

Possibilities of selling mp3-tracks in the Internet:



High Technology Marketing (186206)
Socrates Program 1999/00
University of Twente, June 2000

EXECUTIVE SUMMARY

When analysing the Internet company EMusic, we found out that the company is already combining well its strengths and opportunities. However, we also saw several threats and weaknesses in company's external and internal environment. We developed the following recommendations that can enable EMusic to hold and even improve its promising situation.

We recommend that EMusic should go on with contacting the music catalogues of the major record labels to increase the available range of downloadable music. This could be done by developing new strong strategic partnerships. Due to EMusic's expertise and knowledge about the Internet and the music market, we believe, that EMusic could be an attractive partner, also for the major record labels.

EMusic has to offer additional value to the customers that make them buy downloadable music. This can be done by offering a wide range of downloadable music with easy access to it. In addition, the right combination of a price of the music and the quality of music must be taken into consideration.

We also recommend that the company should stay open for all possible standards of downloadable music, not only MP3. The current EMusic trusts on a business success through selling downloadable music. However, the company should also consider additional sources of income - e.g. music on demand, and selling CDs. Moreover, we also suggest that the company should offer the service in as many languages as possible. EMusic is in business to consumer business and the web site should speak the language of the customer all over the world. An important point is also to strengthen EMusic as a brand.

Despite of the promising situation of the company, Internet offering several opportunities, EMusic faces several threats, which it has to overcome. The biggest ones are the costs and time needed for downloading music and the worse sound quality of MP3s compared to the CD format. In this, the company has to wait for better technologies.

EMusic also has to battle against competing business models. This means that EMusic has to make sure, that the company is growing steadily and organised. The company should also think of the possibility that the flexible structures of the company might end up ineffective.

TABLE OF CONTENTS

EXECUTIVE SUMMARY	I
INTRODUCTION	1
OVERVIEW OF THE COMPANY.....	2
WHAT IS EMUSIC?	2
HISTORY	3
PRODUCTS AND SERVICES	4
FINANCIAL FACTS	5
BUSINESS ENVIRONMENT	6
RECORDED MUSIC INDUSTRY	6
COMPETITION	6
SUPPLIERS	7
PRODUCT SUBSTITUTES.....	7
OTHER FORCES.....	8
COMPANY STRATEGY	9
EMUSIC OPPORTUNITY	9
EMUSIC VALUE PROPOSITION.....	9
STRATEGY ELEMENTS	9
ANALYSIS AND RECOMMENDATIONS.....	10
SWOT ANALYSIS	10
OPPORTUNITIES.....	10
STRENGTHS	11
THREATS	13
WEAKNESSES	16
MATCHING PROCESS.....	16
RECOMMENDATIONS	17
CONCLUSION.....	19
REFERENCES	20

INTRODUCTION

People and different organisations have nowadays very different views about digital music. CEO Jonathan Bulkeley in Barnesandnoble offers one view. He claims that digital distribution of music, as a mainstream industry, is still years away.¹ But he also admits that the digital music distribution will be big in the future. He sees that there will be three phases for the industry.

In the first phase, users will be able to experiment with various music players and download individual tracks. In the second phase, users will be able to mix and match various tracks or music and buy customised packages of digital music. EMusic, a company we introduce in this report, is working towards this model, allowing visitors to purchase and download individual tracks and entire albums. The final phase of the digital music industry will involve the direct distribution of music from the artists to the consumers, according to Jonathan Bulkeley².

There are a number of companies battling for a piece of this market. Only in the United States, online sales of recorded music will grow from \$150 million in 1998 to \$2.5 billion in 2003, according to Jupiter Communications. Predictably, the number of consumers that turn to the Web to buy music will rise, from 10 million in 1999 to 33 million in 2003³.

And at this moment, the most well known format for downloading of digital music over the Internet is MP3 (MPEG Audio Layer 3). The development of MP3 started already in the late 70s. MP3 has created a new way to manage, transfer and listen to music. In an MP3 file, it is even possible to have information on music style, the artist, and the lyrics of the songs.

In this report we start with an overview of EMusic's history, its products and services, and financial facts. First, we describe EMusic's position in the industry. We present EMusic's short history starting from the year 1998. We also illustrate company's products and services, which nowadays include web sites, such as DownBeatJazz.com and RollingStone.com.

In the section of business environment, we describe recorded music industry and its importance; we also state the competition situation that a company operating on that field faces. We end the section by describing the suppliers of the company and the possible product substitutes. We also make a short look at the other possible forces concerning the future development of the company.

After that we go more in-depth with the strategy of the company. We specify the opportunity EMusic tries to explore in the music industry. We also present EMusic's value proposition. Then we make SWOT analysis about the company's external and internal strengths and weaknesses. Finally, we make recommendations for the company based on the analysis previously made.

OVERVIEW OF THE COMPANY

What is EMusic?⁴

EMusic.com is a web site for sampling and purchasing music in the MP3 format, which has become the standard in the digital distribution of music. EMusic.com, Inc. is a leading provider of downloadable music over the Internet. Through its web site at EMusic.com, the company offers a selection of music from which customers may discover, sample, and purchase popular recordings for immediate digital delivery and enjoyment. The recordings available for download at EMusic.com are provided through relationships with a growing roster of recording artists and independent record labels. The company currently has exclusive, multi-year, digital download licenses to over 300,000 titles, from over 85 record labels and over 1,300 recording artists, including selected titles from well known artists. In addition, the company's IUMA subsidiary offers the customers access to over 4,000 unsigned artists. EMusic.com reported revenues of \$92,000 for last year. The company is based in Redwood City, California, with regional offices in Chicago, Los Angeles, New York and Nashville.

The company allows consumers to quickly and conveniently purchase music online at a lower price than most traditional music CDs. The web site also allows consumers to download and listen to music immediately. It also enables artists and labels to easily access a global customer base, while providing them with an integrated means of distributing, promoting and tracking the sales of their recorded music. Recordings are offered for sale on EMusic.com in the MP3 format, the most widely recognised compression standard for the download of musical recordings.

