

‘The impact of digitization on copyright collecting societies’

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Abstract

The established view of copyright collecting societies on the part of copyright economists, the courts and regulators is that their natural monopoly is justified on efficiency grounds. Besides its effects on markets for music, digitization has had a profound effect on the management of musical copyrights in terms of data requirements and the vastly increased volume of transactions: both have raised net costs of administration. Using UK data in musical performing rights, this paper asks if the argument for single national collective rights management using blanket licensing still holds up or if competition would be more efficient.

1. Introduction

The paper is about the changes digitization has had on the economics of collective rights management on the practical aspects of licensing procedures. The motivation is the discussions that have been taking place in the EC on multi-territorial licensing and in the UK on the development of a copyright hub. Despite the advances in digital rights management and in international initiatives on standardization such as the Global Repertoire Database, office procedures in collecting societies are not fully digital and the matching of its databases are the main undertaking of a collecting society’s back office in addition to the front office’s national rates negotiations. These discussions seem not to have been well informed on the economics of collecting societies and this paper addresses that gap. It goes into detail on the data requirements of national and cross-border licensing and costs and revenue streams of digital usage while stepping back from the detail to look at the wider issues of the potential for competition in rights management.

2. Basic economics of copyright

Copyright is an institutional solution to the free rider problem, the use of a good or service without payment. It works through the market – no demand, no payment. The exclusive rights awarded by copyright enable creators to control use and (maybe) obtain payment are an incentive to create. It enables owners to charge a higher price than the marginal cost of producing a copy thus covering the fixed or sunk cost of creating the work. Legal copiers, eg creators of derivative works, require author’s permission and a deal can be struck over a royalty.

There has been ‘piracy’ – unauthorised use of copyright works – since the inception of copyright (Statute of Anne 1710): What has changed over the years is the technology for copying - from engraving to digital – and each new technology has led to increased market size for both legal and illegal copies.

In practical terms, almost all works that are published or intended for the market are contracted to a publisher (record label, broadcaster etc). 'Works' are bundled in a product, such as a CD or a TV programme. In many cases the publisher demands transfer of the main rights and the author has little or no bargaining power, while copyright of works made in the course of employment belongs to the employer.

Copyright is a bundle of rights that can be licensed separately and in different markets. Some rights are more valuable than others. Two types of market for products based on copyright works can be distinguished: primary (initial sales) and secondary (reuse of published works by third parties). In the primary market, a contact is made between the creator and the publisher who controls sales. Secondary use cannot be controlled by the author or publisher (eg broadcast of a CD); those are the markets which collecting societies serve.

3. The role of collecting societies

Copyright collecting societies are private, non-profit, cooperative membership organisations set up by authors and publishers; in some countries, however, collecting societies have been set up by the state. The UK's PRS for music, for instance, was founded 1914 by composers and music publishers and there are around 20 other societies in UK managing various rights. Each collecting society manages a specific right such as public performance of music, copying of images, photocopying literary works etc. Rights are territorial and due to the global nature of markets for creative products, national societies make international agreements with their counterparts in other countries. Some collecting societies require assignment of the rights they administer; others act as agents.

Collecting societies license members' works, negotiate with and collect licence fees from various types of users, distribute revenues to members, monitor uses and enforce rights. These services are bundled. They manage interacting datasets of licensees and writer and publisher members and trade on their knowledge of the market in their territory for the products that include the rights they control. Many products include several works and possibly multiple rights, for example, a CD includes composers' and publishers' rights, performers' rights, sound recording rights and rights of visual artists and authors of the packaging and text sold with the music, rights managed by different collecting societies.

Collecting societies also manage revenues from equitable remuneration payments mandated in copyright law for some rights, such as the artists' resale right and rental rights.

4. Economics of collective rights management (crm)

Collective rights management (crm) reduces transaction costs of administering copyright for creators and users. Transaction costs are those of using the market eg negotiating prices, contracting, collecting revenues, and so on. Crm benefits from economies of scale and scope based on sharing transaction costs of licensing, the size of repertoire covered and databases of works and members' details and network economies. Enforcement by creators and compliance by users would be prohibitively expensive without crm. Thus crm promotes the economic aims of copyright law.

With crm bargaining power is greater than that of an individual creator who is generally in a weak position in the marketplace (Kretschmer, 2002). And in addition, collective action pools risk, acting as

a form of insurance (Snow and Watt, 2005). Some collecting societies in the EU have been set up only for crm and may not license individually.

Blanket licensing is widely used for crm as discussed below.

5. The collecting society monopoly issue

The exclusive right of copyright confers a **legal** monopoly to the creator of a work which is transferred or assigned to the collecting society; rights are territorial and hence, collecting societies are nationally based, ie, they are national monopolies due to the law. In some states, open access to collecting societies is required (common carrier) to ensure that all creators are equally protected. Monopoly confers power over pricing in the domestic market. Licence fees are negotiated on the market, usually with trade associations rather than with individual users, which provides countervailing power; the exception is large users, such as a national broadcaster (eg the BBC in the UK) which negotiate individually. Due to the monopoly they hold, rates are subject to regulation in one form or another by the state.

