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## <a>INTRODUCTION

Economic and cultural sector reforms and engagement with international markets initiated by Deng Xiaoping since 1990 led to the rapid development of the PRC's copyright law. Since China joined the World Trade Organization in December 2001, affluent Chinese consumers have become an important target market for both Chinese and international firms trading in creative and cultural products. While enforcement remains problematic, Chinese creators and businesses are adept at navigating the intellectual property system – developing business strategies that engage with the possibilities of digital technologies and copyright licensing; using copyright to support expansion into new markets; and adapting distribution approaches to reflect lessons provided by first-movers in digital spaces.

This chapter explores how and why copyright's role is expanding and changing in China, focusing on recent developments in digital content markets. It considers the impact of uneven media sector reform processes on the emergence of 'born digital' copyright industries in China. There are signs that the commercial benefits of copyright compliance are beginning to outweigh the advantages of operating outside the intellectual property system for many Chinese stakeholders. We argue that these developments – in particular the emergence of widespread exclusive licensing practices – signal a watershed moment for China's cultural and creative industries, highlighting the potential for digital technology to create new markets for legitimate content and services, as well as the importance of global dynamics in the development of digital era copyright industries. We also caution, however, that despite the adaptability and innovation shown by many players in China's digital culture ecosystem – which includes professional creators, publishers, and key distributors and intermediaries, the sustainability of that ecosystem remains uncertain. Low revenues and the continued prevalence of free, unlicensed content pressure the business models of entities throughout the ecosystem.

Producing economic growth in a market-capitalist system demands much higher levels of individual freedom in relation to production and consumption than existed under a planned economy. However, cultural sector reform in China has not led to a system that is wholly

based on either the freedom of the market or rule of law. In reality, copyright enforcement remains weak, government-protected monopolies persist, and pervasive state intervention and censorship constrain producers and frustrate consumers. China's cultural economy remains transitional and important differences exist between the ways in which businesses operate in this market and the strategies of their counterparts in mature markets. State protected monopolies, in particular, are limiting the extent to which copyright is able to operate as a mechanism for rewarding investments in creativity, and large portions of what are often regarded as 'core copyright industries' remain centrally controlled.

## <a>MEDIA REFORM AND THE EMERGENCE OF CHINESE COPYRIGHT INDUSTRIES

Internal pressures to decentralize production, combined with exogenous pressure by foreign governments – especially the United States – to protect their authors' works, led to the drafting and adoption of the 1990 Copyright Law. The drafting process took more than a decade and was among the most contentious in PRC history (Alford 1995), in part because of conservative officials' concerns over the wisdom of granting private rights in information goods and incentivizing private sector production (Song 2014: 270). The Copyright Law amendments were part of a broader intellectual property reform overseen by Deng Xiaoping's government, and were closely linked to wider efforts to strengthen China's trading relationships and pave the way for eventual entry into the WTO in 2001. In 2001, the Copyright Law underwent a comprehensive revision to conform to international standards and ensure compliance with various copyright treaties, foremost being the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). The Copyright Law was revised again in 2010 as a result of the findings of the WTO Dispute Settlement Body in a case initiated by the United States.<sup>1</sup>

An important element of China's economic reform process has been the marketization, privatization, and deregulation of large parts of the cultural system (Keane 2013). As government subsidies for state-run publishing houses, cultural troupes, film studios, and media companies were withdrawn, advertising, subscription, and box office revenues became vital to the survival of many cultural sector firms. A growing number of both private

and international stakeholders have also been granted space to operate, particularly in the co-production of content. Although the Chinese government continues to maintain tight control over media censorship and ownership, entrepreneurial collaboration between the state and private and foreign investors is now an important element of China's cultural production system (Akhavan-Majid 2004; Keane 2013).

The film industry has been engaged in a process of commercialization and reform since the early 1990s. The policy changes facilitating more private investment in film production have more than compensated for the withdrawal of funding from state-owned studios (Hui 2006: 63; Montgomery 2010; Frater 2015). Similarly, China's music industry has made a remarkable transformation from a system dominated by state-funded cultural troupes dedicated to writing and performing a limited repertoire of propaganda songs during the 1980s (Kraus 2004: 9) to the vibrant, digitally driven, contemporary domestic music scene that exists today (Montgomery 2010; Peto 2014). Reform of the publishing industry has been slower. Official approval for many of the practices widely adopted by publishers over the last thirty years remains a legal grey area. Television has experienced two fundamental reforms: the separation of broadcasting and production in 1999, which allowed private companies to produce more entertaining programmes for sale to state-run TV stations; and the establishment of competition within a national market between central and local TV stations through cable and satellite TV networks.

