

DIGITAL DOWNLOADS:

THE NEXT FRONTIER FOR RETAILERS OF RECORDED MUSIC

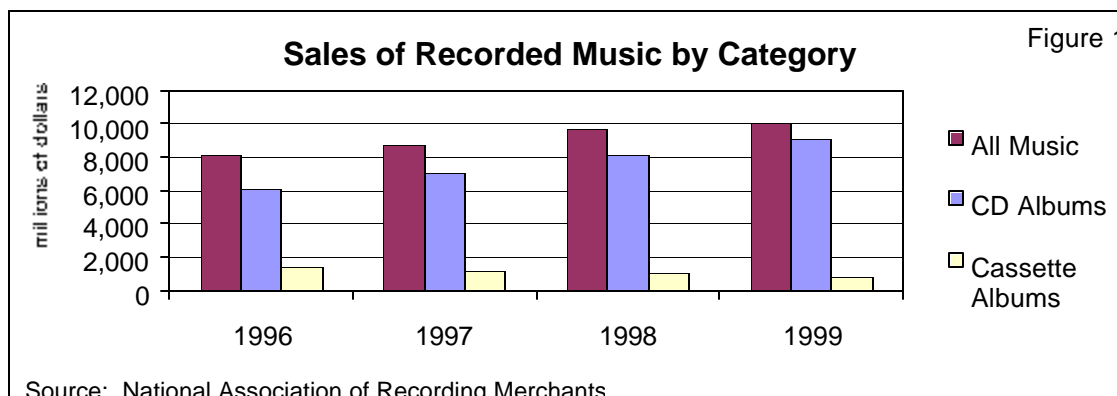
By David Brand

Not long ago, the options for purchasing recorded music were either a brick and mortar retailer or a mail-order club. Since then, the Internet has opened up as a new retail channel for music sales, and many upstarts have entered this business. More recently, we have seen the beginnings of the distribution of recorded music in digital form, some by legitimate retailers. However, a portion of digital music is traded illegally among computer users, an issue which has lately received a lot of attention. So what has been the response of the brick and mortar retailers in this competitive environment?

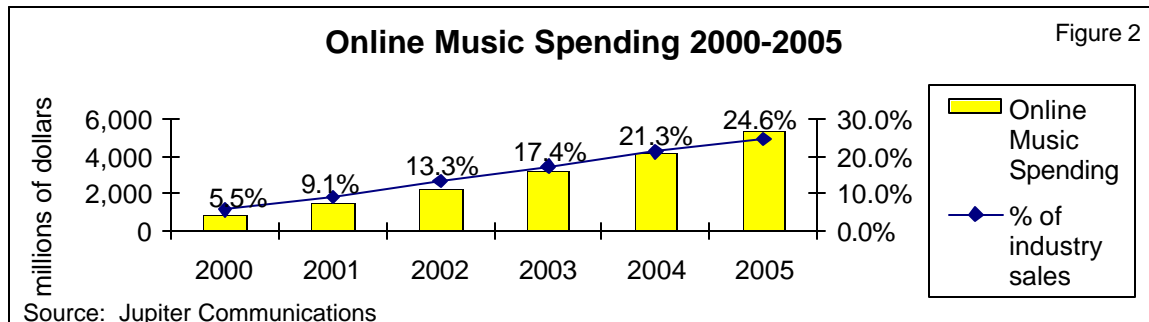
Before we look at this question, it may be useful to analyze the situation the retail music industry currently finds itself in. Until recently, there were many difficulties related to recording and storing music in digitized form. One of the advancements in this regard came with the MP3 file, or MPEG (Moving Pictures Experts group) audio layer 3, which consumes far less digital space than typical audio files. With this format, many discovered that they could not only capture and store music files found on the Internet or in their own CD collections, but that they could also exchange them with others.

Around this idea have spread many sites that make these files available for free or for purchase as well as numerous systems for moving these files around the Internet. The most noteworthy of these has been [Napster](#). Napster began as a largely unknown service that facilitated the free exchange of MP3 files between users' hard drives. However, not all the MP3 files that are exchanged on Napster have permission to be distributed so freely. Napster, which claims to have 20 million users, was ordered to shut down at the end of July, but as of this writing they were still in operation. Even if the music industry can put them aside, they are not the only service of its kind. There are also [Scour](#), [Gnutella](#) and [Nullsoft](#), among others, which also offer free file exchanges.

While the free exchange of copyrighted works without permission is illegal, there are several sites, such as [MP3](#), [eMusic](#), [Riffage](#), and [Launch](#) which all have agreements with major record labels to sell and distribute prerecorded music. In addition, the record companies have gotten into the act—[Sony](#) now offers downloadable tracks from its site, some for free, some for a fee. While at the present time there are no definitive studies that can prove with precision what impact this distribution, legal or illegal, is having on the music industry, sales as a whole have risen 25% since 1996. (See Figure 1.)



While sales for the recorded music industry have improved over the last four years, where those dollars will be spent in the future is another issue. Figure 2 illustrates [Jupiter Communications'](#) prediction for online music sales through 2005 and the percentage of industry sales they represent. Please understand that it is important to keep these numbers in perspective, as they represent forecasts for a nascent industry.



In addition, it is interesting to note that Jupiter believes that by 2005 28.2% of online music spending will be on *digital downloads*—compared to just 1% in 1999—suggesting an inexorable movement toward the demise of physical product. However, this outcome will depend on other variables, such as the penetration of high-speed Web connections and the amount of titles available through this method.

It would appear from a review of the above that traditional retailers might have a tough road ahead of them. If so, what are they doing to ensure their survival in this competitive climate? Their approach has been two-pronged. Until now, most online retailers have been utilizing online channels to sell physical and digital product. [Tower Records](#), in addition to an exhaustive collection of physical product available online, has made 60,000 music tracks available for download as well. [TransWorld's](#) site has entire CDs available for download, as do [Musicland's](#) sites, which include [Sam Goody](#) and [Media Play](#), although on a more limited basis.

The more intriguing response from traditional music retailers has been to make music available for digital download in the stores. At the present time, several retailers, including [Virgin Megastores](#), [Wherehouse Music](#), [Barnes & Noble](#), [Wal-Mart](#) and [Kmart](#) have already equipped select outlets with kiosks that allow a customer buy custom made CDs from a machine that appears similar to an Automatic Teller Machine. Disney Stores put these music kiosks in some of its outlets and revenue reportedly shot from \$270 to several thousand dollars per square foot in these locations.¹ This is also an interesting example of a non-music retailer using these new kiosks to enter this business. However, there are currently drawbacks to these kiosks: they are largely limited to enough disc space for about 50,000 songs—a very limited selection of song titles compared to the millions that have been produced—and it takes roughly twenty minutes for a customer to choose the songs and then have them burned on-site into a CD album, putting a limit on the number of customers that can access this product at any given time.

It is quite possible that the music store of the future may contain numerous kiosks, which may also allow for a decrease in the amount of physical stock that is needed. While there is no hard data on the success of these ventures, these kiosks do present retailers with an opportunity to greatly enlarge their offerings in an existing real world location while still rendering the personalized customer service not found on the Web.

¹ "Are In-Store Kiosks the Future?" Music Week, June 24, 2000, p. 22.