Battle brewing on the digital music front

Microsoft's online song store may pose the most serious threat yet to Apple's domination in niche

By Robert Weisman, Globe Staff | August 30, 2004

Apple Computer Inc.'s reign as king of the digital music business is about to meet its most serious challenge as software heavyweight Microsoft Corp., prepares to enter the fray.

As in other technology niches, from spreadsheets to Web browsers, Microsoft will be arriving late to the game when it introduces its music store with the new version of its Windows Media Player software. But the Redmond, Wash., company will bring some strong assets to the music-download competition, notably the hundreds of millions of visitors to its MSN stable of consumer websites. Microsoft has long sought to boost transaction revenue from those sites, and the digital music business model pioneered by Apple has proved irresistible.

"Microsoft certainly has the potential to create a capable music store and take advantage of the traffic that comes through MSN," said Josh Bernoff, principal analyst at Forrester Research in Cambridge. "Up to this point, there's been very little competition for Apple."

Details of Microsoft's music offering are being kept under wraps until the official launch, expected this week. But even before it comes to market, the Microsoft music store promises to set up a head-to-head battle with Apple that recalls their jousting in the personal computer business. Much of the competition will be about rival formats and which format emerges as the dominant standard.

Digital music has fueled a comeback at Apple, based in Cupertino, Calif., which jumped to an early lead in the field with its popular iTunes music store and iPod portable music player, both introduced in 2001. The company reports it has sold almost 4 million iPods and more than 100 million songs over the past three years. Analysts estimate it has 70 percent of the market for digital music downloads, and about half for music devices with hard drives, the market segment that draws the most serious music buyers.

Apple uses a proprietary digital rights management system, called Fairplay, to stop people from copying songs illegally. It licenses Fairplay only to manufacturers, like Hewlett-Packard Inc., that build digital jukeboxes compatible with the iPod. The copy-protection system has been used to prevent other companies from selling music that plays on the iPod or other devices from playing iTunes music.

Most of the other music players support Windows Media Player software, which Microsoft licenses to all comers. Microsoft, which doesn't make its own hardware, is platform-agnostic.

"There's a genuine format war shaping up, a standards war," Bernoff said. "Apple basically says, 'If you want to use our system, you have to create a player very similar to ours and we will control what you can and can't do.' For Microsoft, it's far more important that their format be well established than that their music store becomes a success."

Representatives of Microsoft and Apple won't discuss their products or strategy until the Microsoft music store is formally launched. But analysts said Microsoft will need to generate some excitement in the marketplace to compete with iTunes and the iPod player. While rivals such as RealNetworks and Wal-Mart have attempted to underprice Apple, which charges 99 cents to download a song, the leader positions its iTunes and iPod combination as a consumer experience, which makes it harder to dislodge.

"The iPod has become a cultural icon," said Michael Gartenberg, vice president and research director at Jupiter Research in New York. "This is the device that's driving digital music sales right now."

Digital music sales are projected to nearly double this year to $270 million, but they still represents just a
small fraction of the $12 billion annual compact disc business, according to Jupiter Research. Over the next five years, the research firm estimates that annual online music sales -- downloads combined with digital subscription services -- will grow to $847 million while sales of CDs will continue to decline.

Microsoft is clearly focused on the long-term trend. But whether it can replicate its success in the personal computer market, where it relegated Apple to a niche player, remains to be seen.

"When the 800-pound gorilla jumps into the water, it's going to create ripples," Gartenberg said. "We'll see if the gorilla can swim."

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