



TO: Interested Parties

FROM: Amy Weiss
Senior Vice President, Communications

DATE: March 30, 2004

Re: The Oberholzer-Gee/Strumpf Study On Impact of File Sharing

The Oberholzer-Gee/Strumpf study published yesterday is certainly an interesting contribution to the literature, especially since it is so counter-intuitive. We look forward to what other academics will have to say about it since it has not been officially peer-reviewed. We also look forward to understanding what the authors actually did in the study, since the text of the analysis is incomprehensible to the layman. Certainly, the results are inconsistent with virtually every other study done by academics and research analysts about the impact of illegal file sharing.

There are many questions to ask about the study, including:

- How did the authors establish a causal relationship between downloading behavior and purchasing behavior? This is not apparent from a quick review of the abstract of the study itself.
- Are the authors actually assuming that download behavior would be different for longer songs than shorter songs? During school holidays? When the network is congested? Since downloaders can simply start the process and then go and do other things while the computer performs the download function in the background, or while the user sleeps, is there any reason to think that these factors actually impact downloading behavior?
- Are the authors concluding that, because it may take longer to download certain songs or at certain times, CD sales should go up in those circumstances? Have they considered that illegal downloading is free but that it costs money to buy CDs? The model has no allowance for what people would have done if file sharing were not an available alternative. Further, it points out that “While downloaders purchase fewer records, it could be because of a lower willingness to

pay.” This does not appear to consider the impact of free music on the value equation, or more simply, how availability of free downloads lowers that willingness to pay.

- Why would they correlate with physical sales instead of also considering online sales? The impact of illegal downloading has been felt in both marketplaces.
- The study shows the most downloaded songs tend to be from top selling albums and compares two completely different sources -- a log of P2P downloads and U.S. sales data. But the sample composition of these data sources are in fact quite different. Not all downloaders are purchasers. Not all purchasers are downloaders. Downloaders are much more likely to report purchasing less music than non-downloaders. The marketplace breaks out something like this among 12 to 44 year olds: 47%, purchase only; 7%, download only; 28%, both purchase and download; 17%, don't purchase/don't download. (Source: Edison Media Research National Record Buyers Study)
- The data collection methodology lacks trending and therefore does not look at changes over time. Those changes (whether observed or stated) would indicate how purchasing behavior has changed among individuals as they start downloading.
- If file sharing has no negative impact on the purchasing patterns of the top selling records, how do you account for the fact that, according to SoundScan, **the decrease of Top 10 selling albums in each of the last four years is: 2000 – 60 million units; 2001 – 40 million units; 2002 – 34 million units; 2003 – 33 million units.**

Competing Analysis

Edison Media Research

<http://www.edisonmediaresearch.com/RecordBuyersIIIPress.htm>

“Among the heaviest downloaders, those who have downloaded more than 100 music files (about 16% of 12-44s), reported purchases of CD's has dropped an incredible 61% from last year's study (28.9 on average per person to 11.3).”

SoundScan Data:

Second and Third Week Sales of Top Albums, Pre- and Post- Internet Piracy

An analysis of second and third week sales using SoundScan data of those albums which were released in the year that they achieved Platinum certification status, demonstrates that the drop in second and third week sales was much more significant during 2000-2003 than during 1996-1999.

% Change 1st Week to 2nd Week Sales, 1996-1999: **-35%**
% Change 1st Week to 2nd Week Sales, 2000-2003: **-46%**

% Change 2nd Week to 3rd Week Sales, 1996-1999: **-19%**
% Change 2nd Week to 3rd Week Sales, 2000-2003: **-26%**

The dramatic decline in 2nd and 3rd week sales during 2000-2003 compared to 1996-1999 points to the effect that internet piracy has on “hit” albums after the album is purchased in the first week and has proliferated the network in the second and third weeks.

Record Industry Decline, Shipments and Dollar Value

(according to the RIAA)

Since 1999, the industry has shrunk a stunning 31% in terms of units shipped of all formats, and 19% in terms of dollar value:

1999 Units Shipped: 1,160,600,000
2003 Units Shipped: 798,400,000
% Change: -31%

1999 Dollar Value: \$14,584,700,000
2003 Dollar Value: \$11,854,400,000
% Change: -19%

Forrester Research

www.forrester.com

“music industry executives claim that downloading tracks via services like KaZaa and Morpheus cannibalies CD sales – and they’re right.”

