

Music Downloading Market in Japan

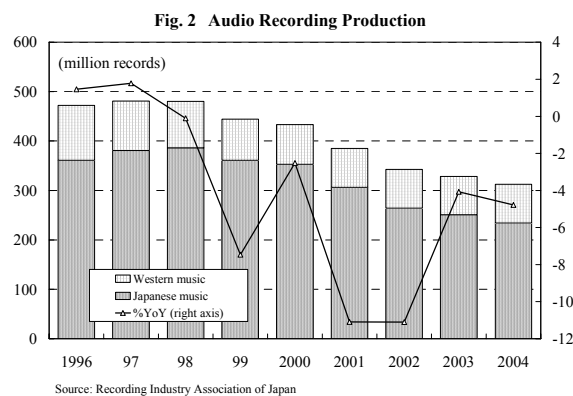
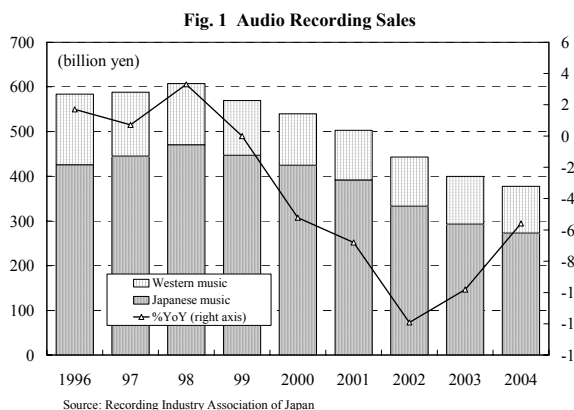
Japanese Economy Division

Summary

Music CD sales have continued to decline in recent years, while sales of music distributed via the Internet and mobile phone networks have been increasing, representing new avenues for music sales. Thanks to digital rights management (DRM) technology, music content can be protected to ensure steady revenue. To compete effectively in the music download field, the key is to offer the best music, unlike brick-and-mortar sales channels that depend on the locations and sizes of stores.

1. Market Overview

The Recording Industry Association of Japan reported that 312.7 million audio recordings were produced in Japan in 2004, a 4.8% decrease from 2003. Retail sales dropped 5.6% to 377.4 billion yen. Production and revenue have been declining since the late 1990s (figs. 1 and 2), with production now only 70% of its peak in 1997. Since 2001, both production and sales have declined faster for domestic music than imported music due to market shrinkage, including a decrease in the youth population (the main consumer base), fewer hit songs and illegal copying.



In this context, electronic music distribution is expected to stimulate the music market. While CD sales have traditionally been the foundation of the music industry, the digitalization of music and the limited data capacity of CDs themselves led to the rapid popularization of music downloading via networks. Moreover, the relatively low level of data makes audio-only content easier to distribute electronically than high-data video content, so business models for audio-content distribution also developed rapidly. Apple Computer's music distribution service, iTunes Music Store (iTMS), founded in 2004, has put the spotlight on electronic music distribution. In Japan, the service started

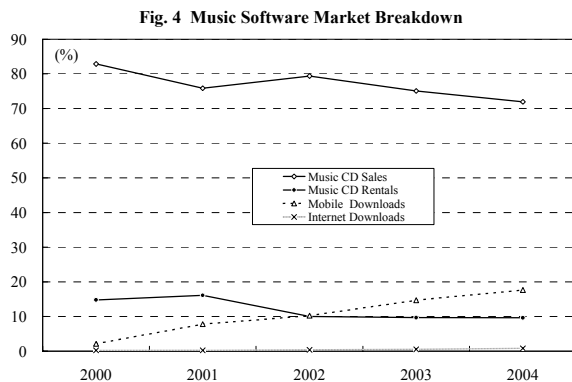
on August 4, 2005, spurring the industry’s growth.

These new electronic avenues for music distribution contributed to a 2.1% growth in the music software market in 2004, with sales reaching 622.7 billion yen (Fig. 3). The ongoing decline in music CD sales, down 2.2% to 448 billion yen in 2004, was countered by an increase in downloads of ring tones and via mobile phones, which increased 22.5% to 109.9 billion yen. Mobile downloads overtook CD rentals in 2002 and continued to widen the gap through 2004 (Fig. 4). Music distribution over the Internet has also continued to grow (Fig. 5).

