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# Kill DRM, Vol. I: EMI's Move Underscores the Power of the Anywhere Consumer



<b>The Bottom Line:</b>	Digital rights management (DRM) software must go.
<b>Key Concepts:</b>	DRM, downloads, digital entertainment, broadband entertainment, music, digital music, online music, movies, video, movie downloads
<b>Who Should Read:</b>	CEO, CMO, VP of marketing, VP of product development, VP of business development

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## Anywhere Consumers Want Anywhere Content

Consumers are taking control of their daily communications, entertainment and shopping. The activities of the Anywhere Consumer™ are unconstrained by physical location, device, form factor or time of day (see the March 2007 Yankee Group Report, [The Battle for the Anywhere Consumer](#)). Anywhere Consumers challenge the status quo for commercializing consumer activities—aided by the pervasive technology trends of Internet Protocol standards, the digitization of content and applications, lower cost of media storage, and a proliferation of broadband networks, both fixed and wireless.

The needs of Anywhere Consumers are directly at odds with the entertainment's industry's Old Guard, who are seeking to recreate traditional systems of selling tangible goods using digital rights management (DRM). Record label and movie studio executives continue to insist that DRM is needed to protect their content from unscrupulous "pirates," otherwise known as consumers, and to ensure that artists, publishers and rights holders get paid. A notable exception is EMI, which on April 2 announced that it would allow the iTunes Music Store and other music services to offer premium-priced DRM-free downloads.

The time has come for content owners to wake up to reality, follow EMI's lead and embrace DRM-free distribution. Here is why:

- **DRM has failed to achieve its goal—stopping piracy.** Today's DRM implementations are the emperor's new clothes. Every mainstream DRM implementation—from CSS to Apple's FairPlay to the Advanced Access Content System (AAC3) high-definition DVD formats—has been broken. Frantic protocol patching simply steals the resolve of the reverse engineers.

Moreover, protected content always manifests itself in an unprotected form over speaker wires or on video displays. Users can obtain high-quality copies of protected audio and video by tapping directly into audio output streams or running software that takes frame-by-frame pictures of movies and stitches them back together. Short of mandating forcible implantation of decryption devices onto the backs of consumers' retinas and inner ears, copy protection is impossible. Determined programmers are making it easier for the mass market to circumvent DRM at increasing levels of quality.

**What content owners should do: Track, don't restrict.** Instead of trying—and failing—to build "better" DRM systems, media companies should embrace techniques such as digital watermarks, which embed cryptographic tracking numbers into ordinary, unprotected media files. Watermarks are completely transparent to consumers and do not restrict usage in any way. By focusing on tracking distribution paths instead of controlling "rights," publishers can understand the extent of file sharing, target promotions more precisely, enable new innovative business models and focus enforcement efforts on the highest volume re-distributors.

- **Publishers' transparent greed is turning consumers into pirates.** Media companies claim DRM is necessary to ensure that rights holders, publishers and artists all get paid. But DRM is really about media companies ensuring they get paid—multiple times—for the same content. If you want to watch a movie on your PSP, you need a UMD disc. To watch the same movie on your TV, it has to be purchased on DVD. Want to watch it on your iPod? You need to purchase it again from the iTunes Music Store. Many consumers feel, with justification, that their needs are better served by simply downloading the movie from a peer-to-peer (P2P) network and watching it on all of their devices without being encumbered by DRM. According to BigChampagne, a P2P measurement company, P2P networks averaged 4.4 million users daily in August 2002, of which the US accounted for nearly 81% of users. Despite a steady dose of lawsuits by the record labels, by August 2005, P2P networks averaged 9.6 million users daily, of which US users accounted for 71%. Content owners are turning consumers into pirates by defining fair use so narrowly that consumers feel they have no other choice.

**What content owners should do: Pretend file sharing services are legitimate and compete on quality.** File-sharing services and the BitTorrent network represent compelling competitors to publishers' legitimate outlets; these alternatives just happen to be illegal. De-commoditizing requires publishers devise a plan to compete against—rather than outlaw—competitors whose commodity prices are zero.