Firms operating in all of these areas face the challenge of developing business models capable of monetizing content. In this context, copyright assumes an important role as a device capable of turning creative works into products that can be traded in a commercial market. In a post-reform era, copyright attaches property rights to creative works, allowing them to be acted on in an entrepreneurial fashion: to be bought and sold, to generate income, and to form part of a wider creative economy. As Chinese entrepreneurs and creative professionals become more conscious of the value of their creative assets and the intellectual property rights that help to define them, their willingness to act proactively to protect these assets is increasing.<sup>2</sup>

Although impressive progress in relation to the growth of a copyright culture has been made, unauthorized use of creative content is common, among both media firms and the public. A clear example of this can be found in the publishing industry. The Nobel Prize winning novel *One Hundred Years of Solitude* has been in print in China since 1985, selling

millions of copies and assuming a place as a literary classic for both Chinese readers and writers. This is remarkable, given that a Chinese publisher first acquired translation rights for the book in 2011.<sup>3</sup> Chinese textbook publishers, who preside over an enormous market, regularly fail to pass on royalties to authors, both Chinese and foreign.<sup>4</sup> In the music industry, hit pop songs from Hong Kong and the United States as well as classical songs are regularly translated and performed by Chinese artists without the authorization of copyright owners,<sup>5</sup> and television broadcasters air foreign films and other content without permission.<sup>6</sup>

This culture of unauthorized reuse has spilled over into the habits of media firms with access to the wealth of user-generated content now available online. Blogs, amateur video content, music, and photos are all regularly re-published and broadcast through traditional media channels without authorization from, attribution, or payment to authors. Difficulties with copyright impact on even the largest media organizations: according to Huayong Zhao, CEO of China Central Television (CCTV), CCTV ‘...is one of China’s biggest victims of copyright infringement, as well as one of the biggest infringers of others’ intellectual property’ (Liu and Bates 2008: 5).

A key challenge for the growth of a culture of respecting copyright in China relates to the power of copyright owners in a system where content production has largely democratized but distribution channels remain tightly controlled. Content distributors such as bookshops, cinemas, digital portals, and television stations are often government owned, either wholly or in part, and enjoy powerful state protected monopolies. For example, distribution of foreign films in China is limited to a state-owned duopoly, and distribution of the most lucrative digital music product – mobile ‘ringback tones’ – is limited to state-owned mobile service providers. Such entities are difficult to hold to account and are able to dictate their own terms to smaller players in the value chain, extracting large profits while taking few risks. In the case of the digital music industry, copyright owners receive less than 3 per cent of digital music revenues.<sup>7</sup> Even the largest Chinese film studios receive only about 40 per cent of the box office return their films generate.<sup>8</sup> Chinese copyright industries also lack the infrastructure for reliable royalty distribution and sales auditing, making it difficult for copyright owners to ensure payment of negotiated shares of revenue. In this context, individual creators have very little hope of securing favourable terms of use or obtaining meaningful copyright enforcement.

## <a>THE CHALLENGES OF UNAUTHORIZED DISTRIBUTION

Strict restrictions on content importation and distribution, consumer appetite for new and higher quality content, and the low cost of pirated media has long fuelled demand for pirated content. The high rates of piracy in China deeply trouble businesses and policymakers in nations that rely on copyright as the basis upon which content can be exported, such as the United States. Grey distribution channels have also provided Chinese consumers, artists, and the next generation of media professionals with access to uncensored international films, music, and literature at affordable prices much earlier than official reform processes might have allowed. The rich availability of content has helped to speed the development of the nation's hardware industries, creating domestic demand for DVD players, e-book readers, computers, smartphones, and tablets. It has also helped to provide Chinese creative professionals and audiences with semiotic tools to build upon as they make the shift from propaganda machine to market-driven entertainment industries with aspirations to reverse cultural import deficits and begin exporting Chinese creative and cultural products. Nevertheless, widespread piracy poses significant impediments to the growth, stability, and independence of China's domestic creative industries (Priest 2014).

The challenge of reining in unauthorized distribution and encouraging consumers (and businesses) to make a shift to legal channels is being made greater by the Internet and developments in digital technologies for making, copying, and sharing. China is now home to the world's largest population of Internet users: more than 640 million.<sup>9</sup> There are also more than one billion mobile users, nearly 20 per cent of whom have 3G services.<sup>10</sup> Open and networked digital technologies are making it difficult to control the distribution of content in all markets. In China, the International Intellectual Property Alliance estimates that 99 per cent of music accessed online is 'pirated,'<sup>11</sup> while local commentators estimate that the illegal online literature industry is ten times larger than its legally regulated counterpart (Ren and Montgomery 2012). Internet search engines like Baidu and large e-commerce portals like Taobao play an essential role in the grey value chain of digital piracy in China, improving the discoverability of unauthorized content and providing digital platforms for the unauthorized sale of pirated DVDs and books.