The idea in MP3 is the same as in packing pictures to JPEG-format; it is possible to reduce the information in the file, if it is done in a way that a human being can not notice it. But MP3 is not the first packing standard for music / sound files. MP3 is widely used because it is not dependent on operating systems or hardware. The music can be encoded between 32 and 320MBps. Music encoded at 128MBps is nearly equivalent to CD-quality.

The company believes that its combination of selection, convenience, varied content, improved distribution and tracking capabilities creates a compelling music purchasing experience for consumers as well as an attractive distribution alternative for artists and independent record labels.

Nowadays EMusic has 180 full-time and part-time employees including employees in content acquisition and marketing, in engineering and product development, in finance and operations, and in other administrative functions. Their future success depends on the continuous service of their key technical, editorial, product development and senior management personnel, and on their ability to attract and retain highly qualified technical personnel, for whom competition is intense. None of the employees are represented for any collective bargaining unit.

EMusic mission can be seen as follows: "to become leading provider of compelling, downloadable music directly to customers over the Internet".

History⁵

Since it was founded in January 1998, EMusic has established itself at the forefront of how new music will be discovered, delivered and enjoyed in the next decade. Actually, only in June 2, 1999, GoodNoise Corp. changed its name to EMusic.com Inc. At that time, the company also announced that its stock would be traded on Nasdaq. Later on, EMusic.com Inc. announced it had signed an exclusive license agreement with The King Biscuit Entertainment Group. Under the terms of the agreement, EMusic.com would release dozens of titles from King Biscuit's four imprints for download in the MP3 format. They also announced that the MP3 availability of selected music from the catalogue of digital pressure, a division of peer music. At the same time, EMusic.com also announced its acquisition of Internet Underground Music Archive (IUMA).

Six days later, EMusic.com Inc. announced new digital distribution agreements with six independent rock record labels, and a new strategic partnership with and equity investment in Crunch Music Ltd., a United Kingdom marketer of independent music in the MP3 format. Under the new relationship, the two companies would work together on marketing and promoting their web sites, partner labels and music on both sides of the Atlantic.

In August 1999 EMusic.com Inc. and America Online Inc. (AOL), an Internet media Company, announced that EMusic.com would offer downloadable music on America Online's ICQ, Spinner and Winamp services. The agreement called for EMusic.com and the ICQ, Spinner and Winamp brands to cross-promote downloadable music products through reciprocal links, web advertising and other marketing initiatives. Under the non-exclusive, three-year agreement, EMusic.com will pay AOL a fixed marketing fee as well as a share of transaction revenues. AOL will also receive warrants in EMusic.com. In the same month they also announced a new relationship with Yahoo! Inc., an Internet media Company, to offer downloadable music, including MP3s, on Yahoo! Digital, a new multimedia site.

In September 15, 1999 Underground Music Archive (IUMA), one of the oldest Internet sites to deliver music on the Internet, re-launched its web site. In November 1999 EMusic.com Inc. announced it had signed a definitive agreement to acquire privately held Cductive.com, a source of music on the Internet.

In November 30, 1999 EMusic.com Inc. announced it has signed a definitive agreement to acquire privately-held Tunes.com, the Chicago-based operator of RollingStone.com and DownBeatJazz.com, and the third most-visited network of music web sites with over 28 million page-views and approximately 1.3 million unique visitors per month. The stock-for-stock transaction is valued at approximately \$130 million, based upon the closing price of EMusic.com stock on November 26, 1999. Those two sites remain nowadays as the most important web sites for EMusic.

In October 19, 1999 EMusic.com Inc. and Concord Records, an independent jazz record label, announced a strategic partnership and exclusive digital distribution agreement covering Concord Record's catalogue of classic and contemporary jazz music, including some recordings not currently available. As part of the agreement, the two companies will receive equity stakes in each other.

During the first period of 2000, EMusic.com Inc. announced the completion of its acquisition of privately held Tunes.com, creating a new company that will serve as a

source of music information. They also announced a new affiliate marketing program that allows any music-related web site to earn money by linking to and selling downloadable music from EMusic.com's catalogue of over 100,000 MP3 songs.

In March 2000 EMusic.com Inc. announced a new partnership for developing new and emerging artists with online record label Kramden Enterprises and The Sire Records Group, a wholly owned subsidiary label of Warner Music Group and Time Warner Inc. Through the new arrangement, Sire will license albums back to select artists who will enter into a service and distribution agreement with Kramden Enterprises. Kramden will promote, market and sell the albums digitally through EMusic.com, and independently through traditional brick-and-mortar channels. As these acts develop through their relationships with Kramden and EMusic, Sire will have the opportunity to provide major label promotion, marketing and distribution.

At the same time EMusic achieved a very important advantage from their competitors: Their customers were allowed to download entire MP3 album automatically at once, as opposed to other sites where separate songs must be downloaded individually.

In April 2000, EMusic.com Inc. announced the acquisition of Music of the World Ltd. and its premier world music labels: Music of the World, Latitudes, and Nomad. In the last months, EMusic has also made some improvements in their activities and in the service delivered to their customers, such as the new relationship with the Hewlett-Packard Company, providing sample digital music in the MP3 format on the new HP Jornada 540 Series Color Pocket PC. As a part of this relationship, EMusic will provide HP with full-length MP3 tracks from ten artists in a variety of musical genres for inclusion on the CD that accompanies the HP Jornada. They also committed with ReQuest Multimedia Inc for providing them with a selection of MP3 music from its catalogue of artists in MP3 format that will be pre-installed on ReQuest's AudioReQuest units.

As we can see from the previous, with company acquisitions EMusic has grown only in few years to be one of the biggest providers of downloadable music over the Internet.

