

Digital Music Success in China: Suggested Guidelines for Foreign Firms

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In this scholarly note, nine guidelines are recommended to foreign firms seeking to sell digital music in China as firms attempt to access one of the fastest-growing and most significant country markets for entertainment product sales in the world. A complementary piece is Jessica Gisclair's "The Dissonance between Culture and Intellectual Property in China" (pp. 182–87).

Digital Music in China: Nine Suggestions for Foreign Firms

China holds enormous potential for the nascent but rapidly developing digital-music industry. According to the International Federation of the Phonographic Industry, China is the world's twenty-seventh largest music market, with total retail sales in 2006 of US \$121.2 million (Butler 2007). China's share of the world market is likely to continue to increase due to the growing middle class with increasing discretionary income. As economic history has shown, consumers become no longer satisfied with purchasing only necessities as income levels rise, so spending on various forms of entertainment—including music—will grow. Consequently, foreign record companies are understandably eager to sell recorded music in such a large market that until recently was largely closed off. If a foreign firm is to reach this large and growing market, the following nine guidelines should be helpful in designing a successful strategy to sell digital music in China.

Suggestion 1: Make Use of Guanxi

More often than not, the success or failure of an enterprise in China, regardless of the form or intensity of entry, resides in interpersonal relationships among the stakeholders—known in China as *guanxi* 關係, 关系 (Luo 2007). *Guanxi* means "relationship" and is similar to the Western notion of networking. *Guanxi* involves a network of relationships that can

help minimize frustration and risk. *Guanxi* is more than good relationships with existing business partners; the concept encompasses political as well as personal *guanxi*. Firms that select Chinese partners with wide-reaching *guanxi* are more likely to perform well than those that have minimal or no relationships in China.

Business *guanxi* will expedite objectives by making useful connections with suppliers, distributors, retailers, lenders, attorneys, customers, and more. Political *guanxi* uses relationships to plot a successful course through bureaucratic mazes and to shield firms legally from encroaching governmental challenges. Personal *guanxi* demonstrates a concern for individual and family matters that may be an essential prerequisite for commercial success. Tapping into a network of relationships is neither unethical nor illegal. *Guanxi* recognizes that the conduct of commerce is always in the context of relationships.

When a foreign digital-music firm finds itself within a network of relationships, the foreign firm must act with honor as well as confer respect on other members of the network, a concept known as “face” (Kim and Nam 1998). Giving, receiving, creating, maintaining, and restoring “face” is a necessary ingredient to receiving favor from members of the network. Consequently, the actions taken by a foreign digital-music firm reflect on the firm as well as on the members of the *guanxi* network in which the firm resides. The Chinese would prefer, out of a sense of obligation, to conduct business with their friends; so positive relationships are essential. If relations sour, the support network could lockout the foreign firm.

Suggestion 2: Prefer Regional Growth Strategies

Large cities and the coastal areas of China are experiencing unprecedented growth; and this growth will continue as 150 million surplus workers begin to leave rural China for urban areas in search of higher-paying jobs providing discretionary income (Central Intelligence Agency 2006). These growth patterns profile the regional demand patterns for Internet services, a primary medium for digital-music delivery.

Nearly 66 percent of all Internet users in China live in East and Central China, with approximately half of these users residing in Guangdong, Jiangsu, and Zhejiang provinces. These provinces, with the addition of Beijing and Shanghai, host almost 50 percent of the 135 million IP address available in China today (China Internet Network 2008). Consequently, any foreign digital-music endeavor should contemplate a regional strategy in partner selection so as to dominate key markets first. These large cities are key markets for both personal computer and mobile phone usage.

Although Internet users are predominately concentrated in coastal areas, foreign digital-music firms and their partners should keep abreast of governmental initiatives set forth in the five-year economic development

plans, especially as those plans seek to construct a modern telecommunications infrastructure further inland. Cities and provinces in the path of telecommunications development should be part of a digital-music strategy.