China's copyright protection challenges are not lacking enforcement activity; rather, China suffers from poor enforcement. China in fact has the greatest volume of intellectual

property enforcement in the world (Dimitrov 2009). The Chinese government's preferred method of tackling unauthorized distribution over the past two decades has been highly publicized enforcement campaigns involving seizure of unauthorized content and the arrest and prosecution of pirates. While such campaigns are intended to reassure foreign governments and copyright owners with images of seized goods being destroyed by conscientious authorities, the efficacy of such campaigns is doubtful. They tend to be poorly coordinated, and they aim to produce short-term, readily quantifiable victories rather than address the root causes of endemic infringement. They are also part of a complex landscape of state control over content and its distribution. Anti-piracy campaigns have been connected to campaigns targeting 'pornography, illegal publications and piracy' (*saohuang dafei*), intended not just to address concerns over intellectual property rights, but also to strengthen the government's control over cultural production and the media. Furthermore, in the absence of serious penalties and consistent enforcement, these campaigns have little impact on highly profitable, often highly organized illegal distribution activities.<sup>12</sup>

Copyright owners may sue infringers in court in addition to seeking remedies through administrative copyright enforcement. However, judicial enforcement, although improving, still fails to provide meaningful deterrence in many copyright cases. Even when plaintiffs succeed in demonstrating copyright infringement, the damages awarded are too low to deter ongoing infringement. Between 2006 and 2009, for example, the average copyright damages awarded were just RMB 31,000 (US\$5,000), and are often less than 10 per cent of damages claimed by plaintiffs (Priest 2014; Sepetys and Cox 2009).

Unauthorized distribution is a threat not just to the profitability of international copyright owners but also to Chinese content industries. In addition to direct economic losses associated with lost sales (which can be difficult to calculate), widespread unauthorized distribution can reduce monetization options for smaller and independent domestic producers, distort market signals sent to producers, and disproportionately expose producers to exploitation by intermediaries (Priest 2014). Further, the scale of unauthorized distribution in China means that those operating within the bounds of the legitimate system are forced to compete for audience time, attention, and spending power with free or very cheap, uncensored material. Access to affordable copies of the latest audiovisual productions from all over the world has greatly increased the media literacy of Chinese audiences, raising standards for local producers who often have less experience than their

foreign competitors (although that is rapidly changing) and who are hamstrung by China's censorship system. Chinese content producers thus have a very real interest in better copyright enforcement, at least in part because piracy is such a powerful source of competition.

#### <a>CHINESE COPYRIGHT INDUSTRY BUSINESS MODEL INNOVATION

The challenges of enforcing copyright in analogue contexts are rapidly being overtaken by the need to find business models capable of functioning profitably in networked digital landscapes. China's publishing industry provides a salient example of the impact of digital technologies and business model innovations that arise in response.

#### <b>E-Book Publishing

Mobile distribution, creative users, crowd-sourced content, and micropayment models are transforming the publishing industry. In 2013, China's total volume of book retail sales was RMB 50 billion (US\$8.2 billion), an increase of 10 per cent compared to sales in 2012. Most of the growth was driven by online bookstores, which grew 20–30 per cent over 2013. E-books are available at much lower prices than in other markets: around RMB 8 (US\$1.30) for the average retail book (Publishing Technology 2015). The volume of titles purchased by Chinese readers is vast and growing. According to Patrick Dodd, Managing Director of Nielsen China, China has an annual e-commerce growth rate of 120 per cent – making it the fastest growing, and soon to be the largest, e-commerce market in the world. The intention of these consumers to purchase an e-book doubled between 2011 and 2014, from 26 to 51 per cent (China Internet Watch 2014).

Continued state censorship in China's print publishing market is also helping to drive authors and readers towards innovative digital models of both production and consumption. Books published in traditional print formats must comply with censorship processes before an International Standard Book Number (ISBN) can be issued. As a result, many readers are turning to serialized fiction made available via online literature portals or microblogging sites, which provide greater freedom for experimentation by both authors and readers. Serialized fiction is ideally suited to mobile reading – providing content in small chunks that can be enjoyed while waiting for a bus or standing in line at a coffee shop.

Freemium fiction sites like Qidian.com allow authors to register for free and to create stories in installments of up to six thousand characters. Readers are able to download these stories without charge – at least at first. If a work becomes popular, authors can choose to become VIP members of a site, which enables them to charge readers for accessing content. Readers are generally given free access to the first installments of a VIP story. If they choose to keep reading, they then pay between .02 and .07 Yuan to read each new installment, with revenue split between authors and websites.

Authors are obligated to sign a formal contract with sites when they join as VIP members. These contracts generally assign exclusive digital distribution rights to the online literature site, in return for the site's commitment to promote and make the work of the author available to readers via their platform. VIP authors are also able to earn additional revenue through VIP bonus programs, which award a cash bonus to authors voted most popular by readers each month, as well as through reader tipping.<sup>13</sup> Licensed adaptation and distribution of popular works across multiple platforms and in different formats is a growing source of income for both online literature portals and some authors (Zhang 2010). However, while sites may invite popular authors to enter into an individually negotiated contract assigning rights to adaptation for print, screen, and games in advance, standard VIP contracts allow authors to retain these rights.

