

Chapter 26

Strategic Starting Points for Dealing with Piracy

26.1 Strategic Action in View of Piracy

The previous two chapters provided some insight into the coexistence of legal and illegal offers on information markets. Crucial motives of (private) piracy have become clear. It has also transpired that bootleg copies cannot be condemned a priori, since self-supply with information goods, particularly through filesharing, can have positive effects on the legal markets. It must be considered how the existing offers might be changed in a way that is mutually beneficial, instead of using repressive measures against piracy and thus scaring away one's own clientele, the end customer.

In the following, we will again focus less on the commercial forms of piracy than on the self-supply aspect. As a further restriction, we will focus on the digital forms of piracy, since it is there that the decisive leverage for quick and worldwide distribution is found.

In the following sections, we will first consider how the different illegal offers should be dealt with, and discuss whether a further tightening of copyright law should be aimed at. Afterward, we will make some recommendations as to how a company can improve its existing (digital) information offer in order to increase its profits. Finally, we will discuss some approaches to developing new business models.

The following deliberations complement the chapters on information providers' competitive strategies. In those chapters, we focused on the strategic positioning in the competition for legal markets. Here, we will investigate how individual providers can survive against, or with, the black market. The variables known to us represent a useful set of instruments for this purpose.

26.2 Measures Against Illegal Offers

As an information provider facing piracy, one can, as a first measure, work toward stopping illegal offers. This form of defense, as can be clearly observed, is being used by the music and film industries. In many industrial countries, cooperation between associations and administrations in the fight against piracy has been intensified over the last few years. For Germany, the Federal Association for the Music Industry (2008, 3) observes that

Germany [is] one of the few countries in which massive legal persecution was able to at least contain the problem of online music theft.

This success is due, among other factors, to the fully automatized search for copyright infringements on the internet, and the subsequent filing of tens of thousands of suits with public prosecutors on the basis of this data (Heise Online, 2006).

As a further measure, the associations strive for a step-by-step sanctioning system against pirates, enforced by the internet providers, which will be applied in case of copyright infringements and leading, finally, to a complete shutdown of their internet connection.

Building upon the insight into causes and effects of piracy, we will rate some aspects of this repressive procedure.

How do moral appeals and a heightening of the pressure of prosecution affect the target group of filesharers? There are a few empirical studies that have tried to answer these questions. Surveys among Swedish and British filesharers revealed that there is definitely a prevailing interest in creative professionals (composers, lyricists, performers etc.) receiving a fair remuneration for their work. Thus, in the Swedish survey of more than 1,000 filesharers, 65% stated that it is a great disadvantage of filesharing services that artists are not paid for their music (STIM, 2009, 11). 74% of filesharers interviewed in the British survey would be interested in a legal filesharing service, and 90% of these proponents would like to see the artists be the main beneficiaries of this system (BMR, 2008, 30-31). Consistently with these findings, Hennig-Thurau et al. (2007, 15) observe:

Specifically, stressing the unethical element of appropriating copyrighted content without compensating the copyright owner in marketing campaigns could increase the moral costs of illegal file sharing and lower file-sharing activities.

A limiting factor, however, is the fact that for each respective target group, one must take into consideration that group's prevalent attitude toward piracy. Free-stone and Mitchell (2004) determined, via an empirical study on ethical views on the internet (e-Ethics), that only around 5% of Generation Y (8-24 years old) think that the free downloading of music and films is wrong or unethical. Moral appeals are probably more effective for older target groups. A proof for this is the relative-

ly high level of attention that this point enjoyed in the Swedish study mentioned above, where the average age of the respondents was relatively high (STIM, 2009, 6). In the British study, however—we can assume—it was lower. Here, only a little more than 10% of interviewees stated that they did not upload because they thought that artists should receive fair recompensation (BMR, 2008, 17). Moral views are generally less pronounced in younger people (Dördrechter, 2007, 275 with further sources), and it is to be assumed that they are not entirely aware of the correlation between downloading and not paying the artists. Educational work seems to be required here. Whether the German “Piracy is a crime” campaign, which is shown to paying customers in cinemas, is the right path appears doubtful (Dördrechter 2007, 276).

