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South Korean Music Market - A Case Study

March 2011

Background

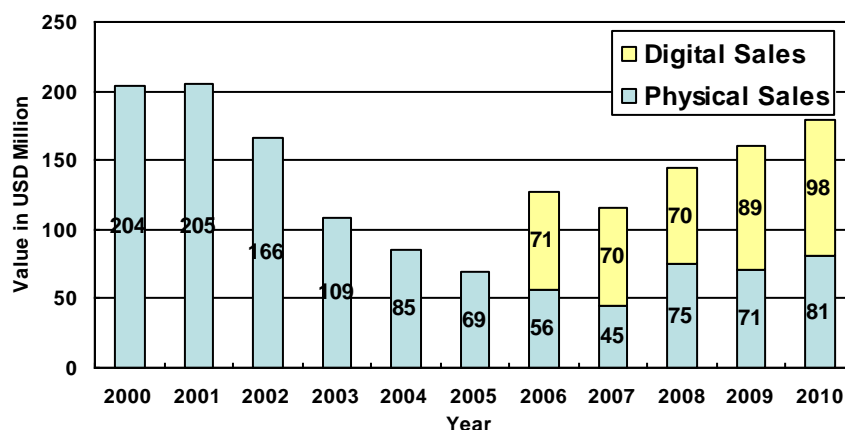
Recent developments in South Korea have transformed the business environment for recorded music. The change of government stance in 2007 coupled with the positive attitude of the new government in 2008 brought a more copyright-friendly approach to a market previously plagued by online piracy and a decimated physical music sector. The implementation of new legislation to fight online piracy and the roll-out of new business models have fostered a new environment for legitimate music. South Korea is an example of a market where both carrot and stick elements are now present, resulting in renewed vibrancy and investment in music.

The South Korean music market

Music sales in South Korea grew by 12% in 2010, following a 10.4% rise in 2009. The audiences for portal music services were up 11% between September and December 2010 – with Music Naver and Music Daum seeing strong increases. Digital music revenues in South Korea now account for over 55% of music sales.

The South Korean music market began to contract in 2002. Fast growing broadband adoption and the growth in illegal downloading were the culprits behind the rapid market decline between 2002 and 2005. South Korea was the 15th biggest music market in the world in 2001 – by 2005 it had dropped to 29th in the global ranking. 85% of physical retailers saw their businesses close down during that period. Despite recent growth, the South Korean market is still 20% down from its heyday.

S. Korea - Sales Statistics Yr 2000 to Yr 2010



Source: IFPI. Digital sales included from 2006.

As a response to widespread online piracy, between 2002 and 2006 a series of lawsuits and criminal complaints were filed against two notorious infringing services by various parties in the music industry - Bugs, a music streaming site with over 10 million members at its height, and Soribada, the South Korean equivalent of Napster. Criminal complaints against Bugs resulted in convictions and imprisonment sentences against its president and injunctions were issued against the service. Injunctions were also issued against Soribada in various cases.

In late 2006, after months of negotiations, Bugs launched a legitimate music service. Soribada followed suit in 2007, initially offering limited domestic repertoire. These were important milestones in the development of the digital music sector in South Korea, but at the same time there remained many other illegal operators filling the space left behind by Bugs and Soribada which required a decisive response from the government.

The change in environment for copyright industries

Over the past few years, the Korean government has made a series of legislative amendments to its Copyright Act which improved the legal environment for the copyright industries and assisted greatly in the fight against digital music piracy. The December 2006 Amendment, effective since June 2007, introduced the ISP Safe Harbour Provisions into the Copyright Act. Korea was the first country in the world to introduce legislation to require P2P operators to take necessary measures to block illegal transmission of copyrighted materials upon copyright holders' requests. The digital sound transmission right for record producers was also introduced in this amendment which allowed record producers to collect remunerations from digital services and for the first time, foreign record producers could claim remuneration for the use of their sound recordings by broadcasters.