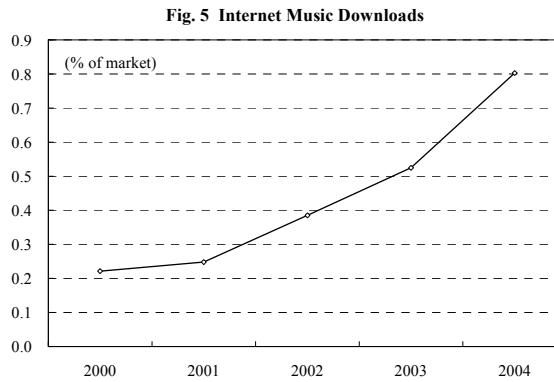
Fig. 3 Music Software Market

	(billion, percent)					
	2000	2001	2002	2003	2004	04/03
Music CD Sales	524	490	516	458	448	-2.2
Music CD Rentals	94	104	65	59	60	1.7
Mobile Phone Music Downloads	13	50	66	90	110	22.5
Internet Music Downloads	1	2	3	3	5	56.3
Total	632	645	650	610	623	2.1

Source: Digital Contents White Paper 2005, Digital Content Association of Japan.



Source: Digital Content Association of Japan

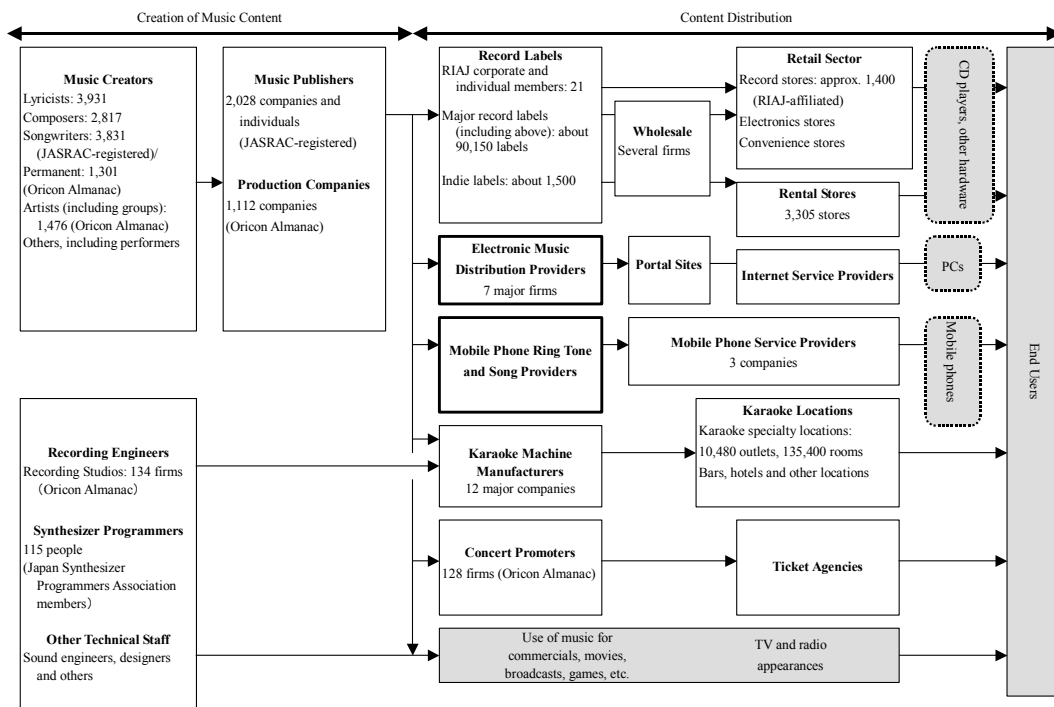


Source: Digital Content Association of Japan

2. Distribution Structure and Technology

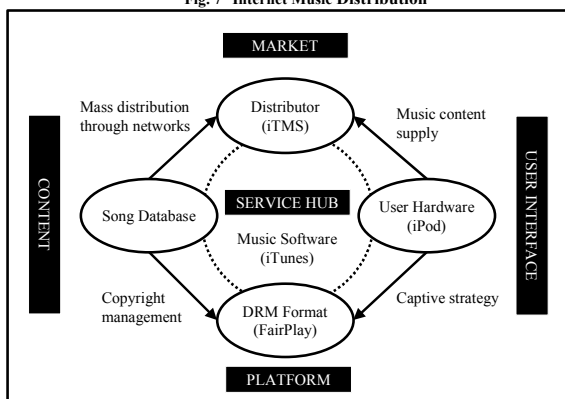
Music production and distribution conventionally involves direct sales from record companies to retail and rental stores, or indirect sales via wholesalers (Fig. 6). Electronic distribution, however, is structured differently, since the music is delivered to the consumer via the Internet or a mobile phone network. The “store” is the distribution service itself and the product is music stored in a data format and embedded with digital rights management (DRM) technology for copyright protection. These facets are crucial to the structure of distribution services (Fig. 7).

