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Online music markets in China The broader picture and the role of copyright and DRM

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Abstract: China is one of the most difficult markets in the world for copyright owners. Illegal distribution networks are well established and consumers are used to content that is either free or very cheap. China's legal system is still in the process of developing and the Chinese government regularly fails to enforce its own IP legislation. As a result, translating formal rights into royalty payments is extremely tough. This article, which is based in part on interviews by the author, describes the present communication infrastructure, social habits, and the copyright environment in mainland China. Against this background the potential role of DRM systems and innovative business models is discussed.

Keywords: country report – business models, consumer expectations, copyright law, music markets, piracy – China

Music downloading and sharing in China

At present, rates of music piracy are high throughout China's audio-visual industries. Music industry executives generally quote piracy rates of between 75% and 95%. Disc piracy is common, particularly in wealthier cities along China's eastern seaboard. People living in less affluent or developed areas still use pirated audio cassettes, which are cheaper to copy than digital media. Cassette players, which are capable of both playing and copying music, are much more affordable to people living in poor areas of China than computers. They are also easier for less educated sectors of the population to use: they do not require computer literacy or the ability to Romanise Chinese characters (pin yin). Expensive hardware investments are also unnecessary, allowing anyone with a tape recorder and a blank cassette to copy and share music using this format, regardless of their access to the internet.

At the same time, the development of an extensive broadband network in China's cities and growing levels of PC ownership among the emerging urban elite are also resulting in high levels of music downloading. MP3 downloading is particularly common among university students and young professionals, who are more likely than other sectors of China's population to have access to the Internet, an interest in music and the skills to engage in this activity.

Consumers have no incentive to pay for MP3 downloads. Chinese Internet search engines such as baidu (<http://www.baidu.com.cn>) and emule (<http://www.emule.com.cn>) provide fast, free, easy music downloading. To date, members of the public have never been prosecuted for downloading music illegally, although action has been taken against some websites by copyright owners (China Economic Review 2005)..

Music labels such as Sony have been involved in high profile events aimed at raising awareness of the impact of piracy on the music industry and on artists: in November 2003 between 50,000 and 60,000 people packed Shanghai Stadium for the Asia Superstar Anti-Piracy Rally Concert.

China's central government has undertaken a number of publicity campaigns encouraging consumers not to purchase pirated audio-visual products, including television and billboard advertisements with slogans such as "be a good Beijinger, resist piracy". In spite of these efforts, Chinese consumers face little, if any, moral stigma related to music downloading. Consumers are now used to downloading music without paying, and even if they did want to download legally, few legitimate services are available. According to *Beaker Huang*, Marketing and Busi-

ness Development Director for Warner Music, China, it took Warner a long time to realise that university students were not their biggest market, but their biggest liability: "...as soon as they get to college the only way they are going to be spending money on music is they keep on spending money to upgrade their PCs so that they can be downloading more songs." (Montgomery 2005a).

PC ownership and access to the Internet

Internet access is growing rapidly and MP3 players are cheap and readily available. According to CNNIC (2005) there are 103 million internet users in China, 53 million of whom have broadband. High speed broadband networks are being rolled out in most urban centres and China is expected to have 34 million broadband subscribers by the end of 2005. This is impressive, when compared with the United States – which has 39 million subscribers. By the end of 2007 China is expected to have 57 million broadband subscribers, compared with a projected 54 million in the US (Reardon 2005). Although at present only about 2% of Chinese households own PCs (Kessler 2004), this number is growing fast. By 2010 it is expected that 178 million new PCs will have been purchased in China (BBC 2004). Internet cafes are still playing an important role in providing access to the Internet. This has significant implications for the types of online music models that new media developers might choose to apply in China. According to *Ruuben van den Heuvel*, Vice President of digital business Asia at Sony BMG: "In China 100 million people access the Web through Internet cafes. For them it is not about downloading, it is about the experience. In the US it is still all about ownership" (Frater 2005).