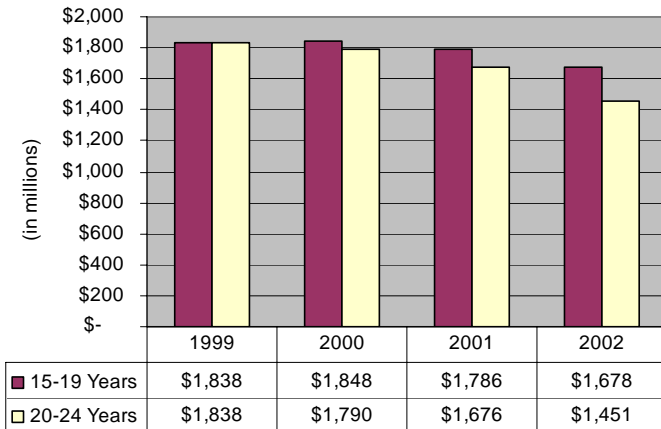
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<http://www.ipsos-insight.com/tech/publications/tempo/>

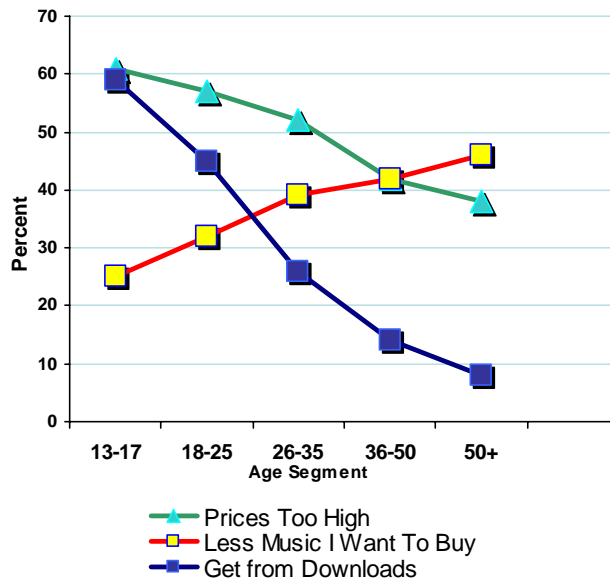
“As at end 2002, the quarterly US study TEMPO found that while 25% of Americans aged 12+ own a PC-based CD burner, 59% of file-sharers own a CD burner. Of these, 42% (representing 17 million people) reported having burned a pre-recorded music CD rather than actually purchasing that CD. Even if this occurred only once per person, it would equate to almost one-quarter of album sales losses.

NPD Group

The impact of downloading on heavy buyers – the importance of the younger age segment to driving music industry sales cannot be underestimated. Over one-third of all music is bought by consumers 25 and younger.¹ This same age segment has purchased less music product since 1999:



This decline can be primarily attributed to one cause: downloading. The heaviest buyer segment is also the heaviest downloading segment, ultimately leading to a negative impact on sales. This is indicated through a study conducted by NPD MusicWatch in fall 2002, in which buyers who reported purchasing less music in the past 12 months were asked for their reasons. The results of the study are as follows²:



¹ “The Music Customer, Basic Profiles,” NPD MusicWatch, May 2003, page 9.

² “The Music Customer, Basic Profiles,” NPD MusicWatch, May 2003, page 11

As can be seen, 59% of the 13-17 age segment and 45% of the 18-25 age segment reported that **they bought less music because they could get it from downloads. This points to the direct correlation between downloading and the ensuing decrease in sales among the industry's largest buyer segments.**

Progress & Freedom Foundation

James DeLong, Senior Fellow & Director, Center for the Study of Digital Property

“A new study by two [Harvard and UNC] business professors – *The Effect of File Sharing on Record Sales: An Empirical Analysis* – concludes that ‘downloads [of music] have an effect on sales [of CDs] that is statistically indistinguishable from zero.’

“The result seems counter-intuitive, since industry data show that the number of units of music shipped fell from 1.161 billion in 1999, the year of Napster, to 798 million in 2003, a drop of 31%. In any event, the music industry has already expressed its skepticism, and will soon have its computers humming, so the debate has just begun.

“This does not really seem like the right question, though. Realistically, music distribution must shift away from putting bits on pieces of plastic called CDs and shipping them around the country on trucks, and toward the practice of sending the bits over the Internet. The recent bankruptcy of Tower Records is the writing on the wall.

“This transition will require huge investments by many companies to create the infrastructure of online businesses. These investments seem to be happening. In fact, the field may be over-crowded; a recent *Wall Street Journal* headline said, "Shakeout May Mute Download Services" (March 23, 2004)

“So the more important issue concerns not the impact of unauthorized downloading on CD sales, but on legitimate downloading services, ones that reward the artists for their work and that must recoup both these costs and their investment. In both law and good sense, the copyright holders are the ones who get first crack at the new business model. “

Professor Stan Liebowitz at the University of Texas, Dallas:

<http://www.utdallas.edu/~liebowit/intprop/records.pdf>

“MP3 downloads are causing significant harm to the record industry.”

Voter Consumer Institute

Those who download more buy less. When asked, of those ages 18-24 who download, 33% said they bought less music than in the past year (21% bought more) and those ages 25-34 25% bought less and 17% bought more."

Peter D. Hart Research Associates

According to a November 2002 survey by Peter D. Hart Research, by a 2-to-1 margin, most consumers who say they are downloading more music report that they're purchasing less. The same survey found that the main reason teenagers aren't buying more music is

that they get a lot of what they want for free by downloading or copying it. Among 12- to 18-year-olds, 35% will download a new song they like vs. just 10% who will buy it. Among 19- to 24-year-olds, 32% download vs. 9% who will buy.

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