



Will Digital Music in China Overthrow the Traditional Music Publishing Business?

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Aigo Music, a digital music downloading website, announced on April 3 that it has entered into a strategic partnership with Warner Music, one of the world's four major music companies, to develop a market in China for legal distribution of digital music. The Aigo site, aigomusic.com, was created last October by Beijing-based Huaqi Information Digital Technology, China's largest producer of MP3 players under the Aigo MP3 brand. Huaqi is seeking to make its Aigo MP3 player and the Aigo online music store into China's iPods and iTunes.



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Aigo wasn't the first to partner with a music company. Beijing-based top100.cn; Shanghai-based Shanda's digital home entertainment product and website EZ Pod; and Shenzhen's A8 Music have teamed up with well-known music companies from both China and overseas. Each of them is trying to build its own legitimate music library through copyright purchases. Taihe Rye Music, a record company founded by an investment pool in March 2004, promotes its own artists and their new songs and albums through its Tailenet.com site. Taihe became known in the industry because it was the first to enter into digital music publishing in China. In October, Softbank Asia bought a 30% stake in Taihe for \$10 million -- a sign that the legal Internet music market may finally have a budding chance after being long overshadowed by rampant piracies.

Digital music can be divided into online music and mobile music; each broadcasts, respectively, through the Internet and a mobile telecommunications network. Online music is downloaded from the Internet to computers or digital music players. Mobile music mostly targets cell phone ring tones and "color ring back tones" -- music downloaded for listening while a caller waits for a call to be picked up. Another type of mobile music developed recently is cell phone music -- downloaded wirelessly and played through software preinstalled in the phones. It remains to be seen if there is a market for this new type of mobile music because it is still at a test stage. In addition, there is not enough network capacity, and music-playing mobile phone software has yet to be fully developed and adopted.

"About 30% of China's cell phone users play mobile music through color ring back tones," says Conor Yang, CEO of Rock Mobile, a Chinese wireless music producer and publisher. "That percentage will rise to 45% over the next three years with the development of 3G networks and the popularity of mobile music cell phones." Rock Mobile, founded at the end of 2002 in Guangzhou, was spun off from Taiwan's Rock Music Group to distribute in China wireless digital music produced by Rock Music. Rock Mobile has ranked in the top five spots since the start of 2003 in terms of China's mobile color ring back tone sales and has a 10% share of the Chinese color ring back tone market.

While mobile music dominates more than 99% of China's digital music market, it is Internet music that threatens the existence of the traditional music publishing business. Ironically, if traditional music publishing is pushed out of business, the Internet music industry probably won't be able to survive either -- without the content that the traditional business provides. Internet music publishing will need to find its own unique operating model and niche so that there's room for its growth. The 2005 launches of digital music sites, including A8, Aigo Music, Shangda's EZ Pod, Top100.cn and Taile, marked the Internet

music publishing business's first step in China.

Advantages of Digital Music Publishing

"The market for traditional distribution of music and music videos was once 40 billion yuan in sales a year, and legal copies accounted for only 5% of that amount," says Song Ke, Taihe Rye's founder and president. "That market has shrunk to several billion yuan a year because of piracies and the rise of Internet music. China's online music market has grown to between 10 billion and 20 billion yuan, and less than 1% of that is legal.

"Legal distribution of digital music is eating into the market for traditional music distribution," Song notes. "While the two distribution channels will coexist the next few years, digital music distribution will eventually replace the traditional channel to become market mainstream. In the short term, traditional music distribution will be able to keep its mainstream position as digital music distributors look for the right business models and solve copyright-protection issues."

Zhang Shuling, president of Aigo Music, has a different outlook for the traditional business. "The publishing and distribution of music albums depend on the needs of users," Zhang says in response to a question on whether music publishing will switch from traditional channels to the Internet or to mobile phone wireless platforms. "Each method of publishing and distribution has its own uniqueness and can't be replaced. I don't think the digital music business means the death of traditional music publishing. Instead, it opens a window for the traditional publishing business, which still has a huge demand from users."

Compared to traditional music, digital music allows listeners to sample music before a purchase, and buy and download music through the Internet at any time. It also offers different value-added services and more flexible pricing plans, such as single track purchases. In addition, digital music provides music publishers more advanced copyright protection technology, limiting the chances of digital music content being pirated.

Some may argue that it's fun to go to a record store to pick up music, see beautifully designed and printed album covers and listen to lyrics. Will they lose that in an age of digital music? Song Ke doesn't think so. "Digital music will provide consumers with more customized value-added services and enrich their music experiences," he says. For example, Taihe's "TaiJoy Digital Music Shop" offers value-added services, including electronic album covers, movie video images and free online recording.

