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WINNERS AND LOSERS IN THE NAPSTER CASE

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Abstract

In this study, we examine the impact of the Napster decision on RIAA sales. We also present a brief introduction to copyright law and DMCA. We compare RIAA sales to DVD and entertainment software sales, both before and after the Napster decision. Analysis of variance showed no differences in sales growth before Napster; that is, all industries showed similar growth. After Napster, however, RIAA showed significantly lower growth than that experienced by the movie and entertainment software industries.

Keywords: Napster, RIAA, legal issues in IT, ethical issues in IT, copyright law, DMCA

Introduction

The Recording Industry Association of America (RIAA) recently claimed a victory over people illegally downloading music. Proponents of file sharing and the open source movement decried the pronouncements of the Court, calling it a temporary defeat for individual music lovers. Meanwhile, the music industry, which saw double-digit increases in sales in 1998 and 1999, recorded declines in sales during the three years following the Napster case. Even in 2004, the most recent year for which figures are available, the music industry reported an increase in sales of less than 2%.

Some may argue that the reason for the slow sales growth is simply a declining world economy. Others say that Napster actually stimulated sales growth, and by putting it out of business, RIAA sales declined. In this paper, we describe the Digital Millennium Copyright Act (DMCA), relevant copyright law, and the implications of the Napster decision on the music industry. We compare the sales reports of the RIAA to two similar industries, the movie industry, and entertainment software. We examine industry sales data from the RIAA, MPAA, and ESA to establish whether RIAA has suffered significant disproportionate losses due to online file sharing.

Copyrights and Fair Use

A copyright is “a form of protection provided by the laws of the United States (title 17, U.S. Code) to the authors of original works of authorship” (United States Copyright Office, 1998). Copyrights give the holder various rights, including exclusive rights to make and distribute copies of the work (United States Copyright Office, 1998). Copyrights are not without limitations, including the “fair use” doctrine found in section 107. Fair use in general includes exceptions for using copyrighted material for educational, non-commercial uses.

The Digital Millennium Copyright Act

Long standing copyright law had its own detractors, but it was not terribly controversial until the Digital Millennium Copyright Act (DMCA) in 1998. The DMCA prohibits actions taken to circumvent anti-piracy measures in

commercial software, with exceptions for research, computer security testing, and to determine interoperability of products (UCLA Online Institute, 2001, 1).

The chief supporters of the DMCA include film studios, members of the record industry, and software companies. Their support is unsurprising, since these are the very groups who have the intellectual property which someone is likely to borrow. One of the most active and outspoken members of those who support the DMCA is the Recording Industry Association of America (RIAA), who in 2001 won the Ninth Circuit Court of Appeals case against Napster, Inc. (Miller & Jets, 2002, 123). Interestingly enough, many authors believe that this was a “hollow victory, since successors have eliminated Napster’s Achilles’ heel, a centralized server” (Fowler, 2002, 28). Perhaps the most interesting aspect of this case is not how Napster allowed people to infringe on copyrights, but how its existence failed to impact the RIAA’s bottom line in a significant way (RIAA Online Pressroom, 2004, 1). In fact, looking at sales figures for RIAA, it appears that sales actually increased during Napster’s heyday and declined *after* the Napster decision.

Opponents of DMCA feel that the DMCA has the potential to endanger rights such as Free Speech and Freedom of the Press, and that it endangers intellectual research in numerous areas. Chief detractors include researchers, software designers, and librarians. They base their position partially on the “fair use” doctrine and the principles of free speech.

Implications of Digital Copyright Law

One of the first cases to test copyright infringement in the digital age was the Napster case filed by the RIAA. The RIAA argued that Napster was responsible for copyright infringement on the music industry. We can infer that RIAA believed that Napster was affecting the bottom line of music sales and thus, wanted to receive legal redress for perceived wrongdoing. But did Napster negatively impact RIAA sales? Or did Napster actually stimulate music sales by allowing users to test music before purchasing? In this study, we investigate the impact of the Napster decision on RIAA sales. Then we compare RIAA sales to two similar industries, motion pictures and entertainment software, as described in the next section.

