Sales of Music, Long in Decline, Plunge Sharply

Rise in Downloading Fails to Boost Industry; A Retailing Shakeout

By ETHAN SMITH
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In a dramatic acceleration of the seven-year sales decline that has battered the music industry, compact-disc sales for the first three months of this year plunged 20% from a year earlier, the latest sign of the seismic shift in the way consumers acquire music.

The sharp slide in sales of CDs, which still account for more than 85% of music sold, has far eclipsed the growth in sales of digital downloads, which were supposed to have been the industry's salvation.

The slide stems from the confluence of long-simmering factors that are now feeding off each other, including the demise of specialty music retailers like longtime music mecca Tower Records. About 800 music stores, including Tower's 89 locations, closed in 2006 alone.

Apple Inc.'s sale of around 100 million iPods shows that music remains a powerful force in the lives of consumers. But because of the Internet, those consumers have more ways to obtain music now than they did a decade ago, when walking into a store and buying it was the only option.
Today, popular songs and albums -- and countless lesser-known works -- can be easily found online, in either legal or pirated forms. While the music industry hopes that those songs will be purchased through legal services like Apple's iTunes Store, consumers can often listen to them on MySpace pages or download them free from other sources, such as so-called MP3 blogs.

Jeff Rabhan, who manages artists and music producers including Jermaine Dupri, Kelis and Elliott Yamin, says CDs have become little more than advertisements for more-lucrative goods like concert tickets and T-shirts. "Sales are so down and so off that, as a manager, I look at a CD as part of the marketing of an artist, more than as an income stream," says Mr. Rabhan. "It's the vehicle that drives the tour, the merchandise, building the brand, and that's it. There's no money."

The music industry has found itself almost powerless in the face of this shift. Its struggles are hardly unique in the media world. The film, TV and publishing industries are also finding it hard to adapt to the digital age. Though consumers are exposed to more media in more ways than ever before, the challenge for media companies is finding a way to make money from all that exposure. Newspaper publishers, for example, are finding that their Internet advertising isn't growing fast enough to replace the loss of traditional print ads.

In recent weeks, the music industry has posted some of the weakest sales it has ever recorded. This year has already seen the two lowest-selling No. 1 albums since Nielsen SoundScan, which tracks music sales, was launched in 1991.

One week, "American Idol" runner-up Chris Daughtry's rock band sold just 65,000 copies of its chart-topping album; another week, the "Dreamgirls" movie soundtrack sold a mere 60,000. As recently as 2005, there were many weeks when such tallies wouldn't have been enough to crack the top 30 sellers. In prior years, it wasn't uncommon for a No. 1 record to sell 500,000 or 600,000 copies a week.

In general, even today's big titles are stalling out far earlier than they did a few years ago.

The music industry has been banking on the rise of digital music to compensate for inevitable drops in sales of CDs. Apple's 2003 launch of its iTunes Store was greeted as a new day in music retailing, one that would allow fans to conveniently and quickly snap up large amounts of music from limitless virtual shelves.

It hasn't worked out that way -- at least so far. Digital sales of individual songs this year have risen 54% from a year earlier to 173.4 million, according to Nielsen SoundScan. But that's nowhere near enough to offset the 20% decline from a year ago in CD sales to 81.5 million units. Overall, sales of all music -- digital and physical -- are down 10% this year.
And even including sales of ringtones, subscription services and other "ancillary" goods, sales are still down 9%, according to one estimate; some recording executives have privately questioned that figure, which was included in a recent report by Pali Research.

Meanwhile, one billion songs a month are traded on illegal file-sharing networks, according to BigChampagne LLC.

Adding to the music industry's misery, CD prices have fallen amid pressure for cheaper prices from big-box retailers like Wal-Mart and others. That pressure is feeding through to record labels' bottom lines. As the market has deteriorated, Warner Music Group Corp., which reported a 74% drop in profits for the fourth quarter of 2006, is expected to report little relief in the first quarter of this year.

Looking at unit sales alone "flatters the situation," says Simon Wright, chief executive of Virgin Entertainment Group International, which runs 14 Virgin Megastores locations in North America and 250 world-wide. "In value terms, the market's down 25%, probably." Virgin's music sales have increased slightly this year, he says, thanks to the demise of chief competitor Tower, and to a mix of fashion and "lifestyle" products designed to attract customers.

Perhaps the biggest factor in the latest chapter of the music industry's struggle is the shakeout among music retailers. As recently as a decade ago, specialty stores like Tower Records were must-shop destinations for fans looking for both big hits and older catalog titles. But retailers like Wal-Mart Stores Inc. and Best Buy Co. took away the hits business by undercutting the chains on price. Today such megaretailers represent about 65% of the retail market, up from 20% a decade ago, music-distribution executives estimate. And digital-music piracy, which has been rife since the rise of the original Napster file-sharing service, has allowed many would-be music buyers to fill their CD racks or digital-music players without ever venturing into a store.

Late last year, Tower Records closed its doors, after filing for bankruptcy-court protection in August. Earlier in 2006, following a bankruptcy filing, Musicland Holding Corp., which owned the Sam Goody chain, closed 500 of its 900 locations. And recently, Trans World Entertainment Corp., which operates the FYE and Coconuts chains, among others, began closing 134 of its 1,087 locations.

But even at the outlets that are still open, business has suffered. Executives at Trans World, based in Albany, N.Y., told analysts earlier this month that sales of music at its stores declined 14% in the last quarter of 2006. For the year, music represented just 44% of the company's sales, down from 54% in 2005. For the final quarter of the year, music represented just 38% of its sales.
Joe Nardone Jr., who owns the independent 10-store Gallery of Sound chain in Pennsylvania, says he is trying to make up for declining sales of new music by emphasizing used CDs, which he calls "a more consistent business." For now, though, he says used discs represent less than 10% of his business -- not nearly enough to offset the declines.

Retailers and others say record labels have failed to deliver big sellers. And even the hits aren't what they used to be. Norah Jones's "Not Too Late" has sold just shy of 1.1 million copies since it was released six weeks ago. Her previous album, "Feels Like Home," sold more than 2.2 million copies in the same period after its 2004 release.

"Even when you have a good release like Norah Jones, maybe the environment is so bad you can't turn it around," says Richard Greenfield, an analyst at Pali Research.

Meanwhile, with music sales sliding for the first time even at some big-box chains, Best Buy has been quietly reducing the floor space it dedicates to music, according to music-distribution executives.

Whether Wal-Mart and others will follow suit isn't clear, but if they do it could spell more trouble for the record companies. The big-box chains already stocked far fewer titles than did the fading specialty retailers. As a result, it is harder for consumers to find and purchase older titles in stores.

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