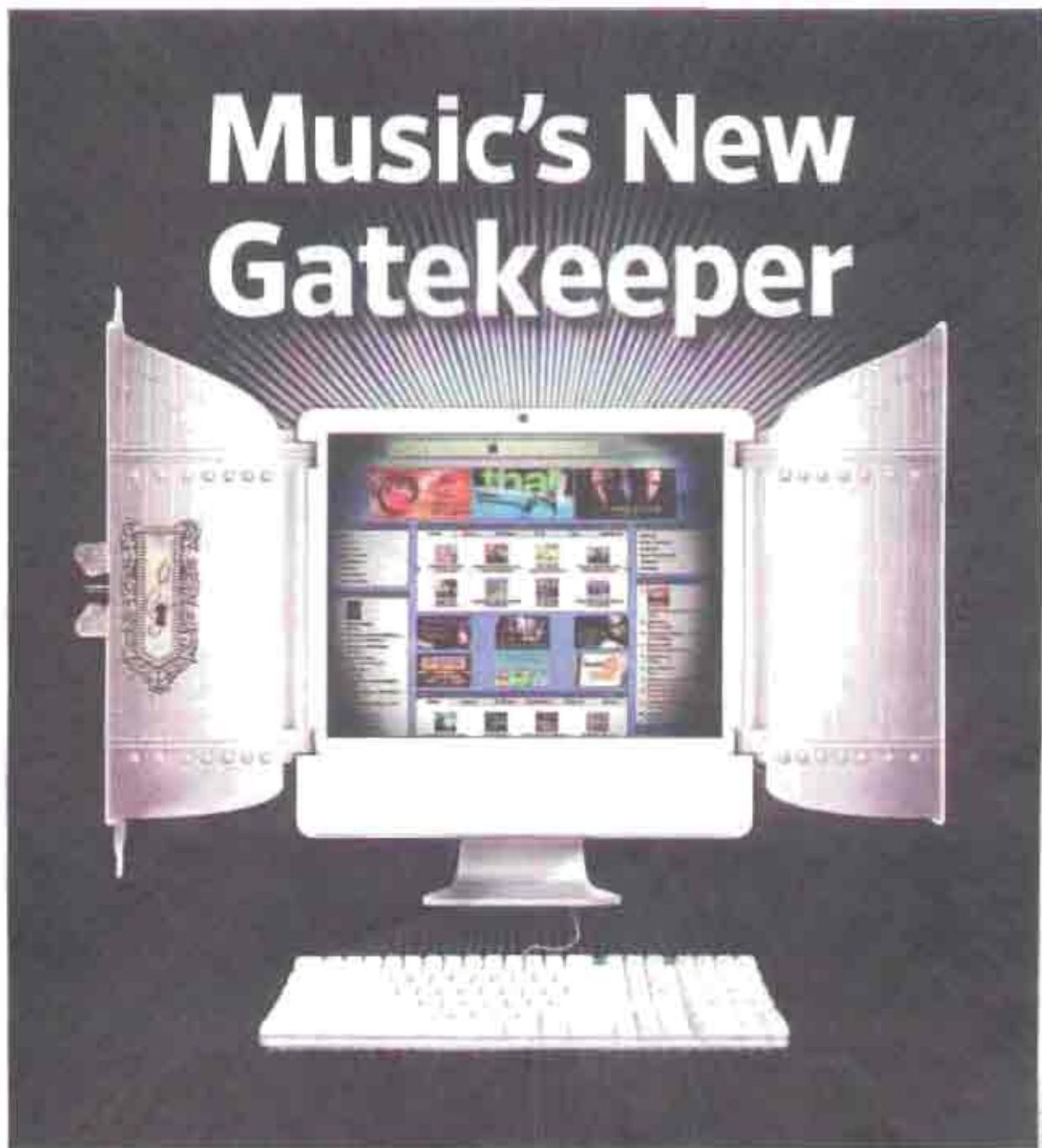


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Music's New Gatekeeper



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By NICK WINGFIELD and ETHAN SMITH

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Every day, the roughly one million people who visit the iTunes Store home page are presented with several dozen albums, TV shows and movie downloads to consider buying -- out of the four million such goods the Apple site offers. This prime promotion is analogous to a CD being displayed at the checkout stands of all 940 Best Buy stores or featured on the front page of Target's ad circular.

What makes up an iTunes page? Find out the difference between "swooshes" and bricks.

How do bands get these boosts? Who decides whether Arcade Fire is plugged at the top of the iTunes site -- or whether Nickelback gets no mention?

Apple has jettisoned some of the conventions of traditional music retailing -- notably, the practice of selling prime promotional spots to recording companies willing to pay for better visibility for their acts. But behind the scenes there's plenty of horse-trading going on that influences which songs are seen and purchased by iTunes customers.