Methodology and Results

We collected annual sales statistics for the RIAA, as shown in Table 1. To select similar industries for comparison, we ensured that the industries have two commonalities with RIAA. First, we selected industries whose products have similar traits relating to piracy and copying, and second we selected industries that suffer a significant amount of piracy.

We selected the software industry and the movie industry as industries similar to RIAA. Both strongly exhibit the traits which are exhibited in the music industry, and both have adopted varying strategies for dealing with piracy. We selected these two comparable industries not only for their digital nature, but also because they represent similar leisure time activities as music, and therefore should exhibit similar qualities.

First, we examine the software industry, whose traits are easily mapped to those of the recording industry. Just as music is easy to distribute, software can be rapidly downloaded and stored for use and reuse. Just as with music, pirates can distribute physical media in the form of compact discs or DVDs at relatively low cost. We also contend that software piracy is as widespread as illegal online file sharing, as noted by the Business Software Alliance, which found that “thirty-six percent of the software installed on computers worldwide was pirated in 2003” (Business Software Alliance, 2004). Their study goes on to say that the world spends only a little more than \$50 billion for software for PCs, while almost \$80 billion was actually installed.

Software sales trends for the entire industry are very difficult to consistently track over several years; for this reason we focus our examination on a representative segment of the entire industry, the Entertainment Software Association (ESA). Table 2 shows ESA industry sales for the past ten years (Entertainment Software Association, 2004). Similar to the music industry, the ESA experienced significant growth in overall sales revenue during the past decade. While their increase in sales has certainly slowed, the slowdown does not appear as significant as the reduction that the RIAA experienced.

Table 1. 1994-2004 RIAA Reported Value of CDs Shipped (Millions of Dollars)

Source	Year	Sales (in Millions)	Percent Change
RIAA	2004	11,446.5	1.90
RIAA	2003	11,232.9	-6.73
RIAA	2002	12,044.1	-6.71
RIAA	2001	12,909.4	-3.31
RIAA	2000	13,214.5	3.10
RIAA	1999	12,816.3	12.30
RIAA	1998	11,416.0	15.10
RIAA	1997	9,915.1	1.98
RIAA	1996	9,934.7	5.94
RIAA	1995	9,377.4	10.80
RIAA	1994	8,464.5	

Table 2. Entertainment Industry Sales for the Past Ten Years (Millions of Dollars)

Source	Year	Sales (in millions)	Percent Change
ESA	2004	7,300	4.28
ESA	2003	7,000	1.45
ESA	2002	6,900	8.66
ESA	2001	6,350	5.48
ESA	2000	6,020	-1.31
ESA	1999	6,100	10.91
ESA	1998	5,500	25.00
ESA	1997	4,400	18.90
ESA	1996	3,700	15.60
ESA	1995	3,200	

The home video industry before the advent of the DVD did suffer from rampant piracy, but as this was an analog device, reproduction and distribution of copies was much more time consuming and difficult than in a digital world. With the advent of the DVD player, video reached staggering new heights of quality and provided a convenient format for pirates all at the same time. For the purposes of this study we will examine both DVD and VHS sales figures for the US market. Since DVDs are a new medium we can only examine data from 1998, the year widespread introduction of DVDs occurred, to 2004. We include VHS data to offset the meteoric rise in DVD format popularity and to maintain a more normalized sales trend curve, as shown in Table 3.

Table 3. 1998-2004 U.S. Home Video DVD/VHS Sales (Millions of Dollars)

Source	Year	Sales (in millions)	Percent Change
DVDEG	2004	24,500	8.89
DVDEG	2003	22,500	1.35
MPAA	2002	22,200	7.25
MPAA	2001	20,700	10.1
MPAA	2000	18,800	9.94
MPAA	1999	17,100	4.27
MPAA	1998	16,400	

The video industry has experienced tremendous growth during the recorded period. Even though this industry has continued to grow, it has clearly suffered from the same economic growth slowdown that the other industries have. During the period from 2000 through the end of 2003, the US saw rising unemployment reach 6% (US Bureau of Labor, 2004) and US GDP decline to 0.8% (US Department of Commerce, 2004). If we accept that the economy has slowed, then we should not be surprised that consumer spending might decrease on non-staple items.