The vast majority of authors that publish works via online literature websites make very little, if any money. But these sites have also created a new generation of literary superstars with a loyal online following that has translated into lucrative fan-bases for print editions, computer games, and film adaptations. In December 2014, the ninth edition of the China Writers Rich List (similar to the annual Forbes Rich List) named 34-year-old Zhang Jiajia as China's highest earning author. Zhang rose to prominence with a collection of bedtime stories for adults posted on the microblogging site Weibo. Having secured an online following, the stories were published as a single volume: *I Belonged to You* (*cong nide quan shije luguo*) earning Zhang RMB 19.5 million (US\$3.1 million) in 2014. The author subsequently secured a deal to turn five of the stories in the collection into films, including one which he will direct under guidance from Hong Kong director Wong Kar-Wai (Publishing Technology 2015).



### **<b>Online Video Portals**

Seismic shifts in the business models of Chinese Internet video portals in recent years are evidence of copyright's important role in the development of that market. These shifts, which emerged in 2009, are serving as a watershed for online copyright enforcement, as well as for the wider commercial development of China's digital creative industries, particularly film and music.

From their inception in the mid-2000s China's major online video streaming portals, including Youku.com, Tudou.com, Sina, Sohu and 56.com have emerged as powerful competitors to traditional television platforms (see Keane 2015; Zhao and Keane 2013). Their success has been built on their ability to provide consumers with access to unlimited free popular content (Priest 2015: 186). Because the websites generate revenue through advertising, their profitability depends on their ability to attract viewers. Professionally produced content plays a key role in attracting viewers to these sites because it is more popular among Chinese audiences than user-generated content (Priest 2015: 186).

Until 2009, domestic and international copyright owners had little success in tackling the unauthorized distribution of their content. As noted above, even if copyright owners prevail in court, the damages awarded in Chinese copyright litigation are typically too low to deter infringement. Chinese online video portals are also notorious for gaming the 'notice and takedown' processes provided for by Chinese copyright regulations, using these provisions to complicate and delay takedown of popular content while infringement persists (Priest 2014: 474–5). Before 2009, the result was a seemingly endless stream of 'pirated' video content available to users through mainstream video streaming sites, and little if any market for the licensed distribution of popular works. In 2009, the free ride for the major Chinese video streaming sites screeched to a halt. They began purging their services of unlicensed content, and spending unprecedented sums acquiring distribution licenses from copyright owners. The sudden change in habits was not precipitated primarily by fear of legal liability or a desire to evolve into pay-per-view businesses. Rather, copyright owners succeeded in shifting the behavior of these sites by threatening their ability to attract the advertising revenue that is their economic lifeline.

In autumn 2009, frustrated by the ineffectiveness of copyright infringement litigation against video streaming websites, a consortium of domestic and foreign copyright owners launched a sustained offensive against the advertisers that used these sites. The copyright

owners targeted major transnational consumer brands in particular. The offensive involved both extralegal and legal pressure tactics, including suing major transnational brand owners such as The Coca-Cola Company and Pepsico, for contributory copyright infringement after their ads appeared with unlicensed content (Priest 2015). While the lawsuits were hastily dismissed, they grabbed the attention of international brand owners, who are themselves owners of valuable intellectual property and frequently battle infringement in China. The tactic worked. Major brands openly pledged not to advertise on known 'pirate' sites, pressuring video websites into compliance.

The overnight shift in the demands of major advertising clients for copyright compliance left websites scrambling to fill their services with attractive licensed content. Having resolved to pay for licenses, the sites sought to outmaneuver competitors by hosting the most desired blockbuster content on an exclusive basis. The result was a bidding war among major online video sites for exclusive licenses to prized content,<sup>14</sup> and a corresponding 'bubble' in video content licensing fees. In 2009, when the major Chinese video portals were still rife with piracy, the licensing fee for online distribution of the most popular show in China – a dramatic serial called *Latent* – reportedly cost US\$1,500 per episode. Subsequent competition for exclusive licenses drove up prices so much that by 2011 the cost of the then-most-popular television drama *Palace* was US\$290,000 per episode (Wang 2012). Websites alternately sued one another to protect their sizable investments in content and formed alliances to pool licenses and stabilize licensing costs. The two largest online video websites, bitter rivals Youku.com and Tudou, even merged in 2012 to pool resources and stave off ruination in the face of soaring content fees.

Video websites' post-2009 shift to licensed content, and the corresponding licensing bubble, has had three significant effects on audiovisual content producers in China. First, the meteoric rise in content fees resulted in a revenue windfall for copyright owners, including domestic and international film studios and television companies, to the tune of hundreds of millions of dollars from Chinese Internet streaming services that prior to 2009 paid virtually nothing to content owners (Priest 2014: 486–7). This has facilitated investment in newer, higher quality domestic works, and increased competition among domestic producers.

