



June 9, 2005

66-20 108th Street, Suite 5F
Forest Hills, NY 11375-2228

Barry Sosnick, President
Email: barry.sosnick@earful.info

Main: (718) 896-2518
Web: www.earful.info

College Music Subscriptions Threaten the Music Industry

By encouraging colleges to offer low-price music subscriptions and downloads to their students the recorded music industry may be fostering a situation almost as detrimental to its long-term health as the piracy it hopes to eradicate.

In 2003, Penn State University became the first institution of higher education to offer free access to music. At least 50 other schools now have similar programs. Their reasons include decreasing their potential liability, safeguarding their students from identity theft, reducing computing costs and protecting intellectual property.

The labels openly endorse inexpensive music at colleges. Sony BMG operates the Campus Action Network (CAN). RIAA president Cary Sherman co-chairs the Joint Committee of the Higher Education and Entertainment Communities with Penn State University president Graham Spanier.

Napster, RealRhapsody and Cdigix are the three companies servicing the colleges. They offer colleges a discounted rate substantially below the usual \$9.95 monthly subscription fee and \$0.99 per download found off campuses. Cdigix offers tethered downloads at 21 universities to 310,000 subscribers for a \$2.99 monthly subscription fee and \$0.89 per song downloads. It is estimated that Real Networks has its RealRhapsody at 20 schools for \$2 to \$3 per month. Napster is servicing at least ten colleges and universities.

The labels subsidize these low-price college subscriptions, according to published reports. Furthermore, some schools (e.g., University of Maryland) pick up the entire fee for the subscriptions, so their students only pay for downloads.

Usage is high at colleges. For example, Penn State has 20,000 students signed up for the Napster service streaming or downloading 170,000 songs a day. The problem will swell as the use of portable MP3 devices grows on campuses. MP3 players are becoming academic requirements in addition to lifestyle products. Duke University, for example, provided all incoming freshmen with 20 gigabyte Apple iPods.

Retail is impacted immediately. For students enrolled in university subscription programs, accessing music entails no variable cost and only a small, below market per track fee for portability; coeds have no incentive to purchase music in stores. Many music retail stores are located in college markets. One major specialty retailer has 43% of its stores in college markets. The loss of sales and its impact on the margin mix could destroy the profitability of even the hardiest retailers.

Low-cost college subscriptions and downloads are essentially continuous promotions that will eventually hurt the industry. Studies show that frequent promotional activity erodes the lifetime value of a customer, destroys brand equity and fosters the commoditization of product categories. For artists, labels and retailers alike, sales and margins are at risk.

Students will face higher music prices upon leaving school. Recent graduates will face sticker shock when considering whether to buy music. This should reduce purchase intentions. The problem is compounded because students often are unaware of the fixed cost for subscriptions: They pay the up-front fee and forget about it.

The effect of promotions on value and purchase intentions is subtle, but profound. We believe the major record labels are underestimating the marketing and financial consequences of their support for low-cost downloads on campuses. In their zeal to combat piracy, the labels are inadvertently eroding music's value and jeopardizing their revenue stream. Moreover, it is likely that the service providers—Napster, RealNetworks and Cdigix—are aware of how their pricing structure will weaken their brands and long-term financial prospects. The music industry must eliminate or alter these college programs for the long-term health of the industry and to protect the brand equity of their companies and artists.

About the Author

Barry Sosnick, the president and founder of Earful.info, held positions as an equity analyst and as a senior project leader for a political polling and market research company. Mr. Sosnick is on the advisory board for the Music and Entertainment Industry Educators Association (MEIEA), the association for entertainment industry academics. Barry presented two major academic studies: "The Changing Recorded Music Industry" at Loyola University, New Orleans in 2003 and "A Capital Budgeting Approach to Understanding Artist-Label Relationships" at the University of Miami in 2005.