Fig. 6 Music Software Production and Distribution



Source: Digital Content Association of Japan

Fig. 7 Internet Music Distribution



Note: Details in parentheses represent Apple as an example.
Source: Yano Research Institute

For example, Apple has expanded its music offerings through agreements with major U.S. record labels. Its digital audio player, the iPod, functions as the user interface for its substantial catalog of titles. The copyright protection file code used by the iPod is restricted to the AAC format, and the DRM platform dominating the market is Apple's own FairPlay. In addition, music files that can be played on an

iPod can only be purchased through iTMS, Apple's distribution service. In turn, iTMS can only be accessed from the iTunes software window. In other words, Apple's music downloading business is based on its own iTunes software.

Music distributors depend on DRM for continuous revenue, because it protects the music from unauthorized copying and use. DRM varies with the music's specific file format, so it is one of the

factors determining the size of the customer base for a particular file format. As it stands now, not many distribution services are compatible.

Apple has adopted a strategy of keeping its FairPlay DRM technology a proprietary secret. FairPlay has been configured so that the iPod cannot play music using other DRM technologies. Thus, only music downloaded from iTMS can be played on an iPod, in effect preventing iPod users from using other music distribution services unless Apple decides to share its FairPlay technology. Other companies in the electronic music distribution market are faced with the problem of not being able to target iPod users, who account for 90% of the hard-disk music players, or iTMS users, who account for over 70% of music downloads. In short, FairPlay enables Apple to virtually monopolize the market for hardware and software. Microsoft is showing no signs of entering the hardware market. In fact, it is tolerant of other companies entering the distribution service market. Sony basically maintains an open stance regarding hardware, software and distribution services.

Popular distribution formats in 2005 were the non-DRM de facto standard MP3, Apple's AAC, Microsoft's WMA and Sony's ATRAC3 (Fig. 8).

Fig. 8 Distribution Platforms, by Administrator

	Apple (AAC)	Microsoft (WMA)
Hardware	iPod	Toshiba, iriver Japan, others
Software	iTunes	Windows Media Player
Distribution Service	iTMS	MSN Music, Excite Music Store, others
DRM	FairPlay	WMDRM

Source: Yano Research Institute

3. Trends in Products and Services

Legal downloading began in Japan on December 20, 1999 with a user-paid copyright-protected service offered by Sony Music Entertainment (SMEJ) in conjunction with Microsoft. The world's first major record label to enter the industry, SMEJ came up with a business model to provide downloads from its own site¹.

SMEJ's entry into the market was a turning point, and many record companies soon followed. In April 2000, Sony Communication Network (SCN) spearheaded the entity of Label Gate, a joint venture set up by various record companies. About the same time, NTT Communications introduced the Arcstar Music & Video platform to enable record companies to offer downloads from their own Web sites. Record companies entering the business during this time used Label Gate, Arcstar Music & Video, or both.

Early download services were offered by record labels to sell their own products. But this was

¹ The compression technology in ATRAC3 has been combined with Label Gate after the end of Microsoft's support.

before broadband had become widespread, so downloading music was very time-consuming for dial-up users. This hurt sales, so the services never really caught on with the general public.

Label Gate updated its download service in April 2004, renaming it Mora. Toshiba EMI and Warner Music Japan (WMJ) announced their participation in Mora, the first instance of downloads offered by major Japanese record companies.

Most major businesses offering music download services in Japan (Fig. 9) are those operating service-oriented portal sites, which indicates that the downloading industry has come of age. Moreover, the entry of world-leader iTunes signaled the full-fledged establishment of the Japanese market. With the market for players and related hardware having matured, and iTunes now operating in Japan (which boosted its global market share to 85%), Japan's download industry is entering a new stage of development. Japanese users rate iTunes highly, which will likely affect the strategies of other companies. Attention now turns to services competing with Apple to establish their respective platform as the de facto DRM standard.

