remain the dominant model. iTunes overtook Amazon and Target in the US to become the third largest music retailer. Big-brand new market entrants in 2007 included Amazon and Nokia's "Comes with Music"
- **Subscription services** such as Napster are growing, especially in the US, but have been held back by lack of interoperability with the iPod and other players and under-investment in marketing. A wave of new services, involving both mobile operators and ISPs, represents an opportunity for to grow such services: for example, Omnifone's MusicStation, Nokia's "Comes with Music" and the Neuf Cegetel/Universal partnership in France
- Interoperability has long been a key goal of the record industry, which has worked with its industry partners to develop technological solutions enabling fully interoperable DRM. Unfortunately, despite the potential for such solutions, some major technology providers have so far been unwilling to participate. Faced with this lack of progress, all the major record labels decided to offer **non-DRM download services**, either permanently or as part of a trial period to supplement their existing offerings
- **Advertising-supported models** and social networks are proving to be exciting ways of promoting new music. Labels and partners continue to test new ways of monetising such models. Record companies have signed various agreements with social networks such as MySpace, Bebo, YouTube, LastFM and Imeem. These are mostly based on licensing agreements for streaming music videos for a share of advertising revenue
- Record labels are also increasingly going **direct-to-fans**, selling products through artist-driven websites. Labels are also working on '360 degree deals' that will see companies and artists share revenues much more comprehensively, from record sales to merchandise, publishing, brand sponsorship and touring
- Record company teams identify **brand partnership** opportunities. With the decline in traditional forms of advertising on TV and radio, music helps brands reach consumers online. For example, the SonyBMG Musicbox video network comprises ad-driven online video players deployed across 600 artist and label websites

SECTION 4: COPYRIGHT THEFT IS CHOKING THE GROWTH OF THE DIGITAL MUSIC BUSINESS

- Tens of billions of illegal files were swapped in 2007. The ratio of illegal tracks downloaded to legal tracks sold is around about 20 to 1. Expansion of broadband,

particularly in developing markets like China and in Latin America, is driving an increase in unauthorised file-sharing on P2P networks

- Online peer-to-peer networks are still the biggest source of online copyright theft –independent surveys say that between 50% and 80% of ISP traffic is on peer-to-peer networks
- Despite the success of mobile music in Japan, the first spectre of large-scale mobile music piracy has emerged. in Japan with more than one third of all mobile users admitting to regularly downloading illegally on mobile networks
- Numerous third party studies show that illegal file sharing results in less music purchased. . Italy's Luigi Einaudi Foundation in 2007 found that 30 per cent of peer-to-peer (P2P) users bought fewer CDs and DVDs, while only six per cent said they bought more CDs. In Australia, research undertaken for ARIA (February 2007) shows that 57 per cent of p2p downloaders rarely or never purchase the music they download – pointing to straight substitution of legitimate sales
- The US economy loses US\$3.7 billion as a result of illegal downloading according the Institute of Policy Innovation study in 2007
- China's, with nearly as many broadband users as the US and little effective enforcement, is one of the biggest sources of illegal downloads in the world. . Large, listed companies such as Baidu, Sohu, Sina and Yahoo! China all offer such unauthorised services that are available throughout the world and particularly popular in Asia. In December 2007, a Beijing court confirmed that Yahoo! China was acting illegally by facilitating mass copyright infringement

The response - industry action is helping contain the problem, disrupting traffic of unlicensed music

- The number of regular illegal file sharers rose 35% between 2003 and 2007, while broadband use globally increased fourfold
- In the US illegal downloads rose 14% in 2007 opposed to 56% increase in broadband penetration. According to Jupiter, 17.6% of internet users regularly file share – the level is the same as it was in 2003
- The number of files on one the world's largest peer-to-peer servers, eDonkey dropped by 40% to 400 million in 2007
- US researchers NPD say that 40% of people searching illegal downloads could not get what they wanted (November 2007)
- The US actions focused on university have succeeded in getting campus administrations to block access to illegal sites and tighten their rules

- IFPI research debunks the common myth that downloaders get a better choice of music on illegal networks. 95% of a sample of 70 artists were found to be more available on iTunes than on Limewire
- Where there is no enforcement, the rates of illegal file sharing are greater such as in Netherlands and Spain (28% and 35% of internet users illegally file share regularly)

Debunking the availability myth: fans get better choice on legal sites

IFPI conducted research with a sample of 70 acts, mentioned by focus group participants (aged between 15 and 25) in the UK throughout 2007, ranging from underground bands to mainstream artists, including names such as Cherry Ghost and Jack Peñate. The research examined the availability of songs from these artists on the legal site iTunes and on the copyright infringing service Limewire. In 95 per cent of searches the artists requested had more songs available on iTunes than on the leading P2P service.