Apple -- now one of the largest sellers of music in the U.S. -- offers home-page placement in exchange for things such as exclusive access to new songs, special discount pricing or additional material such as interviews with stars. Most other big retailers, digital and physical, also seek exclusive offerings, but Apple is especially aggressive and has outsize clout when it comes to the slightly out-of-mainstream music it often emphasizes.

The decisions by the small group of Silicon Valley and music-

industry veterans running iTunes can help put an unknown band on the map, adding millions of dollars in sales, while relegating others to the obscurity of the site's virtual back bins.

Push for Exclusives

Apple's muscle-flexing has begun to rub some artists and music companies the wrong way. During a recent radio interview, outspoken British pop singer Lily Allen accused iTunes of "bullying" artists into supplying exclusive content. There's a further worry among music executives that the few spots available to promote artists on iTunes are dwindling as Apple remakes the store into a broader entertainment destination for TV shows, movies and games.

Lily Allen accuses Apple of "bullying" musicians into providing exclusive content.

But so far, most labels comply because of the site's ability to drive sales. During a week when an album is featured on the iTunes home page it can sell about five times more copies on average through the site than it does in the three to five weeks that follow, when the album isn't featured, says one industry executive.

"The way MTV used to be the place where you had to have a video playing as one of the key legs of the stool, iTunes is now one of the key legs of the stool," says Chris Douridas, an influential deejay at public radio station KCRW in Santa Monica, Calif., and a former consultant to iTunes.

Not only does securing a spot on the iTunes home page require concessions by music companies -- it also depends on having material that resonates with the tastes of iTunes staffers. Three months before Warner Music Group's Rhino Entertainment was gearing up to promote a handful of older Prince titles, timed to coincide with the musician's recent performance at the Super Bowl halftime show, the label entered into talks with iTunes. The result: Four albums, including "Purple Rain," received prominent positions in the store and were priced at \$7.99 -- \$2 less than Apple's standard album price.

"They said, 'We'd like to be able to offer it at a special price,'" says David Dorn, Rhino's senior vice president for digital strategy. "I said, 'We'd like to get in the New Music Tuesdays newsletter and home-page placement.' I gave a little, they gave a little. But no cash changed hands."

Prince cut prices on old albums for iTunes, timed to his Super Bowl gig.

After the prime display, digital sales of "Purple Rain" rose fivefold, according to SoundScan, while sales of "The Very Best of Prince" more than doubled. Three less-known albums in the promotion saw modest increases.

In January, iTunes executives approached several record labels to set up a promotion in which they would slash the prices of 20 greatest-hits albums to \$7.99, and Apple in turn would flag the entire group on the home page. The first album that came up, Queen's 34-song "Greatest Hits 1 & 2," originally released by Walt Disney's Hollywood Records in the mid 1990s and normally sold on iTunes for nearly \$34, zoomed to No. 1 on the site's album-sales chart. It stayed in the top 10 for the entire 10 days of the promotion.

Groups like Gnarls Barkley have enjoyed significant boosts from iTunes. Last year, the alternative-soul duo's "Crazy" became the first song to hit No. 1 on the British pop charts based solely on digital sales. When the Shins' third album, "Wincing the Night Away," made its debut in January at No. 2 on the Billboard 200 album-sales chart, nearly 30% of the first-week sales were made online -- most on iTunes.

For consumers, Apple's growing influence means exposure to a wider range of music. Apple has told some recording companies that music from independent labels accounts for about 15% of iTunes sales, compared with about 5% for physical retailers.

Mike Schiller, a management consultant in Cleveland, says the iTunes home page, along with Apple's New Music Tuesday newsletter, has frequently introduced him to music and movies

that he later purchased, including an album by a British act called Guillemots and a Mark Wahlberg football movie called "Invincible." "It's pretty powerful," says Mr. Schiller, 48 years old, who worked as a record-store clerk while a teenager in Omaha, Neb. "It will give you exposure to stuff that you don't normally see."

Rare Growth Story

iTunes is housed at Apple's Cupertino, Calif., headquarters in a cluster of nondescript cubicles that could easily be confused with a software-development group but for a smattering of music posters on the walls, according to people who have visited or worked there.

The iTunes staff includes people with music pedigrees, including Alex Luke, a longtime deejay who is the director of music programming and label relations. (Mr. Luke still sits in occasionally for stations like Los Angeles's Indie 103.1 FM.) Bruno Ybarra, who co-founded a house-music record label, manages relationships with independent music companies. Denzyl Feigelson, a South African who was a manager for singer Paul Simon's "Graceland" tour, is a music editor for iTunes in London. In all, dozens of iTunes editors and label-relations staffers collaborate in meetings and discussions throughout the week to determine what the home page of the iTunes Store will look like when it is refreshed every Tuesday.