Products and Services⁶

In addition to having the Internet's largest catalogue of downloadable MP3 music available for purchase, EMusic operates one of the Web's most popular families of music-oriented Web sites -- including *RollingStone.com*, *EMusic.com*, *DownBeatJazz.com*, and *IUMA*. The Company currently has over 100,000 titles available for download on its EMusic.com Web site. Through direct relationships with leading artists and exclusive licensing agreements with over 650 independent record labels, EMusic.com offers an expanding collection of tracks for purchase -- individual tracks for 99 cents each or entire downloadable albums for \$8.99.

EMusic.com features top artists in all popular musical genres, such as Alternative (Bush, Kid Rock, They Might Be Giants, Frank Black), Punk (Blink-182, The Offspring, Pennywise), Jazz (Duke Ellington, Dizzy Gillespie, Louis Armstrong, Concord Records), Blues (John Lee Hooker, B.B. King, Buddy Guy), Hip Hop (Kool Keith, The Coup), Country (Willie Nelson, Merle Haggard, Patsy Cline), Rock (Phish, Goo Goo Dolls, David Crosby), World (Nusrat Fateh Ali Kahn, Lee 'Scratch' Perry) and Vintage Pop (Liza Minnelli, Eartha Kitt, Judy Garland).

RollingStone.com is the Web's premier authority on popular music. The site leverages Rolling Stone magazine's unrivalled deep archives, including more than 7,000 artist profiles, an extensive collection of exclusive photos and interviews, 30 years of magazine covers, over 4,000 on-demand videos and Rolling Stone Radio, with 13 stations of streaming music, including a channel programmed and deejayed by the legendary David Bowie.

DownBeatJazz.com is the leading online destination for the jazz community, featuring daily music news, album reviews, and background information on artists, concert/tour updates, and interactive discussions between fans, experts and musicians.

IUMA pioneered the delivery of music on the Internet in 1993 and is one of the Web's top sites for unsigned artists. Similar to MP3.com, IUMA showcases the Web sites and music of thousands of emerging artists to millions of music fans. In addition, IUMA offers its 10,000 bands powerful-but-easy Web development tools, unparalleled ad revenue sharing, and access to EMusic.com's relationships with over 650 leading independent labels - giving them much greater visibility among key Indie labels and Rolling Stone editors.

EMusic also offers many services to their customers, and not only the music. Services online include all services described above plus a free installation of the MP3 software. Thanks to this service, many customers can listen to the music that EMusic.com is trying to sell. Other additional service that EMusic provides, but this one with nothing to do with the music is "the Company Stock Quotes E-mail Service", which provides personalised e-mails to keep the customer informed about the company's stock performance. As a registered user, the customer will automatically receive a daily e-mail update with the current stock price, news headlines and other key fundamental data.

Financial facts⁷

EMusic.com reported revenues of \$92,000 for the fiscal year ended June 30, 1999. Those revenues have been comprised of advertising and sales of physical merchandise and downloadable music recordings. EMusic common stock is traded on the NASDAQ National Market. In the figure 1, we can see the evolution of their shares in the last two years.

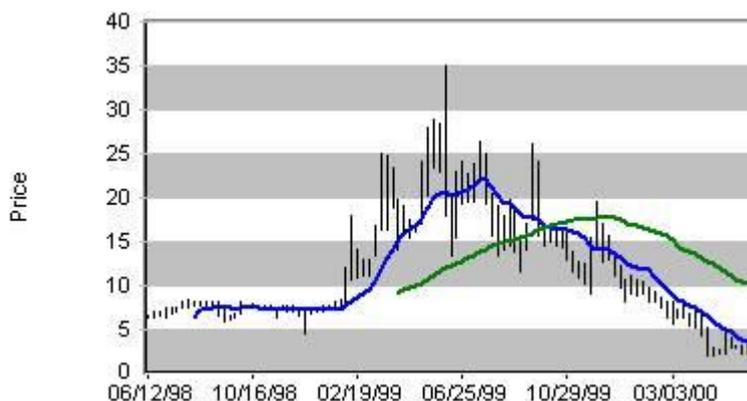


Figure 1. Evolution of the EMusic shares

At June 1999, there were approximately 138 stockholders of record of the company's common stock. The company has never declared or paid dividends on its capital stock, and does not anticipate paying any cash dividends in the foreseeable future. The company currently intends to retain future earnings for the development of their business. The current price of their shares is \$ 2.8125 and the earnings per share in the current year has been \$ -3.52, which means that it has not been a good year for EMusic investors.

BUSINESS ENVIRONMENT

Recorded music industry

According to a report by Market Trading International, world wide retail sales in the music industry were \$39.7 billion in 1997 and are expected to grow to \$46.9 billion by 2004⁸. The music industry can be divided in two kinds of record companies: the major labels and the independent record labels. The five major record labels, BMG Entertainment, EMI Music, Sony Music Entertainment, Universal Music Group and Warner Music Group, currently account for 79% of all recorded music sales world-wide. These companies have substantial investments in the distribution infrastructure which supports the manufacturing, distribution and retailing of records and compact discs and through which the substantial majority of current recorded music sales take place. Thousands of independent record labels account for most of the remaining recorded music sales.

Competition⁹

The market for online promotion and distribution of music and music related products and services is a very competitive one. Nowadays there are more than one hundred music retailing web sites on the Internet. The number of Internet web sites competing for the consumer and the advertiser attention is growing and it will continue to grow. There are few barriers to entrance, so it is quite easy, even for small entrepreneurs, to enter the business. EMusic faces competitive pressures from actual and potential competitors including:

- providers of online music content like MP3.com, Musicmaker.com, Vitaminic.com and various others
- providers of music news and community such as Launch Media, Inc., and various private companies
- companies offering MP3 or other audio compression formats, such as those of AT&T Corp., Liquid Audio, Inc. and IBM Corporation, Microsoft Corporation, and RealNetworks, Inc. Some of these companies also offer customers the ability to download music from their web sites
- online destination sites such as online music retailers like Amazon.com, Inc. and CDNow, Inc. , and online portals like Excite
- traditional music industry companies, including BMG Entertainment, Sony Music Entertainment, Warner Music Group, and Universal Music Group
- search engine companies like Napster and file sharing networks like Gnutella and others

In the providers of online music content, MP3.com and Musicmaker.com, are the biggest threats to EMusic¹⁰. *MP3.com* uses the Internet to enable artists to distribute and promote their music, and to enable customers to search, sample and download certain music free of charge. Consumers can listen to real-time or streaming audio or download thousands of songs posted on the company's web site by artists, to their PCs for no charge and purchase DAM (Digital Automatic Music) CDs. It also allows fans to contact artists directly via e-mail and to communicate with one another through message boards.