Likewise, it must be asked whether the criminal persecution of pirates creates the desired is as much of a deterrent as is aimed for. In the British filesharing study, only 15% of respondents stated that they do not upload because the risk of being caught is too high (BMR, 2008, 17). A survey of German film consumers explicitly concludes that

the movie industry’s initial reaction to the threat of movie file sharing—suing its own customers—appears to be misguided (Hennig-Thurau et al., 2007, 15).

An empirical study by LaRose and Kim (2007) investigates the intentions of music downloaders. They found out that apart from the expected (positive) effects of downloading (e.g. new stimuli, pleasant activity, social status), the individuals under investigation displayed an underdeveloped mechanism for self-regulation. This means that their self-control in utilizing media is inadequate. Following this insight, the music industry’s measures of prosecuting and normative influencing are misguided, at least for the surveyed social group of U.S. college students, because they are foiled by the downloaders’ personality structures.

Consumers’ fear of being prosecuted is obviously no effective means of stopping piracy. Increasing the risk of being caught might even cause the opposite effect, since according to the Optimum Stimulation Level theory, it would only increase pirates’ stimulus. For the film industry, Dördrechter (2007, 276) recommends tearing down the menacing façade. Instead, it would be better to make the actual damage caused by piracy transparent and to communicate in an educational manner. This insight should also be transferable to other industries.

It can additionally be discerned that there is less piracy in countries with great economic power (see Chapter 24). In such countries, copyright also tends to be relatively well protected. As can be shown, the relevant associations are even interested in tightening copyright further. Haller (2005, 305), in a thorough analysis of the existing theories and studies for Germany, arrives at the conclusion that

a further increase of copyright protection does not appear to be a sensible measure for overcoming the current crisis in the music industry.

A further raising of the protection level would increase providers' monopoly status even further and negatively affect welfare. The existence of network effects increases the severity of these consequences. German copyright in particular is already deemed to be one of the world's most restrictive (Haller, 2005, 294 with further sources) and should thus—from the perspective of the film industry, too (Dördrechter, 2007, 278)—not be tightened any further. The situation for countries without pronounced Intellectual Property Rights (e.g. China or India) is to be judged differently, be it in terms of laws themselves or in their execution. Here, a tightening of security measures seems generally advisable (Hill, 2007, 22-23; Reinig & Plice, 2010, 6).

From a more sociological perspective, Tschmuck, in his commentary on the British filesharing study (BMR, 2008) points out, rather formally, that filesharing is probably not to be regarded as a conscious property crime with the intention of harming someone, as is the case for traditional product piracy, but that filesharing is

a novel form of social behavior clashing with very restrictive legal boundaries, which are being increasingly tightened. But this is precisely the wrong path. Legal frameworks should always take into account the reality of life, and not happily risk potentially criminalizing wide sections of the population. In this sense, legal boundaries must be broadened and file sharing [should] be accepted as legitimate social behavior (Tschmuck, 2009).

These deliberations are supported by the empirical study of Altschuller and Benbunan-Fich (2009), who were able to observe an ethical dilemma in U.S. students' dealing with illegal filesharing offers. This dilemma was made clear by the students' ambivalent attitude: there were clear deviations between what the respondents thought was right (e.g. not to download illegally) and what they would recommend others as correct behavior, namely to use illegal download offers and transfer them onto data carriers. They arrive at a similar conclusion as Tschmuck before them, which is that these

inconsistencies support the notion that as technology evolves, it creates discrepancies between the way things are and the way the law expects them to be, leaving society in a muddle, trying to reconcile the two (Altschuller & Benbunan-Fich, 2009, 49).