Second, streaming websites' shift to licensed content has provided a new monetized distribution channel for films and television programs in China. Just a few hundred domestic films are approved for theatrical release each year in China. Anyone whose film is not among

those had little hope of recouping their investment,<sup>15</sup> since endemic piracy has all but destroyed legitimate DVD sales and other secondary markets for video content. Likewise, obtaining distribution on traditional TV in China is difficult due to strict censorship regulations governing TV production. Further, even shows that are distributed on television do not necessarily stand to make significant revenue from broadcast royalties. Instead, producers of popular shows often rely on ancillary revenue streams such as trademark licensing.<sup>16</sup> As discussed below, censorship rules have generally been far less strictly enforced with regard to content distributed online, as compared with theatrical releases and television broadcasts. Now that the major online streaming platforms pay licensing fees, filmmakers are developing 'web-native' films, particularly with mobile distribution in mind (Wan 2014). Currently, advertising revenue still comprises the bulk of filmmakers' online streaming royalties,<sup>17</sup> but web streaming companies have been eager to transition to a predominantly pay-per-view or subscription model and Chinese viewers are increasingly willing to pay for access.

Third, the high licensing costs and the need for better market differentiation have driven Chinese video sites to develop original content in-house. Chinese websites seek to emulate major video streaming services in the West such as Netflix and Amazon, which develop cutting-edge original, exclusive content including *House of Cards*, *Orange Is the New Black*, and *Transparent* to drive up subscriptions. Chinese video websites develop original content by culling the best talent from among their millions of content contributors. Companies such as Youku Tudou Inc. and Tencent support promising filmmakers with capital, professional services, marketing, and access to powerful social media platforms and hundreds of millions of viewers. Scouting and investing in talent for online productions has led companies like Youku to create content for release on its own platform. Moreover, the lines between Internet and 'traditional' film production are rapidly blurring: Youku, for example, has begun producing films for theatrical release with its 2014 hit, 'Old Boys: Way of the Dragon,' based on the smash hit web movie 'Old Boys.' Other Internet media companies such as Alibaba (itself a recent investor in Youku Tudou Inc.) and Tencent are aggressively investing in domestic film studios and feature films projects for theatrical release. In August 2015, Youku announced that it planned to invest US\$1.6 billion in original content production through 2018 (Horwitz 2015a).

The key driver of this surge in energy and investment surrounding video production in China is the shift of video streaming sites from a free-for-all of unlicensed content to a copyright compliant model based on exclusive licensing (see Zhao and Keane 2013). This change is being made possible because video streaming sites that now pay for exclusive licenses have become stakeholders in a copyright compliant ecosystem. For each video website to recoup its substantial investment in content, it needs its competitors to respect its exclusive rights. While lawsuits between the major players over infringement of rights remains part of the landscape in China's video streaming industry, it is not the primary reason why, as Sohu CEO Charles Zhang recently proclaimed, '[Online video in China] is an industry with law and order' (Coonan 2014). For the exclusive licensing model to work, more than legal enforcement is needed. As social psychologist Tom Tyler and numerous legal scholars including Cass Sunstein argue, laws function best when they effectively promote and shape behavioral norms (Tyler 1990: 23; Sunstein 1997: 61). The major video sites are by and large complying with copyright law out of self-interest, producing a widespread change in behavioral norms in the online video streaming industry (Priest 2015). As we discuss below in relation to China's music industry, many of the same major players in online video are also operating in the online music space. There is evidence that the copyright compliance norms now emerging in relation to video have begun to take hold in the online music industry as well.

#### **<b>Online Video: A Haven from Censorship?**

China's online streaming sites have enabled a mass, monetizable market for independently produced films and videos that are not subject to a formal censorship review process and are not strictly monitored. All content developed for television broadcast and theatrical release is required to undergo strict scrutiny by the State Administration of Press, Publication, Radio, Film and Television (SAPPRFT), which regulates audiovisual production, distribution, and broadcast. SAPPRFT is notorious for its opaque film and television content regulations, sweeping discretionary power over audiovisual content, and micromanagement over the creative process. However, SAPPRFT has taken a more hands-off approach to controlling web-native video content. SAPPRFT does not review scripts or even the videos themselves before they are posted online, hence creators feel far more creative freedom

when producing for the web. SAPPRFT's comparatively lax approach to online video has even extended to foreign films and television programmes. In recent years, such hit Hollywood television series as *The Walking Dead* and *House of Cards* have been among the most popular shows in China, available uncensored through online streaming websites Youku and Sohu, respectively, despite transgressing SAPPRFT dictates against violence, horror, and overtly political themes.<sup>18</sup>