Since its introduction in the second half of 2005, TaiJoy has sold about 20 digital music singles. The top four songs among them were downloaded more than 200,000 times in the first two weeks of their releases, with each download costing more than 3 yuan. "Singles purchases will replace album buying," Song Ke notes, repeating what he said several years ago. "Consumers will no longer have to purchase an entire album because of the one or two songs they like. Music will be sold by single tracks online, giving consumers more choices."

The strength of digital music "lies in its ability to use advanced technology to limit pirating," adds Zhang Shuling of Aigo. "Users are willing to pay for legal downloading of Internet music because they want easy downloading, better music quality and other value-added services."

Rock Mobile's Yang Jiahong explains how the supply chains differ between the traditional music and digital music industries. "The traditional music supply chain includes singers, song writers, record companies, local distributors, music retail stores and consumers. Digital music during the production phase includes content providers in addition to singers, song writers and music companies. In its distribution stage, service providers, mobile operators, Internet sites and wireless websites replace local distributors and retail stores. Rock Mobile serves as both a content distributor and service provider within

the supply chain of the digital music industry."

Different Models

No more than 15 of China's more than 7,000 online music sites are legal, according to market researcher iResearch Consulting. Even among the few legal sites, there are differences in their business models, pricing strategies and how they split their revenues with their partners. A8.com charges 0.5 yuan to 2 yuan to download a song and offers a monthly plan for unlimited downloads for 20 yuan (15 yuan during special promotional periods). Top100.cn charges 1 yuan, Aigo 0.99 yuan, and Taile 2 yuan to 5 yuan for a single track download.

"A music CD usually sells for about 20 yuan regardless of the type of music or artists it features," says Taihe Rye's Song Ke. "In the digital music world, prices will vary based on production costs. For example, if it costs more to produce [an artist like] Li Yuchun's single track, we will sell it at a higher price. Taihe sets a basic price of 2 yuan per song, one-tenth of what a consumer pays for a traditional music CD."

"Aigo Music seeks to work with large music companies," notes Zhang Shuling. "Currently, we sell music only from these professional record houses. Down the road we will develop our own music. China's huge appetite for digital music helped Aigo Music generate a profit in March once it began selling prepaid cards for online consumption in December."

But according to Song Ke, "The key to success in the digital music market is through providing services beyond just digital music. I think it's worthless for Aigo, Top100.cn and A8 to spend huge amounts of money to buy copyrights for tens of thousands of songs from big music companies. These songs are being downloaded illegally everywhere on the Internet. If they don't provide other value-added services, I don't think consumers will pay to download from their sites."

Song Ke describes what he sees as Taihe's competitive edge. "Taihe Rye's Internet music business only sells new works by its artists. Taihe also has signed agreements with China's two big search engines, Baidu and Yahoo, to provide links only to the websites of Taihe Rye and its partners during the first two weeks of a new song release. That will help prevent illegal downloads and ensure Taihe's sales during a new release."

A big portion of the company's sales "comes from the first two weeks of the new songs we produce," he adds. "It costs Taihe about 40,000 yuan to 50,000 yuan to produce a single for the Internet. Since each song will be downloaded more than 50,000 times, the business is totally profitable after subtracting marketing and other costs."

How the online download sites and music companies split up their music sales has remained a top industry secret. Typically, a large music company will ask for no less than 50% as its copyright revenue. "Digital music distributors and their other partners have only a small piece of the pie left to share after paying 40%-50% of their sales to content providers and another 10%-30% to payment service providers," Song Ke says. "Taihe's Internet music business generates half of its sales directly from the Taile site, with the other half coming from its distribution partners. With this other half of the sales, Taile gives 30% to its Internet portal partners and 15% to its search engine partners. Search engines are getting a smaller cut because only a little over 10% of the visits their sites help to generate will result in actual purchases."

Future Landscape

The size of the legal Internet music market and the number of its users will grow at the same rate over the next two years, predicts Aigo's Zhang Shuling.

The biggest challenge to the development of China's Internet music market is Chinese consumers' reluctance to pay for legitimate copies of music, according to Song. The industry needs to join together to change consumers' behavior and mindset. The introduction of laws and regulations will also aid the industry's growth. "The business model for China's digital music industry won't be fully developed for another two to three years," he says. "There will be many forms of digital music. For example, Microsoft's Xbox and Shanda's EZ Pod digital consoles will provide connections to top-notch speakers that can play music with high original sound quality rivaling that offered by traditional records."

"The increase in the number of legal Internet music download providers and the rise in the cost to build a complete music library will make it harder to enter the digital music market in the next few years," Rock Mobile's Yang Jiahong suggests. "These websites will have to emphasize what they can offer differently. The most promising business model, I personally find, is one that offers a joint hardware, software, DRM technology and online music retail store package, and provides China's own equivalent of iPods and iTunes."

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