It would thus presumably better to start with the time and effort of procuring pirate copies than to increase the legal pressure (of prosecution). The illegal acquisition of films, for instance, is directly tied to how difficult the process is. Factors such as retrieval, the download itself and particularly quality control play a decisive

role in this context (Dördrechter, 2007, 254-255). The shutting down of known filesharing services increases the cost of retrieval. The flooding of filesharing services with bad copies would drive up the costs of quality control. Brodersen (2007, 233) here developed the idea of “Weak-Copy-Flooding”. Information providers could “flood” filesharing services with low-quality copies of their information goods—possibly even in conjunction with advertising—even before their actual release dates. These copies would provide consumers with the option of gleaning an impression of the contents, but their quality would be worse than the originals’. At the same time, the large number of existing low-quality copies would make it harder for the service’s users to identify the higher-quality illegal copies uploaded after the original’s release. This procedure would increase the incentive to purchase without restricting positive network effects.

We will, very briefly, pick up the aspect of technical protective measures once more. To put it concisely: is Digital Rights Management (DRM) suited for stopping piracy? Generally speaking, this will probably never be the case, because

every time a new copy protection technology (such as Macrovision) is developed, pirates quickly develop a counter-technology to defeat it (Cook & Wang, 2004, 569).

In connection with existing, or newly developed, illegal sharing networks, it is to be assumed that the transformed files will be widely distributed relatively quickly. DRM could perhaps cause a certain delay (Haber et al., 2003), but it will not manage to stop the distribution because it is enough if a fraction of users is able to upload the unprotected contents (Biddle et al., 2003). Dördrechter (2007, 278) even detects an adverse effect: not only does copy protection on DVDs not represent a real hurdle for pirates, but it is an additional stimulus for them, a sort of challenge. It must also be noted that the providers of cleaned-up files do not do so for profit, but strive instead to match the efforts of others (reciprocity) and gain renown in their peer group (Strykowski & Scorpecci, 2009, 8). The costs incurred by the full implementation of DRM systems and the restrictions they place on legal consumption were already addressed in Chapter 21.

If we summarize the results collected so far, we will see that the principle of combating every instance of filesharing is untenable from a purely economical perspective. The study results listed in Chapter 25 demonstrate this for music, but similar effects must be assumed for the other industries, too. Bhattacharjee et al. have even found out, in an empirical and simulation-supported study of the music market, that the complete elimination of piracy would be downright counterproductive, since

maximum profit outcomes occur in the presence of piracy (Bhattacharjee et al., 2006, 154).

This is because access to (illegal) sharing networks lowers search costs, after which the customers can make better purchasing decisions via sampling.

26.3 Improving Legal Offers

A very central starting point for information providers is an attractive offer that moves customers to buy the original product instead of downloading an illegal copy. Napster, in 1999, was the first and only (illegal) offer for downloading music from the internet. In 2001, iTunes entered the market as a legal alternative, and only in 2004 did the music industry come up with further offers for (legally) downloading music (Bundesverband Musikindustrie, 2004, 22). Legal offers have thus always been at a competitive disadvantage against their illegal counterparts from a chronological point of view. As we know from Chapter 17, on the Timing of Market Entry, the late mover's offer must be particularly persuasive. He must make the customer attractive offers in order to win their business. This leads us on to the question of what distinguishes legal offers from illegal ones.

A starting point for developing attractive download offers is the question of why filesharers prefer illegal services to legal ones. An online survey of the Swedish Collecting Society for Composers, Lyricists and Music Publishers, Svenska Tonsättares Internationella Musikbyrå (STIM), interviewing 1,123 Swedish filesharers, produced the results displayed in Table 26.1. The entries with the highest percentages regard the legal aspect, which we will address in more detail in the following section, and the price. They are directly followed by the aspects of Extent of Offer, Usability, Quality of Content and Security.