Musicmaker.com provides customized music CDs compilations over the Internet. The customers can search an online music library and sample and select songs to make their own customized compilation CDs. These custom CDs have sound quality equivalent to pre-recorded CDs available at retail stores and are sold at competitive prices.

In terms of the traditional music industry labels, some of these companies have recently entered the online commercial community and are currently backing the SDMI (Secure Digital Music Initiative) security format. Certain companies have agreed to work together to offer music over the Internet, and EMusic faces increased competitive pressures as a result. Microsoft and Sony announced cooperation projects for the future. Sony has announced that will make its music content downloadable from the Internet using Microsoft multimedia software. Universal Music Group and BMG Entertainment have announced a joint venture to form an online music store.¹¹

Search engines companies like Napster, which makes software that combines chat features and a music player and lets users share their MP3 libraries with each; as well as file sharing networks that allow users to download files from each others computers, are also potential competitors to EMusic.

Suppliers

The copyright owner's are the suppliers of EMusic. They have a lot of bargaining power nowadays because:

- they can always sell it by themselves
- or through other channels
- they can do it in a different format than MP3, for example safer formats as WMA (Windows Media Audio)
- there is no copyright protection in MP3, and they might not want to have their music copied in a very efficient, fast and non-royalty paying way

Product Substitutes

There are a lot of substitutes for EMusic's products and services, we can divide those substitutes into non-virtual and virtual products. As non-virtual substitutes we can see products like CDs, Sony's MiniDisc, tapes, DVDs, and even vinyl's. A new non-virtual product is DAM CD, where you can choose whatever music to your DAM CD in two formats: MP3 and normal CD format.

There is compressed and non-compressed music in virtual substitutes. WAV (Waveform Audio Format) is the standard extension for windows sound files. Wave files can give perfect sound quality. The big problem with wave-files is though, that they take a lot of disk space. WMA is a standard introduced by Microsoft in 1999. The packaging is done differently compared to MP3. WMA file can be protected if wanted, for example you may need a password to open the file. WMA is developed in accordance with guidelines and can be copy-protected through an encryption process. Encryption means that they can't be played without the right licence, making WMA ideal for use when selling commercial music. However, WMA is only used with 32 and 128MBps, so quality is never as good as the music on CD.

Several other players have also entered the market with music-industry endorsed technologies which allow for carriage of medium to high quality music over the Internet but with cryptological protection measures designed to ensure payment for download. First among these competing technologies was Liquid Audio which uses streaming technology to deliver music on demand. Paying customers are given a bookmark with an embedded key which, when executed, streams the digital music to the client at whatever rate the client's Internet connection will support. Nowadays Liquid Audio supports many leading digital music formats, including Dolby AC3 (Dolby's 3rd generation of audio coding), AAC (MPEG-2 Advanced Audio Coding), WMA and MP3¹².

Sony has also begun offering competing streaming audio applications through its Sony Jukebox service, which allows for a pay-for-play download of songs in the Sony Music library. Sony's approach is an encrypted song key that ceases to function 24 hours after purchase. Users can access 50 songs for this period for certain amount. Songs are played either through a web-based music player while logged onto Sony's site or through RealNetworks' Realplayer 5.0 or Realplayer G2 when not logged in.

As virtual substitutes we could also consider digital TV and radio where the customer chooses what music and what time she wants to listen to the music.

There are several other companies that offer music on the Internet (see *competition*). They do it in the same way as EMusic or e.g. for free and they get profits from something else e.g. selling CDs, or through advertisements on the web site. Their services can be seen as substitutes for EMusic's services.

Other Forces

- *Economic/Industry trends* - number of Internet users who do purchases through the net will grow towards 183 million in 2003. And there are already 50 million MP3 capable users today
- *Technology* - high speed connections to the net, e.g., digital cable modems, isdn, and digital subscriber lines; adoption of open standards based on Internet audio; introduction of new hardware; improvements on digital compression technologies; mobile phones; bluetooth technology etc.
- *Legal* - the development of the legal issues related to the copyright laws concerning MP3

COMPANY STRATEGY

EMusic opportunity¹³

The company saw a number of inefficiencies in the current structure of the music industry concerning some of the stakeholders, mainly the fact that:

Consumers are paying higher prices than necessary for music, in order for record labels to recuperate the high costs associated with distribution of music on a physical media through traditional channels. The fact that current dependence on physical media limits consumer convenience, by forcing them to purchase music at retail outlets. And also physical media is less portable and harder to customize than downloadable music.

Independent labels have a great opportunity with the adoption of downloadable music by the consumers. They can supplement or replace their physical distribution networks with electronic channels. Currently most independent record labels rely on the distribution infrastructure of major record labels to distribute their products. For these record labels, electronic distribution will seem appealing, but as most of the independent labels lack resources, EMusic believes they will seek for to partner with established providers of downloadable music.

By supporting independent record labels, the company believes downloadable music creates a compelling solution for *artists*. The costs and contractual constraints of the major record labels, and the limitations of independent record labels using traditional distribution channels will encourage many artists to offer their music in downloadable format, either on their own or through an independent record label with electronic distribution capability.

When trying to exploit this opportunity the company formulated its value proposition.