Tackling Pre-Release Piracy

- A rising problem since an album makes the bulk of its revenues in the first six weeks after release
- The IFPI team monitors hundreds of albums at any one time
- Copies are leaked via the legitimate supply chain to organised ripping groups
- IFPI sent 350,000 warning notices in 2007 and kept 120 million illegal files off the internet
- IFPI-BPI shut down the world's largest source of pre-release copies, OiNk, which had supplied more than 60 major album releases pre-release

SECTION 5: TIME FOR ISPS AND GOVERNMENTS TO ACT

- **ISPs are the gatekeepers of the internet** and have a vital role to play in curbing copyright abuse. IFPI has been urging that government and the telecoms industry recognise this for some time
- **Sarkozy plan leads the way.** In November 2007, President Sarkozy of France announced a potentially revolutionary new agreement under which ISPs would commit to disconnecting persistent copyright infringers from their networks
- **Progress elsewhere.** The Gowers Report in Britain and the Renfors Report in Sweden both recommended to government that ISPs should disconnect persistent infringers, by voluntary agreement if possible or legislation if not. A Belgian court ruling on the SABAM v Tiscali case concluded ISPs should address mass copyright infringement and that they had the means to do so

- **ISPs increasingly have a commercial incentive** to work with the creative industries. Independent studies have shown P2P traffic absorbs around 50 to 70 per cent of their bandwidth. This has a negative impact on the ISPs plans to share in revenue from legitimate copyrighted music
- **Governments must act to stop havens of piracy.** Sweden and China have seen high profile cases, the Pirate Bay, Yahoo China and Baidu, of companies ignoring domestic intellectual property law and making a profit from facilitating access to copyright infringing music

SECTION 6: CREATING VALUE IN THE DIGITAL SECTOR

While the relatively small size of music files makes them the most easily pirated content online, other industries are also affected. Research has shown that industries from film to publishing have been hit. Other industries, from newspapers to television are grappling with dramatic changes in their business landscape. Even firms that are at the most cutting edge of digital technology, from MySpace to Skype, are finding it difficult to monetise the internet.

SECTION 7: HIDDEN DANGERS OF ILLEGAL DOWNLOADING

- Unlicensed internet services, such as P2P networks, are major sources of spyware, malware, adware, viruses and identity theft, according to numerous independent reports
- Symantec's research notes that P2P is one of the top 10 forms of distribution for viruses and malware. The company found that 15 per cent of all potential infections in the first half of 2007 came from eDonkey alone
- McAfee found that clicking through from searches involving P2P terms is highly dangerous
- Benjamin Googins of CA discovered that a single MP3 download from an unauthorised site resulted in trojan downloaders, spyware and pop-up ads installing without permission, having a severe impact on his computer's performance
- Research conducted by Ipsos-MORI for IFPI suggests that one in five young office workers in the UK are using their workplace computers to swap copyright infringing music. Nearly half of those questioned who file-shared at work said they did know their company had a policy on breaching copyright, suggesting they were ignoring such rules
- Recent high-profile cases involving firms like Pfizer and Citigroup have shown how P2P usage in the workplace can lead to breaches of confidential data

SECTION 8: PROMOTING THE VALUE OF MUSIC

Education is a key priority for the music industry. The industry however needs cooperation from governments to help break the “free music” mindset. Some countries are leading the way, such as Australia which is working with the industry to develop an intellectual property syllabus within schools to bring music into the classroom. Other industry initiatives range from Mexico’s ‘Guardians of Music’, which asks fans to report infringing music from their favourite artists on the internet, to the Face/Face project in France, which saw record business leaders directly engage with online commentators about music and the internet.