Nevertheless, SAPPRFT's lack of proactive control over web-native video content does not indicate that the space is censorship free. In fact, SAPPRFT keeps both the video producers and the websites in line by imposing on them legal liability for a video's content, ensuring at least two levels of self-censorship to discourage pornography, nudity, and seditious content. A danger inherent in self-censorship is that SAPPRFT's cryptic rules and erratic enforcement might encourage producers to err on the side of caution, resulting in over-censorship. In practice, however, the market has provided some counterbalance, since in the highly competitive online video environment, innocuous, insipid fare will attract few viewers. Producers of web videos appear willing to push the envelope – to a point – in order to stand out. There are lines that few producers dare to cross, however. In the words of web film director Jin He, 'Don't shoot pornography or nudity and don't talk about the Party or politics. Other than that, anything goes' (Lei 2012).

### **<c>The uncertain future of online video portals in China**

The trend toward copyright compliance and exclusive licensing in the online video space has been a boon for copyright owners and even independent content creators, but its effect on the long-term viability of the video websites themselves is unclear. Online video in China is now a US\$4 billion a year industry, but content licensing fees are onerous, and the major video streaming sites remain unprofitable. Youku Tudou Inc., for example, which runs the popular sites Youku.com and Tudou.com, spends nearly 50 per cent of its budget on content, the vast majority of which goes to licenses. While advertising revenue in China's online video industry is rising rapidly – a 50 per cent year-on-year increase between 2014 and 2015 – it still falls far short, as Youku's net losses over the same period have doubled. Other online video companies enjoy more financial stability, but only because they have deep-pocketed parents, such as the video offerings from Internet giants Tencent and Baidu.

Thus, the trend toward greater investment in user-generated content is more than a differentiation strategy: it is a survival strategy. Investment in original content produces permanent assets (unlike the licensing deals that typically expire within one to three years) and, most importantly, is less expensive than purchasing licenses from other companies. In Youku's case, original productions already reportedly account for 50 per cent of its offerings. Web video companies are betting their future that they will become the primary producers of popular content and that licensing will become a niche aspect of their business models. Even so, it will be some years before video advertising revenue will be sufficient to sustain these sites.

That means hope for business model success lies, at least for the near-to-mid term, in the video sites' ability to convince users to pay for content. There is some evidence to warrant optimism in this regard. iQiyi, Baidu's online video service, launched an original series in 2015 titled *The Lost Tomb (daomu biji)* by making the first episode available for free and releasing a new free episode each week. However, viewers that signed up for iQiyi's premium subscription service had immediate access to all twelve episodes from the first season. The show was a hit and helped iQiyi increase subscriptions by more than 700 per cent in 2015. Subscription options have been available on such services for years getting little traction with consumers and generating negligible revenue, but some observers believe *The Lost Tomb* marks a turning point (*Global Times* 2015).

Despite tremendous gains in the major streaming sites' battle against unauthorized content online, the greatest obstacle to the development of successful subscription models continues to be the ready availability of unlicensed content. While the major video streaming services in China are largely piracy free, as discussed above, unlicensed content remains abundant on smaller websites, and consumers are increasingly using cloud storage services to share content privately. As long as free, unlicensed content remains accessible with relative ease, pay models for video websites will have difficulty gaining traction. In a recent survey of Chinese netizens, 40 per cent reportedly said they would not pay to watch a movie online, and another 26 per cent would consider paying only RMB 3 (US 50 cents) or less (*Global Times* 2015).

The lesson learned from China's online streaming sites' emphasis on copyright compliance and exclusive licensing appears to be that while this strategy benefitted sites in the short-to-medium term, it is not sustainable as long as China's online video industry

remains primarily advertising-supported. Copyright compliance and exclusive licensing helped Chinese streaming sites benefit by facilitating closer relationships with advertisers. However, the effects of exclusive licensing in this context might well be counterproductive long-term. Exclusive licensing in a highly competitive environment begets price inflation, and online video advertising revenues have failed to keep pace. Moreover, hosting exclusive content has done little to truly differentiate the services in consumers' minds or build brand loyalty for the websites. Many Chinese consumers are apt to hop from one site to another in pursuit of their preferred content. Online video services are not abandoning their exclusivity strategy, however. They are merely adjusting it to be more cost-effective and sustainable.

### **<b>Digital Music**

Compared with the film and television industries, China's music industry has had far more difficulty locating an effective monetization model. Digital music is exceedingly popular in China: according to government estimates, more than three-quarters of China's 600 million Internet users listen to music online. The challenge for music copyright owners is motivating this enormous fan base to pay for recorded music. Ubiquitous free recorded music online – most of it unlicensed until recently – has conditioned consumers to expect unlimited free access to music downloads and streams. Pay access music services have therefore enjoyed little traction in China. Even the free, fully advertising-supported, licensed music download service that Google launched in China in 2009 foundered because users already had ample sources of free music downloads, most of which were unlicensed (Priest 2014: 525).