EMusic value proposition

The company wants, with their web site, to provide to consumers the possibility to purchase music online at a lower price than most traditional music CDs and in a fast and convenient way. They believe the limitations associated with the traditional music industry presents the company with an opportunity to redefine the music distribution hierarchy and enable artists and independent labels to access consumer markets at a level currently only available to the major labels, while protecting the artists financial interests and providing consumers with numerous advantages in price, convenience and music information.

Strategy Elements¹⁴

The company's objective is to become the leading provider of compelling downloadable music directly to the consumer over the Internet. Their strategy is to leverage their first-to-market advantage together with their established music industry relationships as they take advantage of the growing market for the digital distribution of music.

To accomplish their objectives, their *marketing strategy* includes an aggressive advertising campaign, high visibility promotions and sponsorships, such as concert tours, conferences and trade shows, strategic public relations and broad loyalty programs, such as rebates and incentives, online advertising to their target demographic and introduction of co-marketing agreements with labels. The corporate branding campaign is targeted at early adopters, music enthusiasts, record labels and the Internet business community. They have designed a multimedia campaign, including network and cable TV ads, billboards and print media. The campaign is also designed to attract new users to the EMusic web site and encourage trial download and purchase.¹⁵

In general these are the company's strategic key elements:

- Continue to acquire compelling and varied content
- Create strong brand awareness
- Leverage strategic partnerships and industry relations
- Continue to enhance the web site
- Become a trusted distribution channel to the music industry
- Continue to promote development of downloadable music market
- Continue to develop and enhance IUMA

Some of these key elements will be examined in more detail in the following chapter, which deals with the analysis of the EMusic project.

ANALYSIS AND RECOMMENDATIONS

SWOT analysis

This section contains a SWOT-analysis of the internal and external business environment EMusic has to deal with. We also make recommendations for EMusic to follow in the future.

Opportunities

- Growing Internet related markets (e-commerce)
- The Internet as a new distribution channel
- Downloadable music – a virtual good
- Development of new music related technologies

The Internet is growing and the number of people with Internet access is growing rapidly as well. The digitalization trend will affect products and services which can be delivered or performed electronically, e.g. books, music, documents, banking, and here the Internet offers a tempting channel directly to the customer. The potential market size for EMusic that is doing business in the B2C e-commerce field is enormous. The market for downloadable music - independently from the chosen business model - is still in its early stages and is expected to grow explosively.

The Internet changes the distribution chains. The middlemen get obsolete, less steps in the chain are necessary to reach the customer. The influence on the logistic costs depends on the kind of product or service and is quite complex. However, the distribution of “digitized” goods via the Internet makes a huge amount of logistic costs disappear and offers the possibility of lower prices.

EMusic offers digital products – downloadable music, a “virtual” product. Once on the server of EMusic or its partners the music can be delivered directly to the customer’s computer. The logistic costs are nearly zero - nothing has to be shipped physically. A company is able to reflect this in the prices of their products. The “transportation costs” - download costs for telephone and/or Internet access - are carried by the customer. That means no seller can gain a competitive advantage through price competition based on logistic costs. However, customer will take into account when purchasing these “virtual” goods the download costs, which can increase the perceived price significantly (see *threats*).

Further storing music digitally offers the possibility of offering old material or not published songs. 80% of the catalogue of major music companies is not available anymore in CD format because of low demand. Electronically stored music has almost no storage costs but offers even with a low sell volume high profit.

The development of new products can push the demand for downloadable music significantly. Last year 900.000 portable MP3 players were sold. This year up to 4.000.000 units are expected¹⁶. A product development which will offer never existed value to the customer is a player which can store 81 hours of music – without reloading or changing of the storage medium¹⁷.

The MP3 hardware is penetrating other areas of classical audio – for example car-audio. Instead of CD-changer which are limited to maybe 10 CDs which then are not available in the home stereo anymore there will be MP3 player combined with hard drives which can store the whole music collection of the customer. Ford is shipping an add-on to its Focus cars this year that is a hard drive that comes with PC software so the user can put all his music on the 10 gig hard drive. Then a wireless multi-megabit protocol on short ranges enables the user to update his music without connecting anything¹⁸. Ericsson is offering an MP3 player that can be used as a plug in to its mobiles. Motorola has also introduced a mobile phone with an embedded MP3 player. Also big companies, such as Compaq, have started to produce and develop MP3 players. All this strengthens the MP3 standard but also creates demand for music in the MP3 format – for example downloadable music offered by EMusic.

Strengths

- Music distribution rights
- Knowledge and expertise in the music market
- Currently biggest catalogue of downloadable music in the Internet
- Lower prices for downloadable music than for CDs
- Large network of strategic partners
- Strong commitment to independent music sector
- Access to new potential artists
- Consumer orientation

- Autonomy in decision making power for EMusic's employees

EMusic does not infringe *copyrights* because it only sells music where it has the permission of the copyright owner. EMusic believes that music needs to be sold and should not be a free good. They generate revenues for their label partners by being an additional music distribution channel. In some cases EMusic has even exclusive long-term digital distribution rights.

EMusic has matched its *combination of Internet knowledge and expertise*, from both a marketing and sales base, and has a very complementary knowledge of the music business. According to EMusic there seems to be a huge gap between what the record business knows about the Internet and what Internet companies know about the record business. EMusic claims to understand both worlds. This is a competitive advantage in the face of the late entrance of classical music labels into business with downloadable music. That makes them also interesting for strategic partnerships¹⁹.

Currently EMusic has with a catalogue of 100.000 songs the biggest collection of downloadable music in the Internet. This stands them out against competitors in the downloadable music sector and brings them closer to the supply of Internet record stores. A huge catalogue on one web destination is generally favored by the customer. Customers are interested in the music and only in special cases - labels with a strong brand reputation that stands for a special music quality or style - in the label that publishes the music. The customer doesn't want to think about the label and the web page which might support that label, he prefers web pages with a complete perceived music catalogue.

EMusic is able to offer *complete albums in the MP3 format for \$9 compared to average \$12 for CD's sold via Internet and shipped physically and \$15 for CD's bought in shops.* The price difference for downloading single songs is even more drastically - \$1 contradictory to \$6 for a single in record stores.