Projects like Microsoft's Venus operating system have focussed on dramatically lowering the cost of accessing the internet from home, a move which would help bring millions of previously isolated consumers into the digital realm. Venus is designed to allow a web browser, a low end personal computer and a video compact disc player to be combined in a single box that can be used in conjunction with a television, for people who cannot afford a traditional PC (Reuters 1999). Another, more recent development is Internet Protocol Television (IPTV; cf. sources), which allows television or video signals to be distributed over broadband, using Internet protocols. Telecommunications providers are also looking towards IPTV as one of the next major developments in content delivery in China. Rapidly rising rates of broadband penetration and the launch of IPTV services by Internet service providers will undoubtedly create new opportunities for digital content providers. According to IDC, although there are expected to be less than 300,000 IPTV subscribers in China by the end of 2005, this figure is expected to reach 9 million by 2008 (Le Maistre and Newlands 2005).

Mobile devices and services

China has experienced enormous growth in mobile phone uptake over the past five years. Each month about 5 million people sign up for mobile services for the first time (Kessler 2004). Saturation of the handset market is prompting the industry to focus on handset upgrades and value added services. Mobile technology companies predict that overall growth in the market will continue, and expect to see sharp increases in demand for mobile content as 3G networks expand and the content becomes more affordable.

Mobile phones are already providing an important revenue stream for Chinese record labels. Consumers are paying for mobile ringtones (*cai ling*) and ringback tones and copyright owners have had some success in ensuring that they receive a portion of the money being spent on these services (Montgomery 2005a, c, d). Many record industry players see mobile content as key to the future of China's music industry (Montgomery 2005b, c, d, e). Chinese consumers are spending a high proportion of their income on mobile telephones, accessories, and content required to personalise them.

In contrast to the slow development of online MP3 sales, two important factors are making it possible for a copyright compliant mobile music market to emerge. These are

- 1) An established billing system; and

2) The ability to control the distribution of mobile phone content through a limited number of mobile service providers.

The cost of mobile content services is simply added to each customer's monthly bill (Montgomery 2005a). Mobile service providers are responsible for collecting payments and passing royalties (or a negotiated fixed amount) on to copyright owners.

Legal protection for copyright owners and user rights

Membership of the World Trade Organisation requires China to enforce its domestic intellectual property laws and to meet the obligations relating to copyright protection set out in the agreement on Trade Related Aspects of Intellectual Property (TRIPS). China has been involved in a steady process of copyright reform in accordance with international practice since the 1980s (Qu 2002). In November 2001, as a result of joining the World Trade Organisation, the government approved amendments that brought China more closely into line with TRIPS and the Berne Convention (Fitzgerald and Montgomery 2005).

Anti-circumvention provisions

Technical protection measures put into place by the copyright owner are explicitly protected under Article 47 of the Chinese copyright law (1990). Civil and administrative remedies are available for any act of intentionally circumventing and damaging protection measures put into place by the copyright owner, and for deliberately deleting or altering electronic rights management information, without the copyright owner's consent (Fitzgerald and Montgomery 2005).

Moral rights

Authors have a right to be acknowledged for their efforts (a right of attribution) and a right to be consulted in relation to any changes made to their work (rights to alteration and integrity) for an unlimited period. These rights exist separately from the economic rights associated with copyright, and continue to belong to the author even after the exploitation rights have been sold on. Copyright is protected for the life of the author plus fifty years. Works created by corporations or other entities are protected for fifty years, as are cinematographic, film or photographic, television or audiovisual broadcast radio and television programs (Fitzgerald and Montgomery 2005).

Fair use

China's copyright law provides extensive fair use exceptions, including for "private study, research or self-entertainment". Nonetheless, copyright owners do have legal protection against sites providing music downloads without payment to or permission from the copyright owner. In addition to the anti-circumvention provision of the law, it is an offence to reproduce or distribute a product of sound or video recording, or to make it available to the public through an information network, without the permission of the producer.