Legal downloads cost money, usage of sharing services is possible without payment. As always, the customers want the price to represent a suitable relation between service and fee. Apparently, there are many consumers who regard the price of the legal offers as too high in relation to the service they provide. Let us first discuss the service aspects that arise from this survey and others.

Customers want a large music catalog, from which they can choose their product. Here it is also important—thus a study of the British collecting society (BMR, 2008, 13)—that rare and unpublished materials can also be found. Just like every website, usage should be simple and intuitive. In this regard, there is still room for improvement in many legal offers.

A great advantage of the legal offers is the quality of their content. The customer gets what is advertised, and in corresponding quality. Furthermore, the subject of security does not play a role in legal offers, as it is a given. In addition, adequate sampling options should be provided (BMR, 2008, 13) in order to prevent information asymmetries.

Form of Offer Rating	Filesharing Sites	Legal Download Offers
Advantages	<ul style="list-style-type: none"> • Music is available for free (78.3%) • They are easy to use (58.7%) • Files can be stored anywhere (49.5%) • You can find anything you are looking for (48.5%) 	<ul style="list-style-type: none"> • Purchases are legal (74.7%) • High sound quality (49.7%) • No danger of viruses (37.8%) • Easy navigation on the websites (23.9%)
Disadvantages	<ul style="list-style-type: none"> • They are illegal (66.2%) • The artists are not remunerated (65.0%) • Threat of viruses (60.9%) • Corrupt files (47.6%) • Files with wrong content (41.3%) • Incomplete files (40.3%) • Downloads take too long (22.2%) 	<ul style="list-style-type: none"> • Titles are expensive (62.7%) • You do not find everything you want (61.4%) • Music is often DRM-protected (38.9%) • Formats on offer cannot be played on all end devices (38.8%)

Table 26.1: Comparison of Advantages and Disadvantages of Legal and Illegal Downloading Alternatives for Music. Source: STIM, 2009, 8 et seq.

Also empirically proven is the consumers' desire for additional offers.

We found that all participants were less likely to pirate when the alternative, pay Web site offered features such as extensive music catalogs and the availability of extras, such as rare recordings, live concerts, and downloadable ringtones and videos (Sinha & Mandel, 2008, 12).

Here the wide area of complementary offers that can be made to customers opens up. Deiss (2006, 111-112) proves empirically that users of filesharing services go to concerts and listen to the radio more often.

Similar statements can be found with regard to the offer of films. Filesharers appreciate the flexible usage options of previewing (Dördrechter, 2007, 274-275). The film industry could significantly improve its offer via a better Video-on-Demand (VoD) system, which might offer the customer the possibility of previewing the first fifteen minutes of any movie, or even to select the scenes they wish to see. VoD could also make it possible to make films available earlier than they have been so far, as we discussed in Chapter 18 on Pricing (Figure 18.5). An attractive added-value offer could be peer-supported film ratings. Another advisable measure is to increase the attractiveness of moviegoing, preventing the substitution of visits to the cinema by digital offers. Here, the cinema industry is taking

the first steps and is banking on luxury offers, which enhance the cinema experience via service offers such as ushers, good parking spaces, generous seating opportunities, good food and digital 3-D projections (Killing, 2009, 113-114).

Let us now look at the pricing side of things. What first recommendations might be tendered for pricing, in regard to the existence of illegal copies? The studies mentioned above have been very important in demonstrating the music, as offered legally, is regarded as too expensive. More than 70% of respondents in the British study stated, as their reason for illegal downloading: "It's free, save money" (BMR, 2008, 13). The same results can be found for the film industry (Dördrechter, 2007, 273). The costs for the original, be it in cinemas or on DVD, are regarded as too high by pirates. If providers are thus unable, or unwilling, to significantly improve their services, the first simple consequence to be taken might be the lowering of prices. There is much in favor of not doing so generally, but to open up the toolbox of pricing and introduce differentiated pricing models. An ideal strategy would appear to be Mixed Bundling, in which customers are offered either the entire repertoire, on a subscription basis, or single titles in online stores (Bhattacharjee et al., 2006). The "digital record store" Napster, now legalized (www.napster.com), offers such combined models, which thus represent more of an ongoing service than a one-off purchasing offer for a single product. For single titles, it also seems to be of advantage not to offer them at a flat price, as customers' preferences differ. With regard to piracy, Gopal et al. (2006, 1529) observe:

