

The Evolution of iTunes

Apple gets ready to stir up the music business—again

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Apple, the company that revolutionized the music industry with its iPod players and iTunes music service, is at it again.

This time, the computer company is considering overhauling the way it sells and stores music, in order to extend its influence to the Web, according to people familiar with the strategy.

The key vehicle for the change is La La Media, a music-streaming service that Apple acquired last year for about \$85 million. Where Apple's iTunes requires users to download music onto a specific computer, Lala.com lets users buy and listen to music through a Web browser, meaning its customers can access purchases from anywhere, as long as they are connected to the Internet.

Apple is considering adopting that same model for songs sold on the iTunes, a change that would give consumers more ways to access and manage their iTunes purchases—and wouldn't require them to download Apple's software or their purchases. For consumers, such changes could make it far easier to manage and access large libraries of music, which need to be stored, maintained and backed up on computer hard drives and portable devices.



WHAT IT MEANS TO OWN A SONG

That new business model would effectively tighten Apple's grip on the music business, giving it the ability to sell music through search engines and other Web sites and broaden its reach beyond people who come to its online store.

It would also represent a fundamental redefinition of what it means to own a song, movie or other piece of media—shifting the emphasis from possession of a physical disc or digital file to the right to access content.

Certain legal issues remain hazy: If music becomes a virtual product, it isn't clear how Apple would be able to guarantee that a buyer would retain access to a song forever if, for instance, a new owner gained control of a record label's catalog and changed the terms of its deal with Apple.

Thorny issues have already arisen around media sold as virtual goods. Last year, for example, Amazon.com outraged consumers when it deleted two books by George Orwell from its Kindle electronic readers after a rights dispute with their publisher.

Record company executives say privately that they are optimistic about the prospect of consumers being able to buy music from more Web sites, but they're cautious about any development that would add to Apple's already significant power over the music industry.

SLOWING GROWTH

Apple, which last year surpassed Wal-Mart Stores as the biggest music seller, generated about \$2 billion in iTunes revenue last year, according to the brokerage firm Piper Jaffray. That's about 20% higher than the previous year, Piper estimates, but growth has slowed over the past several years, because most people now own iPods or iPhones, and iTunes is attracting fewer new users.

Overall sales figures for last year show that while digital downloads now account for 40% of music purchases, the recorded-music industry is still struggling to adapt to the digital age. According to Nielsen SoundScan, which tracks music sales, U.S. album sales declined in 2009 for the eighth time in nine years, while online song downloads grew too slowly to close the gap.

Music fans bought 1.16 billion individual songs from services such as iTunes, up 89 million, or 8.3%, from 2008. That represents a significant slowdown: In 2008, sales of digital songs increased by 27% over the previous year.

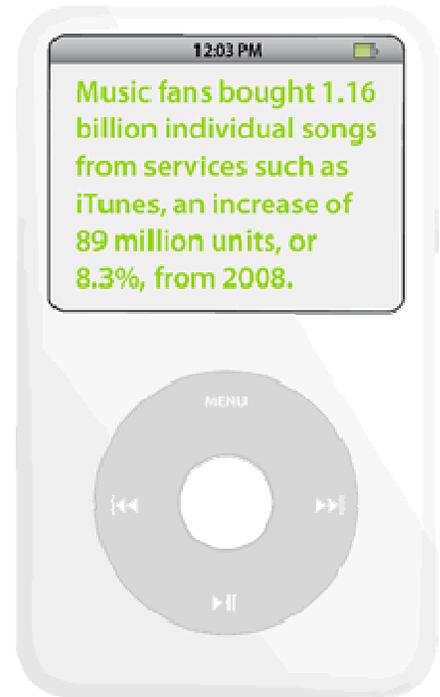
Download services like iTunes face pressure from competing services that allow users to listen to "streaming" music either cheaply or free on computers or portable, Internet-connected devices like the iPhone or iPod touch. Streaming has been at the heart of La La's strategy for the past two years, in the form of what the site calls "Web songs," which cost 10 cents and are accessed via a Web browser.

TEARING DOWN WALLS

For several months last year, La La was field testing a version of its service that works on the iPhone or iPod touch. The company has told people in the music industry that test users spent at least as much money every month, on average, buying the service's 10-cent Web songs as iTunes users do paying for full-priced downloads.

La La has partnerships that allow it to sell songs from links embedded on sites as major as Google and as specialized as the indie-music site Pitchfork Media. Adopting that strategy would represent a major departure for Apple, which has always relied on what is known as a walled-garden approach, in which its machines run on proprietary software that Apple controls.

In addition to selling music, La La's software also scans a user's existing music library and matches its contents with songs on its own servers, then gives the user access to that music via a Web browser. That approach, known in technology circles as cloud



computing, could also be part of a revamped, Web-based iTunes, according to the people with knowledge of the company's discussions.

It is also possible that Apple would use La La's streaming technology as the basis for a subscription service, for which users would pay a flat rate in exchange for unlimited access to music. Such offerings already exist but have never gained much traction with users, mainly because most don't work with iPods or iPhones.

As part of the shift, La La executives have been given key positions at Apple helping to shape music strategy for the iTunes Store, and some iTunes executives may report to them.

UNCOMFORTABLE TOPIC

Some people familiar with Apple's thinking cautioned the changes are in the planning stages and could still be altered. A spokesman for Apple says, "We generally do not comment on our purpose or plans."

Apple has revisited its iTunes strategy from time to time and has discussed the impact of streaming music services like La La and Pandora in the past, but concluded that people wanted to own their music, according to a person familiar with Apple's thinking.

The latest shift could reopen an uncomfortable topic between Apple and the music industry. Record-label executives were relieved in 2003 when Apple launched what was then called the iTunes Music Store. At the time, the online store appeared to be a virtual lifeline for the record companies, which had lost much of their revenue and profits to pirates sharing and downloading songs illegally.

But since then, record companies have also become frustrated that iTunes' dominance of music sales has turned it into a gatekeeper, with what they view as too much control over the market.

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