In June 2007, the US and South Korea signed the Korea-US Free Trade Agreement (KORUS FTA) containing strong commitments to copyright law reform and enforcement, which included a side letter dealing specifically with online piracy. The negotiations in itself focused the Korean government on the need to take action against online piracy.

Despite these developments, however, online piracy continued to have a big impact in the South Korean market. Digital sales saw small declines in 2007 and 2008 before returning to growth in 2009. 2008 was a defining year for the South Korean music industry. Following the change in government, in July 2008, a new provision in the law was introduced whereby internet users found to be repeatedly transferring copyrighted content, who had been warned three times or more, could have their internet accounts suspended for a period of up to six months. Authorities were also given the power to shut down message boards, blogs and forums over copyright infringement after three notices.

The new legislation was passed in April 2009 and became effective in July 2009. This marked a shift towards legitimate business models, acting as a catalyst for deals between music companies and new partners seeking licences for music distribution. The Ministry of Culture, Sports and Tourism ("MCST") started sending graduated response notices in March 2010. A total of 696 notices were sent out by the end of 2010. In November 2010 MCST announced the suspension of internet accounts of 11 individuals who had received at least three notices. MCST has continued to send such warning notices and more suspensions of accounts are expected. Parallel to the graduated response measures, the Korea Copyright Commission has also been active in sending takedown notices to infringing services. More than 100,000 notices have been sent, the vast majority to cyberlocker (or webhard) services.

Consumer awareness of the illegality of file-sharing was also boosted by the engagement of

major players, such as social networking sites Cyworld and Naver, who began notifying their customers of the change in the law and of infringing activity. Portals have also started filtering illegitimate activity on their portals. The Korean government also rolled out a programme of consumer education about copyright in schools.

According to indicative research by the Korean government, after the implementation of the graduated response law, awareness of the new Copyright Act of Korea was at 42% of respondents, with 52% saying they had been informed of the law through the TV and the remainder via the internet. 70% of respondents said they believe that it is necessary to protect copyrighted works. After the implementation of the new law, 21% of respondents said they had tried a legitimate music service.

These developments are helping reduce online piracy levels in South Korea. While music file exchanges between consumers will continue, the mass-scale nature of online piracy has been significantly reduced. Consumers are increasingly migrating to legal services and pirate services are becoming more underground.

The impact of new legislation on the South Korean market has been and will continue to be gradual. But the new legislation is a turning point for the content industries, unleashing enormous market potential. South Korea was a market plagued by piracy, with music companies going out of business, a decimated physical retail sector and with low levels of investment in A&R. Today there is a new market environment for South Korean music companies. The improved legal environment in Korea has also resulted in music companies investing again in local A&R.

In line with the creation of a more conducive legal environment for the music industry, the National Assembly proposed and passed further amendments to the Copyright Act according to record producers and performances the right to equitable remuneration for the public performance of sound recordings. These amendments became effective in September 2009. In October 2009, the Free Trade Agreement negotiations between the European Commission and the Korean government ("EU-Korea FTA") have been completed and the agreement has been initialed. The EU-Korea FTA covers, inter alia, the protection and strengthened enforcement of intellectual property.

New services come into the market

Alongside the decisive action taken by the government, 2008 was also the year that legal unlimited MP3 subscription services offering a wide range of domestic and international repertoire took off. Today, major players like Soribada, M.Net Media, LoEn Entertainment and Neowiz Bugs all offer unlimited MP3 subscription services. Monthly prices vary between 7,000 and 11,000 won (US\$ 6-9).

Consumer take-up of these services has been encouraging. Soribada now has 300,000 paying subscribers, compared to 700,000 subscribers in its previous illegal format. M.Net Media and Neowiz Bugs have attracted 350,000 and 320,000 subscribers respectively.