Lower valued music items are pirated more than higher valued items [...] and consequently sales of those suffer. If a producer is aware of the true value of a song to consumers, he can set the price accordingly to maximize profits. For producers, the model shows that in the presence of online music sampling, uniform pricing for all music items is a sub-optimal strategy.

Alternatively, the creation of legal music-sharing services might be of interest. In the Swedish study, almost nine out of ten users (86.2%) stated that they would be prepared to pay for such a service. More than half would thus be willing to pay between 50 and 150 Swedish Kroner (ca. €5-15) per month. Only 7.4% are unwilling to pay for filesharing (STIM 2009, 3 et seq.).

On the basis of an empirical study, Dördrechter (2007, 273-274) recommends that the film industry try to contain piracy by lowering admission prices in cinemas during the week and the prices for original DVDs.

Generally, the recommendation can only be to apply the manifold methods offered by the pricing of information goods in the first place (Linde, 2008). Bundling on its own already offers a multitude of variants, e.g. bundling sound carriers in combination with live offers, or selling cinema tickets and DVDs in one package. In the digital world, put simply, customers must be made attractive offers with high usability and appropriate prices, which make purchasing and direct usage as easy as possible. All that stands between the buying impulse and the buying

decision is the potential danger of secession to the black market. This might be the reason why the existing offers still aren't balanced enough:

The harsh reality for the studios is that for consumers to buy an official packaged media version of a film, they must be given more and pay less—a model that is being forced on other media markets (Starling & Roberts, 2003, 29).

Similar statements are made by Chiou et al. (2005, 170), concerning the music industry. There appears to be a need for creating

easily searchable indexes of music items, fast download access to music items in different secure formats, provisions of posting consumer reviews on items, creation of fan club sites within the search portal, etc. Some of these items are now being made available on online music portals—however there is little evidence of an integrated offering of such strategies (Gopal et al., 2006, 1529).

26.4 Developing New Business Models

Apart from the measures that can be taken by information providers against piracy and to improve their own offer, there is also the option of “taking the bull by its horns”. New, creative business models may provide them with possibilities for marketing their own offer in the digital world in new, and perhaps even better, ways. No matter what industry you look at, what is important is that the (legal) online offer has the quality that its target groups demand and an appropriate “ease of use”. If that is accomplished, there will be good chances that the legal offers will oust their illegal competition (Stryszowski & Scorpecci, 2009, 12). We can only give some pointers as to the direction that such business models might take, where “business model” only means the rough summary of a for-profit enterprise (Knyp-hausen-Aufseß & Meinhardt, 2002). The central elements of such a model are the combination of product and market, the configuration of activities for creating added value and the revenue mechanism. Even without any changes to the product-market combination, ideas for altering preexisting business models can easily be developed. The different aspects of Price Differentiation, via Bundling, Versioning or Windowing, have been discussed in Chapter 18, and, partly, in the above section on improving offers.

At this point, we would like to introduce some seemingly radical solutions for pricing. Due to their known cost structures, information goods are eminently suited for being priced via the **pay-what-you-want** (PWYW) approach. Here the customer can either sample the product extensively, or even own it, and decides what it is worth only after sampling or consumption. Interestingly, a large number of

customers is prepared to pay on a voluntary basis, which means that providers do not have to fear that their profits will inevitably decrease (Kim et al., 2009).