Apple is a rare growth story in the music business. It nearly monopolizes digital-music sales, just about the only growth area for the beleaguered industry, which saw CD sales fall for seven years running. iTunes sold 1.2 billion songs last year compared with 30 million in 2003, its first year in operation, Apple says. The company says it passed Amazon.com last year to become the fourth-largest music retailer in the U.S., behind Wal-Mart Stores, Target and Best Buy, a claim that isn't disputed by music companies. At the end of last year, Apple was selling five million songs a day at 99 cents each.

Its growing clout has transformed Apple Chief Executive Steve Jobs -- who kick-started online music sales several years ago

with a set of breakthrough song-licensing deals with major recording companies -- into a figure music executives alternately admire and grouse about. Mr. Jobs recently caused a kerfuffle by urging music executives to consider dropping their insistence on digital copy-protection software on songs, which Mr. Jobs believes is holding back Internet music sales.

Label executives say that since Apple began selling TV shows and movies in the past year, they must begin discussions with Apple three to six months before a major music release if they want a shot at home-page promotion. In physical stores, such prime real estate is typically for sale. To secure prominent "end-cap" placement on CD racks near the ends of aisles at national retail chains, major music labels can pay as much as \$5 per disc displayed in the form of discounts, "cooperative advertising" payments and other fees, according to executives. That adds up to tens of thousands of dollars for a major promotion involving 5,000 discs or more. Such hefty payments can effectively erase any profit on the CDs on display in an end-cap.

Apple says it shunned pay-for-placement -- as have online rivals including RealNetworks' Rhapsody -- to provide unbiased music recommendations. Eddy Cue, the Apple vice president who oversees iTunes, says the company hopes to recapture some of the spirit of independent record stores, when clerks would give uncompromised tips on promising performers. "That for us was kind of gone in the new retail environment," Mr. Cue says. Customers used to believe that advice on music "was coming from someone who really liked it versus someone who was paid to say they liked it."

Apple isn't under as much pressure to squeeze profits from iTunes because of the money it makes on iPods. In fact, it earns little from iTunes after paying fees for the music and credit-card processing. iTunes typically pays major labels about 72 cents a track, while it pays most independent labels around 62 cents.

Exclusive material greatly increases the likelihood that iTunes will turn up its promotion machine. In some cases, that involves getting artists such as Sting or Willie Nelson to record interviews and performances that Apple sells as a package. The company

recently struck up a relationship with the Las Vegas casino the Palms to record live concerts by artists such as John Legend, for which it pays production costs.

The Orchard, an online distributor of music from independent labels, recently agreed to let Apple have an album of material by the artist G. Love one week before other Internet retailers got it. Apple ran a promotion on the front page of iTunes and the album reached No. 17 on the site's album charts, says Greg Scholl, the distributor's CEO.

Yet Ms. Allen, the young British singer behind the hit "Smile," complained during the recent radio interview about Apple's tactics. "They won't advertise your album unless you give them extra material," Ms. Allen said. She said iTunes pushed her to quickly turn out a version of a song, so she planned to give them a "rubbish remix." Ms. Allen said she would offer a better version free on her MySpace page. Apple declined to comment on Ms. Allen's remarks, and a spokeswoman for her label, EMI Group's Capitol Records, said the singer and her manager weren't available to elaborate.

And while Apple has made it a practice to seek out new artists, iTunes still has glaring gaps in its inventory. The best known is the absence of anything by the Beatles and much of the band members' subsequent solo recordings -- a situation that stemmed partially from a trademark dispute between Apple and the band's Apple Corps Ltd. record label. (Apple has said it's hopeful it will get the Beatles on iTunes following a recent settlement between the company and Apple Corps.) Led Zeppelin, AC/DC and Radiohead, too, haven't licensed their music to the service. And due to licensing issues, some albums are sold minus one or more songs. Elvis Costello's "Spike," from 1989, is missing one track, while only three songs from the J. Geils Band's 1972 "Full House 'Live'" are available on iTunes.

Still, Apple is being fawned over by much of the music industry. Digital Music Group, a Sacramento, Calif., company that handles online distribution for independent labels, has four people on staff who spend most of their time chatting up iTunes editors and sending them CDs of bands in an attempt to get promotion on

the site. Tuhin Roy, the distributor's chief strategy officer, is impressed by the knowledge of the Apple staffers. "Clearly, they know the music they're dealing with," he says.

Josh Deutsch, chief executive of Downtown Records, went so far as to bring urban artist Kevin Michael to Cupertino to perform for iTunes staffers. Apparently impressed, iTunes executives committed to releasing an Apple-only collection of tracks next month, in advance of Mr. Michael's debut album. While some music executives are frustrated about what it takes to woo Apple, "The flip side is, when they do step out on a new artist, it's that much more meaningful," Mr. Deutsch says.