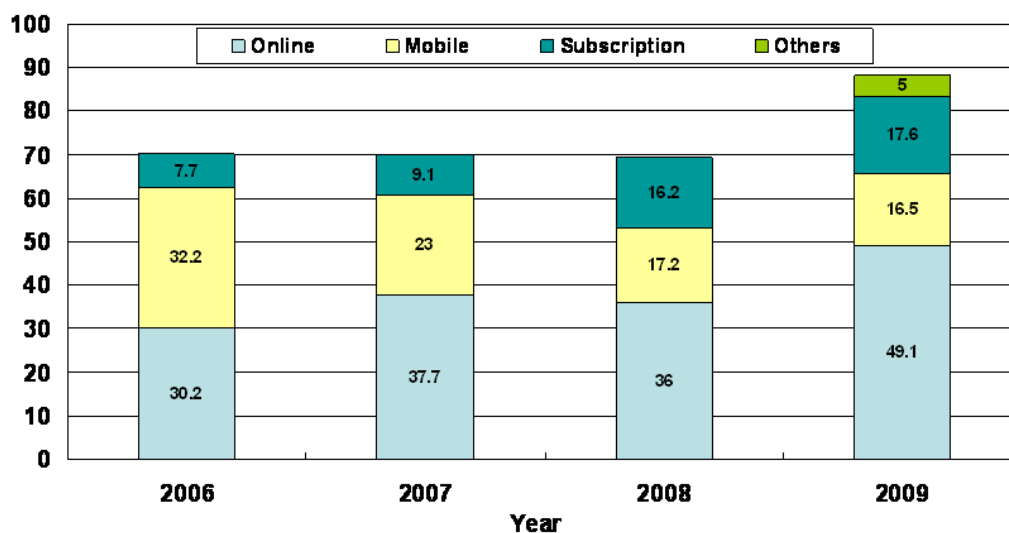
This shift towards subscription based models is driving digital growth in South Korea. The digital sector has grown by around 27% in 2009, with subscriptions up around 9% to account for 20% of digital music revenues.

These new services are complementing existing offerings. MelOn remains the leading player with 750,000 subscribers. Users can download individual songs or access music via a

subscription package where they get access to a vast catalogue as long as they remain a SK Telecom customer for 5,000 won per month (US\$ 4).

Another important income stream for music companies in South Korea is online background music (BGM). Social networking sites like Cyworld and blogs are important music applications, offering personalisation services and playlist tools.

S. Korea Digital Sales (Trade, USD M)



Source: IFPI

Increased investment in music

Another recent development in South Korea's music market is the return of investment in local repertoire. For years the high piracy levels in local repertoire devastated the physical market and restricted investment in the sector. Music companies are again investing in new talent, marketing and A&R in South Korea. Universal Music, for example, after having withdrawn from local talent development in Korea following sharp declines in sales and widespread online piracy, returned its A&R investment programme to the country.

Domestic repertoire is a key element for music services, who need local repertoire licences to have a chance of capturing a large subscriber base. Local repertoire accounts for over 70% of music sales in South Korea if digital sales are included. Korean repertoire also travels in Asia, particularly to Hong Kong, Taiwan and China. International and classical repertoire are also important in South Korea. Considering most young South Koreans are trained in a classical instrument, classical music accounts for 10% of the physical sector in 2010. The live classical market is also sizeable, with young classical acts attracting a young audience.

The positive impact of the new legislation and improved market conditions are also being felt in the physical sector. After years of successive decline, CD sales have leveled off. In the first half of 2009 physical sales grew by 5% mostly driven by domestic K-pop. Physical deluxe products and big acts still sell well in South Korea. According to one music chain shop, Hottracks (Dae-hak-ro chain), in August 2009 CD sales for local acts nearly doubled compared to the previous month, and sales of concerts and music video DVDs have also gone up. Physical sales in 2010 were up by 14%, and the legitimate music market in South Korea appears to have benefited from the measures implemented.

The next step for the South Korean market will be in product innovation – how to increase the average consumer spending on music, how to create further value-added products and establish the next generation music experience.