Movie studios and record labels can compete against “free” by stressing quality, bundling, convenience, choice, community and immediacy. One way digital content providers (DCPs) can compete with file-sharing services is to offer to replace any games, videos or music tracks purchased through the DCP and lost because of system crashes or other hardware failures. DCP already maintain a database of consumer purchase. This provides consumers with an incentive to purchase content rather than pirating it.

- **DRM raises costs for consumers and service providers.** Any interruption to information flow frustrates Anywhere Consumers. According to Deutsche Telekom's MusicLoad, three out of four customer service calls are ultimately attributable to DRM. As a result, MusicLoad is moving to a DRM-free model for albums and tracks from independent artists and labels. In addition to lowering the costs associated with customer service calls, sales of DRM-free albums and tracks have increased 40%. If evermore draconian DRM efforts frustrate both retailers and consumers, how can content owners expect to be paid for their content.

**What content owners should do: Embrace DRM-free music and drive volume.** EMI has recognized the folly of DRM and agreed to allow the iTunes Music Store to sell DRM-free audio and video tracks. DRM-free tracks will be encoded in AAC at 256 kilobits (twice the bit rate of DRM-protected files) and will cost US\$1.29—a 30% premium over tracks with DRM. Based upon this pricing, EMI is assuming that for every three tracks sold, a copy will be shared. Yankee Group predicts EMI and Apple will see a 50% uptick in digital sales as a result. This will provide Apple further ammunition to convince skeptical record label and movie studio executives to go DRM free.

- **Excessive focus on publishers “rights” damages relations with consumers.** Record labels are alienating an entire generation of consumers by treating them like criminals. Universal Music Group Chairman and CEO Doug Morris flatly stated digital audio players “are just repositories for stolen music, and they [consumer electronics manufacturers] know it, so it's time to get paid for it.” Universal, Warner Music, EMI and Sony BMG have sued more than 20,000 consumers believed to be sharing music. Now record labels are attempting to circumvent the courts by having ISPs charge suspected pirates \$1,000 to be paid directly via p2plawsuits.com. Sony BMG has gone so far as to include anti-piracy technology on CDs—an act that damaged consumer's computers and caused Sony to be accused of planting rootkits. Furthermore, lobbying for consumer-hostile legislation such as the “broadcast flag” continues apace. These assaults on fair use and common sense leave consumers feeling abused and encourage piracy.

**What content owners should do: Think “viral” and channel the passion of movie and music lovers.** Stewart Brand once famously remarked that “information wants to be free.” Now that media has become digitized bits flowing over wires, these activities are even more natural and effortless than ever. According to the Yankee Group *2006 US Digital Home Entertainment Survey*, 59% of PC households with home networks distribute movies, videos, music and games throughout their home. By insisting on increasingly invasive controls on how, when and where media can be watched or heard, publishers are swimming against an increasingly swift current. They would do well to embrace the little-known other half of Brand's remark: “On the other hand information wants to be expensive, because it's so valuable. The right information in the right place just changes your life.” Creating urgent, immersive, compelling experiences for movie and music lovers should be the goal. Where passion and loyalty arise, profits will follow.

Other industries understand that revenue need not be directly linked to the content they distribute. Many newspaper publishers with online divisions offer tiered models that make commoditized information free, but require subscriptions for premium content. The New York Times online has 1.5 million online subscribers versus 1.1 million print subscribers. The Wall Street Journal's online subscription service has long been profitable, as has The Economist's. Moreover, revenue not derive simply one-to-one from subscription fees; ad revenue, up-selling opportunities and joint ventures also play a role.

Companies such as BurnLounge and Weedshare have integrated Web 2.0 features such as social networking and viral marketing into their services, encouraging consumers to become legitimate distribution channels, enabling them to profit from it. Rather than file meaningless lawsuits that have no effect on the overall piracy problem (i.e., record labels vs. Napster, Viacom vs. YouTube), media and entertainment companies must find new innovative business models that tap into innovative software stacks (see the February 2007 Yankee Group Note, *Emerging Business Models for Music Distribution*).