Although we established through qualitative analysis that the three industries are similar, we also conducted analyses of variance (ANOVA) to compare sales data. First, we compared raw sales figures for all three industries. Since these industries appear to have very different sales dollar amounts, we propose:

Hypothesis 1: The raw sales data will differ for the three industries in question, both before and after the Napster case.

Since the Napster case was decided in 2001, we divided sales into those before the Napster case (2000 and earlier) and those after the Napster case (2001-2004). As expected, sales for 2000 and earlier were different between the three industries ($F=55.58, p<0.0001$). MPAA sales for this period averaged \$17,433, with RIAA sales of \$10,734, and ESA sales of \$5,505. Sales for the three industries were also significantly different for 2001-2004 ($F=240.16, p<0.0001$). MPAA sales for this period averaged \$22,475, with RIAA sales of \$11,908, and ESA sales of \$6,887. Therefore, Hypothesis 1 was supported.

However, we theorize that the Napster case actually hurt RIAA sales. Although the RIAA claimed a victory, music lovers were no longer able to test-drive songs before purchasing. Moreover, the ill-will that RIAA garnered after the Napster decision may have negatively impacted sales. Therefore, we propose:

Hypothesis 2a: Percentage sales growth between the three industries will not differ for 2000 and earlier years.

Hypothesis 2b: Percentage sales growth between the three industries will differ after the Napster decision (2001 and later). Specifically, percentage growth for RIAA will be lower than the growth for MPAA and ESA, industries not impacted by Napster.

ANOVA showed that sales growth was not significantly different for the three industries for 2000 and before, supporting Hypothesis 2a ($F=.24, p=.7925$). MPAA sales growth for the period was 7.105%, with RIAA sales growth of 8.203%, and ESA sales growth of 11.533%.

However, a comparison of sales growth after the Napster case did show differences between the three industries ($F=9.45, p=.0061$), supporting Hypothesis 2b. MPAA sales growth for the period was 6.898%, with RIAA sales decline of 3.173%, and ESA sales growth of 4.968%. Pairwise comparisons showed that MPAA and ESA sales growth did not differ significantly from each other, while RIAA sales growth (negative) was significantly different from the other industries. The lower sales growth for all industries during this period could clearly be due to an

economic slowdown and reduced spending after 9/11. However, we would anticipate similar levels of growth (decline) between the three industries. Instead, RIAA experienced negative levels of growth during 2001-2004.

Conclusion

Since MPAA and ESA have not faced the rampant online file sharing attributed to the music industry, we would have expected that the music industry (before Napster) would have shown a disproportionate loss in sales compared to MPAA and ESA. Instead, our results indicate that during the peak of online file sharing, RIAA had increasing sales growth that was not significantly different from two similar industries. After Napster, however, sales growth declined for RIAA, but not for MPAA and ESA. The recording industry seems content to blame its woes on online file sharing and piracy from Napster and sites like Napster, but our results indicate that Napster may not be the underlying cause of sales decline.

With one dollar of pirated software for every two dollars spent on software (Business Software Alliance, 2004), we must conclude that software suffers from the same vulnerability and the same level of piracy as the music industry. We should therefore expect a similar loss of sales in this industry, but we do not see such a decline in the software industry. If piracy alone were the problem then how could the software industry, which we know suffers from similar levels of piracy, continue to see sales growth? In 2001, the recording industry claimed that Napster was the source of their woes, and eventually the industry was successful in their drive to close down Napster, yet there is no corresponding increase in sales. The recording industry has been far more aggressive in its pursuit of individuals responsible for piracy than has any of the other industries, yet they have not seen an increase in sales, or a significant decrease in piracy.

Did the Napster decision turn consumers away from purchasing more music? Did music lovers simply become more savvy, and find new ways to circumvent digital copyrights? Was the Napster decision truly a victory for RIAA, or are the declining sales a direct result of the “victory”? Whatever the reason for the current slowdown in RIAA sales, it seems very unlikely that it can be blamed solely on copyright infringement and file sharing. More research is clearly needed to better establish the winners and losers in the Napster case.

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