Suggestion 3: Utilize Internet Delivery

As of December 2007, there were 210 million Internet users in China, of which 78.0 percent have broadband Internet access and 66.7 percent report going online from home (China Internet Network 2008, note 5). Current users represent a population penetration rate of 15.9 percent, ahead of India (at 5.3 percent) but behind Europe (43.4 percent) and rates in excess of 70.0 percent in the United States and Japan (Internet World Stats). Although the penetration rate in China is lower than that of developed countries, the absolute number of users is greater than the entire population of some developed countries. As China's middle class continues to grow, this penetration rate will rise, and the absolute numbers will continue to expand as well.

The demographic characteristics of Internet users in China indicate that 69.0 percent are under the age of 30 and 50.9 percent are under the age of 24 (China Internet Network 2008, note 5). Purchasers of digital music are also consistent with these age profiles. Because of the government policy of "one child" per family, China, like the Western world, is confronting an aging population with population growth slowing to approximately 0.63 percent per year (China Internet Network 2008, note 4).

In 2005, 119.6 million people in China were between the ages of 15 and 19, about 9.1 percent of the population of 1.31 billion. By the year 2010, the 15–19-year-old population will shrink to 102.6 million (7.7 percent of the estimated total population of 1.34 billion). In 2005, 193.5 million Chinese citizens (14.8 percent) were between the ages of 20 and 29. By 2010, the number of 20–29-year-olds will rise to 215.3 million (16.1 percent). By 2010, 317.9 million people between the ages of 15 and 29 will reside in China (Economist Intelligence Unit). Maintaining the 15.9 percent Internet penetration rate, 50.5 million 15–29-year-old users will have Internet connectivity.

Despite a low population growth rate and an aging population, the absolute number of Internet users will continue to grow. The average Internet user spends 16.2 hours per week online; 86.6 percent of users listen to music online; 71.2 percent of users download music via the Internet; and 94.2 percent of users agree that the Internet enriches their entertainment life (China Internet Network 2008, note 5). Consequently, foreign digital-music firms should consider the Internet a necessary first medium of delivery.

Suggestion 4: Deliver by Mobile Phone

In the United States, downloads of single songs from online stores such as Apple's iTunes have proven to be the most popular digital-distribution format. However, what works in the United States and in other highly de-

veloped economies may not work as well in China. Although download and subscription services will play an important role in the growth of the digital-music market in China, the primary growth stimulant is likely to be mobile digital-music delivery.

Out of a total of 453.6 million mobile phone subscribers in China, approximately 50.4 million individuals access the Internet through mobile phones. The number of subscribers is projected to rise to 575.2 million by 2010, with 63.9 million individuals accessing the Internet through mobile phones (if current ratios hold). Approximately 20 percent of mobile phone users are between the ages of 20 and 24. By 2010, this percentage would represent approximately 115 million mobile phone subscribers. Even assuming no growth, at the current Internet penetration rate of 9.4 percent with mobile devices, this age group alone would represent a potential market of 10.8 million users by 2010. The majority of mobile phone users, approximately 50 percent, are between the ages of 25 and 35. By 2010, this percentage would represent 262.6 million users; and, with constant Internet penetration, rates could represent another 24.7 million customers to access digital-music delivery through their phones.

Approximately 34 percent of Chinese Internet users access the Internet by visiting Internet cafés, locations that may not be well suited for a digital music–download model, since those without their own computers will not likely store music file downloads unless they own portable storage devices. By 2010, China will be home to 150 million personal computers, but nearly four times as many mobile phones will be in use. Clearly, then, mobile devices are likely to be a primary Internet and digital-entertainment access point as the mobile industry continues to evolve beyond phone calls and text messaging (China Internet Network 2008; Economist Intelligence Unit).

Suggestion 5: Use Joint Ventures with Chinese Companies as an Entry Strategy

Under Chinese law, foreign record companies are unable to operate in China as wholly owned enterprises and consequently must form joint ventures with Chinese partners (International Intellectual Property 2007, 14–15). Beyond the basic consideration of finding an established and trustworthy partner, two strategies in choosing such a partner seem prudent.

One strategy involves choosing a Chinese record company to help develop and market local Chinese recording artists. Due to differences in language and culture, finding and developing Chinese artists will give foreign companies an important advantage over competitors merely selling recordings by non-Chinese artists. A productive business synergy could result from a joint venture with a Chinese record company that has an existing roster of popular Chinese artists and is capable of finding and developing more such artists. Moreover, established Chinese record companies would likely have experience with managing related business opportunities such

as concerts, TV shows, sponsorships, and digital distribution to mobile phones.