EMusic runs *several web pages*, e.g. RollingStone.com, which offer information around the music sector but link directly to the possibility of purchasing downloadable music from EMusic.com. Further EMusic goes into *strategic partnerships* with companies that enable them to cover a bigger range of potential customer or strengthen downloadable music in general. For example EMusic will sell downloadable music through Yahoo's recently launched retail site, Yahoo Digital, through ICQ, Spinner and WinAmp (widespread MP3 player) sites²⁰. This supports the idea and acceptance of selling downloadable music. EMusic can reach customers very easy and makes them buying downloadable music from EMusic as easy as possible.

EMusic's *commitment to the Independent Music sector is unmatched.* They contracted exclusive licensing agreements with over 650 independent record labels²¹. This is a mutual source of income for EMUSIC and Independent record labels and bands. Using the classical way of selling music bands and labels especially in the Independent music sector were faced with the problem of getting access to distribution channels and shelf space in record stores. At first they had to convince a record company to publish their music. This company then had to convince wholesaler to distribute this music and then record stores to list this bands and finally the customer to buy the CDs. Now the music is available on EMusic's web pages and can reach the customer easily with revenues for artists, labels and EMusic.

EMusic's IUMA page, direct competitor to MP3.com, offers publishing possibilities and revenue sharing to *emerging artists*. They also have the possibility to reach record labels. Emerging artists might become successful artists and together with a possible success of downloadable music in general there are income possibilities for EMusic as partner and distribution and marketing channel²².

EMusic has *strong consumer-oriented beliefs*²³. This is in particular important because the company is still pioneering the business of downloadable music. EMusic believes that that certain developments (*opportunities*) will provide the impetus for consumers to have the rich life improvement by digital downloads as a normal means of acquiring music²⁴.

Working in EMusic can be described as "controlled chaos". *The members of the content team have almost complete autonomy* in choosing label partners, structuring deals and implementing strategic alliances. There is a kind of policy of hiring people and letting them do their job. There is very little that prohibits decision-making. The goal is to create a revenue generating music sales company with a generally agreement upon the structure and the path to get there. Doing so, EMusic is able to react quickly to new information, new ideas, and strategic decisions. For example, the implementation of online marketing programs can happen almost instantaneously²⁵. This is an important strength in the still developing and fast moving business environment of downloadable music. However, this point can also be seen as a weakness.

Threats

- Costs and time of downloading music from the Internet
- Sound quality of MP3's
- Uncertainty about the standard for downloadable music
- Still limited range of artists in the catalogue
- Digital music distribution and copyright infringement
- Competing business models for downloadable music
- Competition of the "majors"

In particular in Europe *the costs and the time needed to download MP3 files are significantly higher* than for example in the USA. There low prices and fast "steady Internet connections" promote music downloads. However, this summer the German Internet provider t-online wants to introduce unlimited Internet connections for around 80 DM monthly (flatrates). As long as download costs are so high there will be no mass market for downloadable music, but if the trend of flatrates comes true this would boost Internet downloads and would open the mass market for downloadable music²⁶.

By compressing the music to 1/10 of its original size (eliminating of non-audible frequencies) the music loses *sound quality* compared to the original. This "limits" the market of compressed downloadable files to non-audiophile customers. Further potential customer could still prefer buying CDs and then transfer this music to the MP3 format on their own with all possibilities of application.

Downloadable music has to offer additional value to the buyer that outweighs the only near CD quality of the compressed files. EMusic offers the music to lower costs than buying CDs. EMusic has to look for ways to distribute the music as uncomplicated as possible - links on pages of strategic partners, easy download etc. EMusic has to identify this

customer segment and if necessary - when it is an important market segment - and efficient to spend effort in promoting music downloads of compressed files there as well.

There is still much confusion about *the final file-standard for downloadable music*. Currently the MP3 standard is the quasi-industrial standard for downloadable music. It is widespread (number of sold MP3 hardware) and accepted by the computer user. Trying to enforce a new standard will suffer on the “DOS syndrome”. The MP3 standard is so ubiquitous and will have a “legacy application problem”. Customers will have no incentive to change until there is a new and better standard (sounds better at the same or smaller sizes etc.). That would be the only thing to replace MP3²⁷.

EMusic is open for all possible standards of downloadable music²⁸. They are technology agnostic in terms of download formats which enables them to use later download standards without complicated adjustments of their business processes²⁹. EMusic’s technology is not dedicated to MP3. But at the moment where there is no alternative to MP3 they are promoting this standard.

With about 100,000 songs available, EMusic currently has the biggest selection of downloadable music for sale on the Web. But still *the range of artists is limited*. Not all major labels made all their catalogues available for EMusic. “The music industry itself believes that by withholding content from the Internet, they will create a standard of their own choosing when they finally do get in the download business. I might humbly suggest that the Internet strategists at the major record labels acquaint themselves with the history of the software business and all the failed attempts to create standards not of the consumers choosing” says Brian Brinkerhof VP of Content Acquisition³⁰.

EMusic is contracting for new music heavily. But in the long run there is no business success when the company cannot offer the full range of music - at least the range classical record stores can offer. Although EMusic is strong in niches (see Independent music; *strengths*) it has to use the potential of being a main portal for downloadable music right now by widening the catalogue.

Copyright law prohibits copying, performing, altering of intellectual work (music, literature, paintings etc.) without permission of the copyright owner. Copyright law is national in scope and so in the face of the global span of the Internet difficult to enforce. However there are international treaties existing which ensure the reciprocal enforcement. The copyright owner of music might be the artist or the publisher of the music. Everybody who wants to make business with copyright protected music needs the permission of the copyright owner to do so. Further royalty payment to the copyright owner might be part of the permission.