Legal remedies

According to articles 46, 47, 49 and 50 of the copyright law, victims of copyright infringement can seek civil and administrative remedies, including monetary damages, injunctions, public apology and destruction of offending products. The onus of proof rests with alleged infringers. The copyright law requires infringers to pay compensation according to the actual injury inflicted on the copyright owner by the infringing act, or according to the profits derived from the infringing work. In cases in which it is difficult to establish the right holder's actual injury or the infringer's unlawful income, the courts may award statutory damages of up to 50,000 RMB (approximately US \$6,200). China's 1997 Criminal Law also provides penalties of up to seven years imprisonment for copyright related offences.

Three channels for copyright enforcement exist in China: Civil, Administrative and Criminal. Civil action requires parties to take action on their own behalf, through the courts, in response to infringement of their rights. Administrative action is taken by the Administrative Department for Copyright directly, rather than through the courts. Prosecution of criminal actions can only be undertaken by the state. This means that, in addition to civil action, copyright owners also have the choice of working with the copyright department directly in order to stop infringement. The Copyright Department has the power to issue injunctions, confiscate unlawful gains, confiscate and destroy infringing material and the tools used to create them, and to issue fines to punish infringers. However, while administrative authorities have the power to impose fines, only the courts have the power to require infringers to pay compensation to copyright owners.

Discussing the role of DRM and alternatives

The biggest challenge for Digital Rights Management in China is the availability of un-protected content. It is unrealistic to expect users to pay for content that carries restrictions relating to the ways in which it can be copied, shared and re-distributed while unrestricted versions of the same material are available for free elsewhere.

Current levels of piracy are forcing copyright owners in China to develop business models that take into account the distribution environment. Major record labels originally attempted to charge Chinese audiences prices for CDs comparable to those demanded in markets such as the US and Australia. However, since 2003, all of the major labels have lowered their prices in an attempt to compete with pirated products (Montgomery 2005c, d, a). Advertising, product endorsements and sponsorship are also being pursued as important strategies to generate revenue streams.

Ring tone downloads and ring back tones are arguably more significant as a source of income for many Chinese music industry players than royalties from album sales. Artist management services, which allow record labels to capitalise on advertising, publicity and concert fees generated by their stars, are also much more significant in the Chinese music industry than they are in markets where intellectual property rights are easier to enforce.

In this environment, new technology, which can be engineered with controlled distribution in mind, will play an important role in China, where existing media formats, such as cassettes and CDs, are already established as the centre of a massive industry of un-regulated distribution. It is highly unlikely that the genie can be put back into the bottle when it comes to established piracy networks. Nonetheless, technological developments that force content to pass through a limited number of regulated portals may help to secure new income streams in the future.

The success of mobile content services in an environment where most copyright owners are struggling to realise the value of their intellectual property may provide lessons for the sector more generally. The fact that consumers have no choice but to purchase mobile services from a restricted number of mobile providers makes it possible, for the most part, for copyright owners to monitor the distribution of their products. It is conceivable that similar arrangements with IPTV service providers may help to resolve some of the problems associated with micro payment for online content as the sector develops.

Greater transparency and accountability within China's group collection agencies, as well as among internet service providers and search engines will also be crucial to realising the potential of China's copyright industries. The availability of illegal online content cannot be controlled without such changes. But reducing the availability of free online content will not be enough. China's copyright owners will also have to ensure that legitimate content is available quickly, conveniently and easily to consumers when they want it. The impact of DRM measures on the attractiveness of the content being offered will need to be considered in the context of this supply/demand equation.

Bottom line

It is possible that the copyright environment in China may force intellectual property owners to move away from a royalty-based system for content provision. Advertising is already playing a vital role in generating music industry income. It may be necessary for record labels to consider an integrated business model, in which content is given away online, in exchange for audience numbers and willingness to purchase mobile content services, merchandise, tickets to live performances and other associated products. It may be time for China's music industry to accept that the intrinsic value of their products lies in the ability to attract audiences, to entertain, and to spark an interest in purchasing associated services. Consumers who are used to receiving content for free will not willingly shift to a system which expects them to pay. This will be particularly true if the products they are asked to purchase are rendered less attractive and convenient to use by DRM restrictions.

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