Another strategy involves choosing a Chinese partner that is capable of digitally distributing recordings in China. Such companies might include telecoms, Internet service providers, and mobile service providers. A key consideration for the foreign company would be to partner with a Chinese company that has a well-established distribution network in place that is able to reach a large percentage of Chinese consumers. An example of this strategy is provided by a joint venture between Warner Music Group and China Unicom (one of China's biggest mobile service providers). The joint-venture company, Warner Music China, sells music downloads, ringtones, and other digital content to China Unicom subscribers.

Suggestion 6: License & Adapt Core Products

Along with their management expertise, foreign digital-music firms are able to provide another core asset to the Chinese digital-music joint venture: international music content. Licensing music catalogues is an effective first step toward an evolutionary entry strategy that, in the longer term, will also seek to develop local talent for China and abroad. Licensing has the advantage of reducing the cost of market entry while allowing the foreign firm to assess local experience, overcome foreign direct-investment ownership restrictions, and avoid some of the pioneering costs of market development. However, the application of the license may embody several forms other than just the song itself, e.g., reproduction, streaming, performance, royalty, and distribution licenses. Because content is also found in many mediums such as ring tones, ring-back tones, sound clips, and music videos, foreign digital-music firms should allow for the adaptation of their content to Chinese preferences in order to leverage success.

Suggestion 7: Adopt a Synergistic Business Model

Several business-to-consumer digital-music models for the Chinese market will likely emerge as both new technology and the purchasing preferences of consumers become manifest. Familiar approaches such as Internet e-tailers or content providers currently exist on the Mainland, and new approaches such as mobile delivery are gaining ground. In any model, ease of use and payment will influence success. Mobile delivery embodies both advantages by providing a medium for easily acquiring and storing digital music while allowing for charges via mobile billing (rather than having need for a credit card). Additionally, mobile delivery increases the security of digital media by working with firms that respect intellectual property rights.

Foreign digital-music firms may want to take advantage of this environment by using multiple delivery methods rather than an exclusive approach. By combining various business-to-consumer models, foreign digital-music

firms may achieve greater overall success while allowing local partners to incur some of the development costs in exchange for the content and management expertise of the foreign enterprise.

Suggestion 8: Take Advantage of Price Elasticity

The Internet may be one of the fastest-growing industries in China, and digital music may be one of the fastest-growing segments of that industry. However, demand is still a function of product price, so the price elasticity of demand will affect total revenue. Digital music is likely to be elastic in that an increase in price will not generate a sufficient increase in revenues to offset the decline in the number of units sold. Digital music is more of a discretionary purchase that competes with other consumption choices. Lowering price could see a greater percentage increase in units sold than the percentage decline in price so that both revenues and profits rise. Consequently, a pricing strategy that enters the market with a low price point in reference to substitutes will likely be met with greater success.

Suggestion 9: Enforce Intellectual Property Rights

Piracy is a significant concern for foreign firms wanting to distribute music digitally in China. Some estimates suggest that 90 percent of the recorded music sold in China originates from illegal sources and therefore poses a competitive disadvantage (International Federation 2006). Companies must take steps to mitigate these risks as much as possible.

Contrary to popular opinion, China's efforts to develop a legal framework for the protection of intellectual property have been substantial. However, the primary responsibility for such enforcement falls on intellectual property owners. There has been a significant increase in civil copyright infringement lawsuits filed in China by domestic as well as foreign copyright owners. The year 2004 witnessed a 71-percent increase in the number of copyright infringement cases filed in China over the previous year, indicating a growing wiliness on the part of copyright owners to enforce their rights (Intellectual Property Watch 2005). Strong local legal counsel familiar with Chinese law is a necessary component of an offensive corporate strategy and should not be an afterthought resulting from a defensive response to infringement.

Keys to Digital Music Success in China

China's economy has grown dramatically in recent years, and higher standards of living for Chinese consumers have resulted in increased demand for music and other forms of entertainment. As broadband and mobile Internet access continues to increase, foreign companies will have even greater opportunity to offer digital-music services in China. However, the overall

success of the digital-music industry in China is likely to depend on one or more of the aforementioned guidelines.

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