Fig. 9 Major Download Services since 2004

Service	Service Provider	Compression Technology	Administrator	Start of Operations
Mora	Label Gate	ATRAC3	Sony	April 2004
Yahoo! Music	Yahoo/Label Gate	ATRAC3	Sony	February 2005
Excite Music Store	Excite	WMA	Microsoft	May 2004
OnGen	Usen Corporation	WMA	Microsoft	August 2004
MusicDrop	Label Gate	WMA	Microsoft	October 2004
MSN Music	Microsoft	WMA	Microsoft	October 2004
goo Music Store	NTT-Resonant Inc.	WMA	Microsoft	December 2004
Oriicon Music Download	Oriicon Style	WMA + ATRAC3	Microsoft	March 2005
iTunes Music Store	Apple	AAC	Apple	August 2005

Note: Oriicon began using ATRAC3 plus as its compression format in September 2005.

Source: Major media.

Since the download industry does not have differentiators, such as store location, the product line-up is a key factor in attracting customers. In addition, while the total number of songs is important, the presence of top labels also determines a service's appeal.

A good indicator of a label's strength is the Japan Gold Disc Awards from the Recording

Industry Association of Japan (RIAJ), which recognizes the achievement of shipment milestones for music releases (Fig. 10). Mora, Music Drop and Yahoo! Music Downloads dominated the awards

Fig. 10 Japan Gold Disc Award Categories

Japanese & Western Music	Code	Minimum net shipments of recordings (albums/singles)
Gold	G	100,000
Platinum	P	250,000
Double Platinum	PP	500,000
Triple Platinum	PPP	750,000
Million	M	1,000,000
2 Million	2M	2,000,000
3 Million	3M	3,000,000
4 Million	4M	4,000,000
5 Million	5M	5,000,000

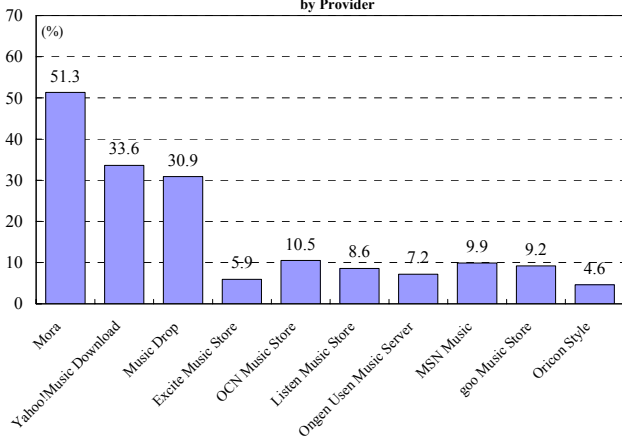
Source: Recording Industry Association of Japan

Fig. 11 Japan Gold Disc Award Title Downloads, by Provider (2004)

Provider	Format	Results (recordings)	
		Number of Titles	Downloads
Mora	ATRAC3	78	14,100,000
Yahoo! Music Download	ATRAC3	47	9,300,000
Music Drop	WMA	51	10,250,000
Excite Music Store	WMA	9	2,350,000
OCN Music Store	WMA	16	3,350,000
Listen Music Store	WMA	13	2,500,000
Ongen Usen Music Server	WMA	11	2,450,000
MSN Music	WMA	15	2,750,000
goo Music Store	WMA	14	2,100,000
Oricon Style	WMA	7	2,050,000
Total		152	27,000,000

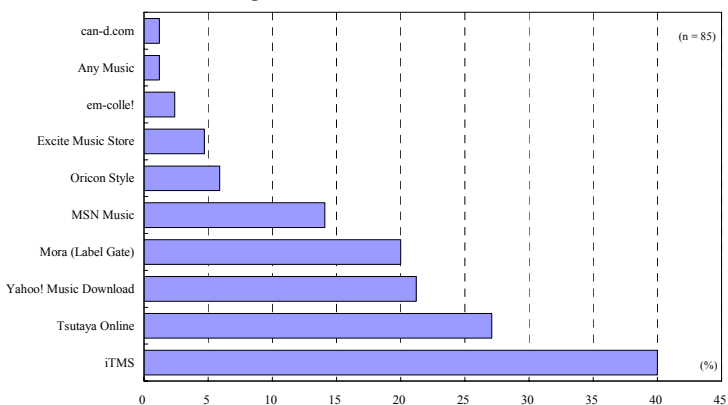
Source: Yano Research Institute

Fig. 12 Breakdown of Japan Gold Disc Award Title Downloads, by Provider



Source: Yano Research Institute

Fig. 13 Music Distribution Services Used



Note: includes multiple responses.
Source: BCN Inc. (September 2005)

for singles in 2004 (Fig. 11), although this was before iTunes had entered the market. Strictly speaking, the number of titles and net shipments are not actual sales results, so distributors are compared by their share of Japan Gold Disc Awards. Mora, Music Drop and Yahoo! Music Downloads

accounted for more than 30% of the awards (Fig. 12), but since both Mora and Music Drop were developed by Label Gate, and Yahoo! Music Download is connected with Mora, the strength of Label Gate is apparent.