- **DRM alienates early adopters by accelerating product obsolescence.** The most eager adopters of HDTV have recently learned that the expensive sets they bought several years ago are obsolete because they do not support HDMI, and won't work with current high-definition DVD players. PC hobbyists face a similar conundrum: with Windows Vista, movie studios persuaded Microsoft to implement draconian video controls that will automatically degrade all unprotected high-definition video. The prospect of ever-changing restrictions scares off early adopters who buy the newest technologies, when product margins are highest. Consumers who purchase content from a company that uses DRM are locked to the specific form factor and software version. Lock-in limits competition; limited competition raises prices. All bets are off if the DRM provider goes out of business or requirement change. Limiting content flexibility scares off buyers of both content and hardware.

**What content owners should do: Unite with consumer electronics manufacturers to drive consumption.** Marketplaces aren't served well with conflicting standards that retard interoperability. Consumers want simple solutions that work. Aside from Apple, hardware manufacturers and digital content providers have had a difficult time working together. Even Microsoft's PlaysForSure initiative failed because it lacked testing, which forced Microsoft to develop Zune. The market wants one standard that digital media hardware can interoperate with, and it won't be one that has DRM in it. The media and entertainment industry is fighting against a torrent that is crashing down on all industries—powerful multimedia software and the digitization of content. Embracing the flexibility and ingenuity of software unfettered by DRM will cause the market will grow by orders of magnitude.

## Recommendations for Consumer Electronics Manufacturers and PC Manufacturers

- **Apple: Don't stop with EMI; emancipate independent artists and labels.** Existing contracts with Universal Music Group, Warner Music and Sony BMG prevent Apple from selling DRM-free version of these label's songs. But many independent artists and labels do not require DRM. Apple should build upon the momentum it has gained and follow eMusic's lead and remove DRM from all independent artist tracks on the iTunes Music Store, while attempting to obtain more unprotected content from the major record labels.
- **Microsoft should follow Apple's lead and remove DRM from Vista.** The phone-home features in Microsoft's new operating system (i.e., Windows Genuine Advantage and Internet Explorer anti-phishing filter) are already making some consumers nervous. Vista's invasive DRM features, which degrade or attempt to control consumers' listening and viewing experiences, will frustrate them even more. The need to evade Vista's hardware and content restrictions is creating an XP gray market for consumers looking to downgrade their operating system to one that "just works." We also expect that horror stories, real or imagined, will push many potential Vista customers to the Macintosh.
- **Consumer electronics manufacturers and PC manufacturers must lobby more effectively.** Historically, the consumer electronics and PC industries have wanted as little to do with Washington, D.C., as possible, ceding influence to the much smaller media and entertainment industry, although recently their influence has grown. According to *opensecrets.org*, which compiles lobbying disclosure reports from the Secretary of the Senate's Office of Public Records (SOPR), media and entertainment companies are significantly outspending CE and PC manufacturers. In 1998, the electronics manufacturing and services sector contributed \$11.5 million to political campaigns, while the TV/movie/music sector contributed \$31.1 million. In 2006, the electronics manufacturing and services sector increased its annual contributions to \$14.7 million as compared with \$62.9 million for the TV/movie/music sector. Media and entertainment companies are dominating public policy to the detriment of consumer electronics manufacturers, PC manufacturers and consumers alike. The consumer electronics and PC industries must wake up to this fact and start wielding their power in the halls of Congress.

## Recommendations for Congress

- **Reject the rhetoric from media companies and repeal DRM laws.** DRM puts everyone at a disadvantage by driving up costs and alienating consumers. In contrast, *lack* of copy protections has been an advantage for other countries, such as Romania, whose president specifically cited piracy as the key reason why the country's indigenous software economy has grown so rapidly. Congress must recognize the damage DRM is doing and rectify the situation by repealing the Digital Millennium Copyright Act (DMCA). Congress could also force a new era of creative thinking in the media industries by rejecting proposed DRM legislation, thus depriving publishers of ammunition they seem destined to use—over and over.