Nevertheless, Chinese consumers have proved willing to pay substantial sums for music in one peculiar context: mobile phone 'ringback tones.'<sup>19</sup> Ringback tones are monetizable because they are integrally tied to mobile phone services. They are not susceptible to piracy because they are centrally controlled and broadcast by mobile service providers. Mobile phone subscribers can add a ringback tone service to their account for an additional fee. Chinese mobile providers gross over US\$4 billion annually in ringback tone fees. That amount is comparable to what the recording industry grosses annually in the US market, which ranks first in the world in recorded music sales. If Chinese mobile providers were to split the ringback tone revenue equally with music copyright owners, China would instantly rank third in the world in recorded music revenue behind the United States and Japan, and ahead of Germany and the United Kingdom. But Chinese mobile providers keep 98 per cent

of ringback tone revenue, passing along a mere 2 per cent to copyright owners. Since the service is controlled by a duopoly (China Mobile and China Unicom), the copyright owners have little leverage. This is especially true since ringback tone revenue, as meager as it is, accounts for a substantial percentage of record labels' income. As a result, copyright owners are able to wring less than US\$100 million annually from China's vast music market (Priest 2014: 496).

Widespread infringement of music online, long a major obstacle to monetization for record labels, has been slowly improving. For years the largest alleged infringer of music copyrights was Baidu, the Chinese Internet search giant, which provided free downloads to vast amounts of music through its MP3 search feature. In 2011, the international major labels – Universal Music, Sony, and Warner – settled with Baidu, ending years of contentious litigation. In return for payment and Baidu's commitment to develop a premium paid-access tier, the labels granted Baidu blanket licenses to lawfully distribute their content. Ultimately, the Baidu deal, in the words of Universal Music's international business head Max Hole, was not 'fantastically successful' but it was 'a start' (Cookson 2014).

The Baidu deal, and the trend toward licensing and copyright compliance among the major Internet video sites, set the stage for a spate of more recent music-oriented deals with major Chinese Internet portals. Music copyright holders watched with great interest the rise in video licensing fees spurred by exclusive licensing and fierce competition between video streaming sites. In hopes of driving up the value of their content and enlisting powerful Internet companies as stakeholders and copyright enforcers, record labels are granting exclusive rights to major Chinese web companies. In 2014, Warner Music and Sony both granted Internet giant Tencent the exclusive right to distribute their recordings online in China. Other web portals that reportedly have acquired exclusive licenses from domestic and South Korean pop labels include Alibaba, NetEase, and Kugou. In a trend reminiscent of the early days of exclusive licensing by Chinese video websites, music streaming providers such as Tencent, NetEase, Kugou, and Alibaba have actively sued one another to enforce their exclusive licenses (Horwitz 2015b).

The websites acquiring exclusive digital music licenses plan to be more than just online streaming services – they plan to be music rights management companies. Major Internet players such as Tencent envision eliminating smaller, unlicensed competitors by coercing them to pay licensing fees or suing them out of existence. As Chinese music industry expert



Ed Peto (2014) observes, '[W]e will see these few major players – with the support of the government – being able to shut down or license any rogue sites or apps, leaving a handful of services who will in turn most likely have been consolidated into one of the fiefdoms.'

Whether the exclusive licensing strategy will ultimately be a net positive for music copyright owners or the websites, however, is unclear. By all indications, exclusive licensing practices have yet to fuel a bubble in music copyright valuations. The long-term benefit of exclusive licensing for websites is also questionable: it is not clear that hosting exclusive music content drives brand loyalty among consumers, particularly as long as exclusive licenses are spread among numerous providers. There are strong incentives for one major Internet company, such as Tencent, to monopolize the online music market by acquiring exclusive licenses to the bulk of popular music content in China. There is a very real danger, however, that consolidation of market power in one or two monopsony intermediaries will drive licensing fees downward, as is evident from the mobile ringback tone example.

## <a>CONCLUSION

Digital technologies and the open and networked architecture of the Internet are creating new challenges for copyright in all markets. In a brave new digital world in which the role of copyright in processes of value creation, innovation, and trade in creative works is not yet fully understood, businesses, policy makers, and users in China face many of the same challenges as their counterparts in more mature markets. Rather than simply managing a shift from analogue to digital technologies, China's cultural and creative industries must come to terms with the role of copyright in the context of other complex changes in media regulation and markets, as well as rapidly changing access to technology and evolving patterns of user engagement with content. All of this makes China one of the most exciting places in the world for those interested in understanding the conditions necessary for the growth of vibrant creative industries and relationships between legal frameworks, like copyright, and creative and cultural economies of a digital age. It also makes it one of the most challenging markets in the world for businesses that depend on copyright to define their products and to enable their trade.