For small labels, and less-known artists, Regner and Barria (2009) found out that customers are even prepared to pay more than suggested by a price recommendation. Three central motives for the willingness to pay transpired in this situation: the customers felt the need of compensating for the openness they were granted in accessing music by paying accordingly (reciprocity), they could feel positive about themselves having contributed to a good cause, namely supporting the artists, and they did not need to have a guilty conscience due to having paid less than they should have. This approach gives rise to whole new possibilities of building business relationships and creating a relationship of trust between provider and customer.

A second line of thought goes in the direction of **offering information goods for free**. To put it simply: cost-free offers will substitute piracy if all the other parameters, such as usability, quality, freedom of use etc. are adequate as well. This variant must not be confused with a comprehensive sampling offer meant to lead to a purchasing decision. It actually means that music, software, films, books etc. should be offered for free. Of course, revenue must then be generated elsewhere. In this respect, it would seem advisable to only offer certain (lower-quality) versions for free and to make money from selling complements or advertising space. One example is the Chinese music market, serviced by Google (Schwan, 2008). Music from Chinese and international labels, among them EMI and Universal, can be searched via Google and then downloaded for free. Revenue is generated via ads.

Further potential for changes to preexisting business models of information providers lies in the restructuring of their value chains. The music industry could create greater pricing leverage for itself by changing the licensing structures. The predominant model of licensing payments per download could be replaced by blanket payments that depend upon the repertoire on offer, or percentage payments relating to the provider's profit. Bhattacharjee et al. (2006) determined that payment per download is the worst of the three variants for both retailers and customers. In order to lower the fees, and profit from possible revenue increases via lower prices, however, prices need to be redetermined throughout the entire value chain, i.e. incorporating artists, labels, retailers etc. (Strube et al., 2008, 200-201).

A step that would go far beyond this would be to expand the value chain. Music publishers, for instance, who have to realize that revenue from simple music sales is dropping, could try to make complementary offers. The music corporations are already thinking about fully supplying consumers, by not only assuming responsibility for sound carrier sales and the marketing of artists, but also offering concert tickets, MP3-players and merchandising articles (Postinnett, 2008).

The increased revenue generated by the greater distribution of music due to piracy mostly goes to the artists themselves, not to their labels. In order to soften the pressure in the labels' repressive measures, and not to endanger the quality of new releases, artists might consider sharing some of their profits from touring with their labels. The stronger distribution of music should result in increased demand

for sound carriers, live concerts and complements (Curien & Moreau, 2009, 111-112). Both sides in unison might manage to create a win-win situation.

A further variant would be the integration of filesharing into the value chain. A great danger for the music corporations lies in being circumvented by seeing artists self-marketing their work:

[...] instead of fighting the file-sharing services, musicians would embrace the Kazaas of the world as a free promotion vehicle and distribution pipeline to an audience of millions (Lasica, 2005, 63).

One might even go further and grant consumers more extensive rights to the information goods they acquire. Why not allow users to integrate the music, film, text, game etc. into a creative process at their discretion and to create new works? This practice, often encountered in computer games, still seems unimaginable for music and film:

Imagine buying the latest "Lord of the Rings" DVD and discovering that the cameras, lights, special effects and editing tools used in its making had been included at no extra charge. Or finding your favourite CD's crammed with virtual recording studios, along with implicit encouragement from the producer to remix the music, record your own material and post it all on the Internet (Marriott, 2003).

Social networks in particular represent an ideal breeding ground for the creation of new creative works, and the flexible rights found in the Creative Commons scene even provide an adequate legal framework.

In sum, the recommendations for information providers consists of making their own offers more attractive in order to allow for substitution effects in the reverse direction, i.e. to see legal offers displacing illegal ones. To attack filesharing services outright or to undermine them can only provide limited relief, namely only insofar as the desired network effects are not eliminated.

26.5 Conclusion

Only available in the printed version.
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26.6 Bibliography

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