After Apple entered the market, iTunes was used at least once by more users (40.0%) than any other service (Fig. 13), according to a BNC Inc. survey. Since iTunes did not start until August 2005, the same month that the survey was taken, its market penetration was remarkably high. Following iTunes were Tsutaya Online (27.1%), which is connected with Tsutaya audio-visual software rental stores and Internet services, and Yahoo! Music Download (21.2%), which is especially easy to use for Yahoo! Premium members and benefits from the large Yahoo! Japan portal.

4. Laws, Regulations and Market Entry

The distribution of intellectual property is protected by Japanese copyright law. Protected works are defined as “a production in which thoughts or sentiments are expressed in a creative way and which falls within the literary, scientific, artistic or musical domain.” Since electronic distribution offers works in digital form, content can be easily copied, which encourages illegal copying and distribution. This is why distributors must use some form of DRM technology.

Music distribution in Japan is also governed by a “resale price maintenance system,” which manufacturers use to set retail prices. Label Gate acts as a sales subcontractor and collects fees from recording companies for the use of its download system, but the record companies set the retail prices. Apple, however, as a result of negotiations with the record companies before entering the market in 2005, has a say regarding pricing, thereby creating a loophole in the resale price maintenance system. As a result, Apple was able to lower the cost of one music track to 150 yen, which was lower than the prices of Label Gate and the others.

5. Market Entry by Foreign Companies

The entry of Apple’s iTMS into Japan in August 2005 received a great deal of attention. With market-leading prices as low as 150 yen per song, plus a broad catalog and unrestricted transfers to many devices, iTMS achieved one million downloads in just its first four days of service. This was a turning point leading to immediately intensified competition. Prices are expected to drop further and new services, such as subscription plans, are anticipated.

For foreign companies, such as Yahoo!, MSN and Excite, that entered the market in 2004, music downloads are merely one of many content services they offer. For general portal sites, downloading is an extension of existing services aimed at introducing new music. Excite, however, has made a significant investment in its music information site, Excite Music, which began offering original content in 2002, and it built a strong relationship with Label Gate before launching a download service. The site has information on 250,000 artists and 300,000 albums, and also sells CDs. So Excite Music, rather than being just a part of the Excite portal, is actually an online music store.

6. Related Markets and Other Topics

No discussion of music download services in Japan can omit the subject of distribution to mobile phones, and even motor vehicles, as well as the potential of the neighboring market in China².

A. Downloads for Mobile Phones

Music distribution to mobile phones has been anticipated by record companies, and mobile carriers NTT DoCoMo and KDDI are selling mobile phones with music playback capability. Mobile

² Yano Research Institute, *Digital Market Music Industry*, pp. 50-56.

phone platforms have an advantage over PC platforms in that a payment system is already in place. Another attraction for businesses is the relative ease of providing service, since the mobile phone platform is already set up to receive electronic content and many mobile phones also function as music players. KDDI launched a high-quality ringtone download service in November 2004, which exceeded 10 million downloads as of June 2005 and 30 million downloads as of November 2005.

B. Car Audio (Telematics Service)

The advent of HDD-equipped navigation systems has paved the way for new developments in music downloading, because these systems not only record the tracks in their hard disk drives when a CD is played, they also have music servers that automatically download additional information, such as track titles and artist data. Apple, through tie-ups with automobile makers such as Mercedes Benz and Volvo, is working to integrate its iPod with new car audio systems.

C. Electronic Music Distribution in China

While it would be difficult to distribute Japanese music in countries due to language and cultural differences, Japanese pop music enjoys a strong following throughout Asia, making this region a possible target for market entry. China has an Internet penetration rate of around 7% (compared to Japan's 62.3% in 2004), and a population of 1.3 billion, affording great potential for market development. However, there is already a comparatively large amount of downloading taking place in China, most of it as free downloads of MP3 files that are unprotected by DRM. China could become an attractive market for the electronic music distribution industry if the Chinese government were to establish legal countermeasures to protect content.³

This report was compiled by JETRO based on research consigned to Yano Research Institute.

³ For a detailed report on the current state of the music distribution business in China, please refer to the JETRO report *Actual Conditions of the Music Distribution Business in Japan (Export Promotion Research Series)*, March 2005. (<http://www.jetro.go.jp/biz/world/asia/reports/05000956>)