As China's cultural and creative industries become more commercially focussed, the role of copyright and exclusive rights in every aspect of China's creative economy is becoming more pronounced. On paper, China's copyright law now has much in common with

copyright laws that exist elsewhere in the world and China's policymakers, creative professionals, and businesses are becoming conscious of the value of recognizing and protecting intellectual property rights. China remains the subject of robust criticism from trading partners for its failure to effectively enforce copyright. However, while trade relations remain an important factor, international pressure is no longer the main driver of copyright's development in China. As local creative industries become more deeply invested in protecting and monetizing creative works, the ecosystem is shifting.

Most players in China's digital creative ecosystem – from individual creators to publishers to online intermediaries – still seek sustainable monetization models in this environment. Somewhat counter intuitively, however, their business model innovations all betray a familiar and decidedly 'twentieth-century' device: rights of exclusion. Publishers of online e-books might not charge for access to their serials, but they monetize them by selling exclusive film rights, which are in turn monetized via the most venerable exclusive right of all: the right to permit or exclude one (a paying customer) from entering a controlled space (the movie theatre). Internet video portals appear to have tied their future to exclusive rights, acquired either through the creation of original content or through licensing from other content owners. Music portals are adopting a similar approach. To date, the rise of exclusive licensing has been a boon for many creators and content owners, but it remains unclear whether exclusive licensing models will enhance or destabilize China's digital creative ecosystems in the long term. Exclusive licensing can engender bidding wars that drive up content licensing fees unsustainably. Exclusive licensing can also concentrate too much power in one or a handful of intermediaries, leading to downward pressure on content licensing fees and exploitation of creators.

Ultimately, however, the biggest obstacle to sustainably monetizing China's digital creative industries may not be the proliferation of exclusive rights, but rather the ongoing challenges with enforcement of those rights. So long as paying for content is effectively 'optional' for consumers, most will choose not to pay. Many digital services offering original or licensed content must then rely on online advertising revenue, which is presently insufficient to cover costs. In short, the future viability of the online creative ecosystem is unclear if consumers remain unwilling to pay for content and can readily acquire access to unlicensed copies online.

<a>NOTES

<insert notes here>

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<sup>1</sup> The WTO Dispute Settlement Body found that China's failure to accord copyright protection to works that had not been submitted for censorship approval constituted a breach of the nation's obligations under several international conventions, which China accepted (Mara 2009; World Trade Organization 2010).

<sup>2</sup> This is evident in the rise in formal copyright registration that has taken place since 1995. Although copyright registration is optional in China, it can make seeking enforcement easier. In 2010, the NCAC held records for 359,871 formally registered creative works, accessed 20 August 2015 at <http://data.chinaxwcb.com/epaper/2011/2011-09-07/14116.html>, as compared with just 2,915 registrations in 1995 when the service was first launched, accessed 20 August 2015 at <http://file.lw23.com/f/f7/f70/f703b86a-b95c-45ea-b572-14824d4047a9.pdf>.

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- <sup>13</sup> Abrams (2013).
- <sup>14</sup> The video streaming sites with the greatest market share at the end of 2009 were Youku, Tudou, Ku6, PPStream, PPLive, UUSee, and 56.com (Ding 2010).
- <sup>15</sup> An exception came in the form of foreign distribution. Chinese films that secured a coveted spot in a foreign film festival, or that appealed to the Chinese diaspora, had a chance of earning revenue in foreign markets. This, however, had the effect of incentivizing Chinese filmmakers to produce content not for domestic audiences but to appeal to foreign critics and consumers (Barmé 2000: 190–92; Pickowicz 2012: 316).
- <sup>16</sup> In this regard, one of us recalls a conversation in 2007 with the producer of an extremely popular Chinese animated television series. According to the producer, he lost money every time China Central Television (CCTV) aired an episode of his show. CCTV paid him no royalties, but it cost him

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about US\$15 to deliver the master to the broadcaster. Nevertheless, the national broadcast was important because it promoted the show and its characters, catalyzing a lucrative business licensing the characters for use on myriad consumer products.

<sup>17</sup> This advertising revenue may come in the form of payments by the websites to copyright owners, but often comes in the form of product placement advertising, for which the video producer strikes a deal directly with the advertiser to feature its products or services in the video.

<sup>18</sup> In 2015, SAPPRT imposed tighter restrictions on the distribution of foreign content, including that foreign works (including Hong Kong productions) must be submitted to SAPPRT for approval and that foreign content can comprise no more than 30 per cent of a video streaming site's total content. The requirement that domestic videos must comprise at least 70 per cent of a site's content is likely animated as much by economic protectionism as by concern over information control (Priest 2014: 482–3).

<sup>19</sup> Ringback tones are songs or other recordings that a caller hears while waiting for the call recipient to answer her mobile phone. Ringback tones are essentially 'hold music' that the mobile phone company plays for the caller while he waits for the recipient to answer.