There is an ongoing discussion about downloadable music and possible copyright violation. Extreme opinions even questioning the legitimacy of copyright protection for music. The music industry works on means to prevent the unauthorized use of downloadable music³¹. Competing business models to EMusic are “under attack” by law suits, e.g. Napster, and MP3.com. Although attempts to stop MP3 related technology, e.g. the Rio MP3 player, claiming this technology would promote copyright infringement³², failed, this discussion and lawsuits cause uncertainties about the future downloadable music – and the future of EMusic.

EMusic owns long-term digital distribution rights and does not infringe copyright with its business model. EMusic spends a huge part of its marketing budget to “teach” customer why to buy music³³.

As EMusic’s CEO Gene Hoffman says: “Music fans must recognize that artists and record labels must be compensated for their work. It is perfectly OK to rip your own CDs and play them in MP3 format. It is not OK to make those tracks available to others without the copyright owner's permission - even if you think CDs cost too much. Music and all intellectual property must have value to keep artists and their partners in business producing more, better work. On the other side, the music industry must make its own concessions and stop viewing the Internet as a threat, but as a great opportunity for more effectively promoting and distributing music. It may mean less control and more flexibility, but, the fact is, millions of fans have spoken: They want the convenience of downloadable music. How can you not give them what they want?”³⁴

But this discussion is not yet solved and there might be developments which make legal downloads of music annoying for customers (filter software, authorizations etc.) and destroy business possibilities. EMusic should work close together with the music industry and responsible governmental offices to influence the way copyright law and music download techniques are developed.

An important threat is the possibility of getting downloadable music for free. One way is downloading by infringing copyright and the other possibilities are *competing business models* for downloadable music, which allow free-downloads - music as bait. That makes it difficult for EMusic to get its business model message out³⁵.

EMusic has to continue its marketing effort to “teach” customers why they should buy downloadable music. Also a complete range of available music and easy access (e.g. via ICQ) would deliver value to the customer making them buying the music. A way to market downloadable music could be to place “MP3 dispenser” at high frequented locations - universities, train stations - where people can fast and easy download the music directly on their portable player. This promotes buying downloadable music, promotes the brand EMusic, offers the service of EMusic also to people without a fast Internet connection and could offer an additional income for EMusic.

The majors did not yet go into selling of downloadable music. They even withhold their content from the Internet. *The major record labels* still seem to see downloadable music as a substitute for their classical business with CDs and so as a poison for their future, instead of seeing downloadable music as a chance and opportunity. The music industry seems to believe that by withholding content from the Internet, they will create a standard of their own choosing when they finally do get in the download business, offering them control³⁶. But there is still the history of the software business and all the failed attempts to create standards not of the consumers choosing.

EMusic has to work together with the majors. They have to make sure that the content in the achieves of the majors gets accessible for EMusic. The record label should understand EMusic as a mean of distributing music similar to the distribution via record stores, only with a different product, downloadable music. EMusic has to continue with its efforts to win the catalogue from major record labels.

Weaknesses

- Autonomy in decision making power for EMusic's employees
- Business success rise and falls with the acceptance of "buying" downloadable music through customers in the face of getting it for free
- Web page only in the English language

The strength of EMusic, *autonomy in decision making power* for EMusic's employees, is on the other hand their weakness regarding the way of organized growing. The company could develop an ineffective structure during the next years. EMusic has to make sure that the organization stays effective by planning the growth and the business processes. This needs a split between flexibility and structure. The management should put more effort in that.

EMusic is selling downloadable music. There is *no other revenue sources*, e.g. CD distribution etc. Should the business model of downloading music for money not succeed, EMusic will fail. But there are two other possibilities than only downloading a song for money. EMusic could offer "music on demand". For less money the customer would choose music and like in a radio only listen to it once. He does not get a copy of the song. In this way the customer can listen to music which he would not consider to buy. Further he can listen before buying – just to become sure that he wants the music. Of course, the artists have to be compensated by EMusic and the customer can listen to the music before buying it.

Further there is the possibility to sell additionally CDs as well. This would complete the range of offered product categories and every customer segment is considered – the whole range of ways to buy music combined in one portal. Disadvantages are the increased complexity in the business processes of EMusic and the need for worldwide physical distribution. However, the link to a strategic partner who is already in the business field of selling CDs via Internet could solve that problem.

Actually there are *no other languages than English* supported by EMusic's web page. But to speak the language of the customer is as important in B2C e-commerce as in "classic" consumer markets. At least main languages, like Spanish, German, French should be implemented.

Matching process

EMusic already combines strengths and opportunities in a good manner. There are the growth of the Internet, the advantages of the Internet as means for distributing a virtual good like downloadable music and finally developments of hard- and software for downloadable music which will increase the spread and use of downloadable music like (see *opportunities*).

EMusic has an excellent position in the business field of downloadable music - clear legal position, biggest catalogue of downloadable music in the Internet, lower prices than for

buying CDs, strong commitment to the independent music sector, access to new potential artists. The company is enabled to take advantage from its opportunities.

Recommendations

We developed the following recommendations that can enable EMusic to hold and even improve this promising situation.

- Go on with contacting the music catalogues of the major record labels to increase the available range of downloadable music
- Continue to go into strategic partnerships
- Offer additional value to the customer (e.g. by means of easy access to MP3 music)
- Staying open for all possible standards of downloadable music
- Make sure an “organized” growth of EMusic
- Consider additional sources of income (e.g. music on demand, selling CDs)
- Offer the service of EMusic in as many languages as possible

EMusic has to *go on with contacting the music catalogues of the major record labels to increase the available range of downloadable music*, which should at least be similar to the offer in ordinary record stores. A mean might be the use of strategic partnerships - offering an additional established distribution channel which works similar to the shared distribution of CDs from several labels via record stores - with mutual benefits. However, there is some hampering derived from the boycott of some major record labels (see *threats: still limited range of artists*).

Also the combination of the wide range of available music and the possibility of offering music in a downloadable format which is not to market economically as CDs, (see *opportunities: downloadable music as a virtual good*) gives EMusic even more advantage regarding the range of offered music compared to companies which distribute CDs.

Finally EMusic has to *continue going into strategic partnerships*. Due to their expertise and knowledge about the Internet and the music market this makes EMusic to an attractive partner for suitable companies which offer EMusic additional possibilities for future market success. These relationships can and have to have mutual benefits. In this context EMusic should be aware not to ignore the major record labels. It's better to succeed together with them instead of trying to win alone against them (*threats: competition by the majors*).

Despite this promising situation - opportunities and company strengths - EMusic faces several threats, which have to be overcome.

There are the costs and time needed for downloading music and the worse sound quality of MP3s compared to a CD. Here EMusic has to *offer additional value to the customers* that make them buy downloadable music. New products around MP3 offer the opportunity and combined with an easy access to MP3 music - via portals, links implemented in chat programs or music playing software, strategic partnerships, “MP3 dispenser” etc. - a wide available range of any kind of music, mainstream, independent, new artists, rare materials, and a good customer communication EMusic can overcome these threats. An important point here is to strengthen EMusic as a brand. All this might also help EMusic to succeed against competing business models. The uncertainty about a future technical standard for

downloadable music can be anticipated by *staying open for all possible standards of downloadable music*. However, here EMusic is already doing fine.

To overcome the internal weaknesses which faces EMusic it has to make sure, that the company is *growing organized*. The current flexible structures might end up ineffective. EMusic only trusts on a business success through selling downloadable music. But there are some possibilities to spread the risk and offer *additional services* with less adaptation of the existing business processes, e.g. music on demand, selling CDs via strategic partner. And last, the EMusic web page should speak the language of the customer all over the world. Due to the easy way of delivering music via the Internet worldwide, customer can be served worldwide. EMusic has to offer its services *in as many languages as possible*, but at least the main languages like Spanish, German and French.

CONCLUSION

In this report we introduced and analysed the Internet company called EMusic. EMusic has been one of the companies in the frontline of developing new ways to deliver music in the field of digital music. It already has well-established network of strategic partners, very large catalogue of downloadable music and strong commitment to customer-orientation.

After introducing the company by describing its history, products and services and some financial facts, we analysed the current situation of the company. The analysis was mainly based on the analysis of business environment, company's strategy and SWOT analysis.

When analysing the business environment we illustrated the recorded music industry. We also described the hard competition situation on that field. Briefly, we also illustrated suppliers, product substitutes, and other forces, which the company has to confront.

In the section of company strategy, we specified the opportunity EMusic tries to seek. That includes a number of inefficiencies the company recognised in the music industry, such as the situation of independent record labels. We ended the section by describing company's marketing strategy and the elements of their overall strategy.

Then we made SWOT analysis about the company's external and internal strengths and weaknesses. Based on the analysis we made recommendations for the company. Concerning the threats the company faces, we recommended that the company should concentrate on offering real value to the customer - including easy access, and right price and quality combination. We also recommended that the company should stay open for all possible standards for downloadable music and continue contracting for new music content. Concerning the weaknesses of the company, we recommended that the company should grow organised, consider additional sources of income - e.g. music on demand, selling CDs, and support additional languages.

REFERENCES

- ¹ <http://www.redherring.com/insider/1999/0710/news-barnesandnoble.html>
- ² <http://www.redherring.com/insider/1999/0710/news-barnesandnoble.html>
- ³ <http://www.redherring.com/insider/2000/0108/vc-artists.html>
- ⁴ <http://www.emusic.com>
- ⁵ <http://www.emusic.com>
- ⁶ <http://www.emusic.com>
- ⁷ <http://www.emusic.com> (annual report)
- ⁸ <http://www.emusic.com> (annual report p.11)
- ⁹ <http://www.emusic.com> (annual report p.14)
- ¹⁰ <http://www.marketguide.com>
- ¹¹ <http://www.emusic.com> (annual report p.15)
- ¹² <http://www.liquidaudio.com/company/index.html>
- ¹³ <http://www.emusic.com> (annual report p.7)
- ¹⁴ <http://www.emusic.com> (annual report p. 9)
- ¹⁵ <http://www.emusic.com> (annual report)
- ¹⁶ <http://www.wired.com/news/print/0,1294,35738,00.html>
- ¹⁷ <http://www.wired.com/news/technology/0,1282,32129,00.html>
- ¹⁸ <http://www.wired.com/news/print/0,1294,35738,00.html>
- ¹⁹ http://www.newmediamusic.com/breaking_ground/bg_emusic.html
- ²⁰ <http://www.wired.com/news/business/0,1367,21385,00.html>
- ²¹ <http://www.emusic.com/about/index.html>
- ²² <http://emusic.com/s=10005393a7c622f00c3;h=407;/about/index.html>
- ²³ http://www.newmediamusic.com/breaking_ground/bg_emusic.html
- ²⁴ http://www.newmediamusic.com/breaking_ground/bg_emusic.html
- ²⁵ http://www.newmediamusic.com/breaking_ground/bg_emusic.html
- ²⁶ <http://www.welt.de/daten/2000/04/13/0413w1162301.htx>
- ²⁷ <http://www.wired.com/news/print/0,1294,35738,00.html>
- ²⁸ http://www.newmediamusic.com/breaking_ground/bg_emusic.html
- ²⁹ http://www.newmediamusic.com/breaking_ground/bg_emusic.html
- ³⁰ Interview with Brian Brinkerhof ; http://www.newmediamusic.com/breaking_ground/bg_emusic.html
- ³¹ <http://www.welt.de/daten/2000/04/13/0413w1162300.htx>
- ³² http://www.zdnet.com/zdnn/stories/zdnn_smgraph_display/0,4436,2147735,00.html
- ³³ <http://www.wired.com/news/print/0,1294,35738,00.html>
- ³⁴ <http://music.zdnet.com/features/visionaries/>
- ³⁵ http://www.newmediamusic.com/breaking_ground/bg_emusic.html
- ³⁶ http://www.newmediamusic.com/breaking_ground/bg_emusic.html