A collecting society also is a **natural** monopoly in economic terms. Natural monopoly occurs where market forces lead to single seller. It is common for utilities which have networks and the bundled services of crm fall into this category. A national collecting society is a single seller of crm services for one (or closely related) rights.

Thus a collecting society has two sources of monopoly - the law and economic incentives - and that has to be considered in the discussions of introducing competition into the world of collecting societies. If copyright law were made EU wide, for instance, how would market forces react?

The natural monopoly is due to increasing returns to scale – the greater the output, the lower the average costs. Marginal costs (adding one more work or member) are lower than average costs and with digital registration with a collecting society, are very low indeed. As larger markets lead to lower costs, countries with small markets are at a disadvantage; administrative costs would be higher even if their societies were efficiently run. The natural monopoly in cs lies in matching databases of works, owners, licensees, members' details for distribution etc. Bundling the services of licensing rights (setting the rate, collecting fees), distributing revenues and monitoring and enforcing rights is efficient. As a result, the natural monopoly and blanket licensing of collecting societies is widely accepted by governments and courts, in many official enquiries, law cases, etc. (Gallini, 2011).

6. Economics of blanket licensing

Blanket licensing has been the main business model of collecting societies since their inception, especially in music. It has been accepted as the most administratively efficient means of licensing for both rights owners and users; however, it has long been viewed by economists as economically inefficient as it does not send accurate price signals to creators or users (Besen et al., 1992; Hollander, 1984). The advent of digitization has offered the possibility of individual transactional licensing and this forms the basis of the belief that competition can improve the administrative and economic efficiency of collecting societies, replacing collective rights management. Before discussing this fundamental change, it is worthwhile to go into detail on how blanket licensing works.

Rights owners' incentive to obtain royalties and remuneration means almost all join collecting societies. With assignment of all works in the member's catalogue, a collecting society can control use of the whole repertoire and with its collaboration with foreign societies, it effectively controls the worldwide repertoire of the rights it administers. Licence fees are negotiated at varying tariffs according to usage and revenues of users. Large-scale users are required by the terms of the licence to itemise works and usage. Thus some of the administrative costs are borne by the user. Small users are exempt from detailed reporting but then the cost of estimating usage falls on the collecting society. The society records use of works and distributes revenues to its members net of its administrative costs. The amount paid out depends on the quantity of usage since the 'price' is same for every work in the blanket licence.

Blanket licensing reinforces the collecting society's monopoly power over pricing but some users also have strong bargaining power. The absence of a market means the price (licence fee) is often arbitrary especially for new uses and is often set according to analogous uses. This has been evident with new digital uses.

The collecting society's monopoly also offers rights owners no choice over the price they would like to see applied to their works: 'top' creators could earn more. However, cherry-picking by 'big' rights owners would weaken the 'solidarity' of collective bargaining (Kretschmer, 2002) and raise administration costs for others (Liebowitz and Margolis, 2009). In fact, rights owners may join 'foreign' (but rarely 'competing') collecting societies: what has held most back is language difficulties and problems with tax withholding.

7. Impact of digitization on crm and collecting societies

The above relates to crm of any right (though all collecting societies do not require assignment or rights and act instead as agents) and sets the scene for what follows, analysis of the impact of digitization in a collecting society based on my recent work on performing rights in music at the UK PRS for music (Towse, 2012; 2013a).

With digitization, licensing replaces sales of products (CDs, books and so on) with rental of online services and fees replace prices with implications for administration costs and the basis for paying royalties to creators. In the music industry, debundling of albums into streamed tracks has resulted in vastly more transactions for a collecting society dealing with performing rights with users pay only for tracks they want. For instance, the UK's PRS for Music had 21.5 billion uses received in 2010: by 2012 it was 124.6 billion. Administration costs have risen and are not covered by online revenues meaning there is cross subsidization of administration costs, though online represented only 12% of PRS revenues in 2013. Blanket licensing is still used for the majority of its revenues, however, and even large scale users of online music, such as the BBC, continue to pay a blanket fee that includes online use. Transactional licensing is also causing confusion for users over ownership; though it is supposed to bring greater 'transparency' to copyright owners, it causes extra search costs for legal (or more illegal) use. Overall welfare is therefore affected.

Another element to the story is multi-territorial licensing. Much of the pressure in the EU for changes to crm and collecting society procedures arose in this context with claims that the development of online services was being held back by need to license in each EU country. That also was the basis of the setting up in the UK of the Copyright Hub (supported by shaky evidence on its potential economic benefits - Towse, 2013b). While the Hub would provide an essential service of effective (voluntary)

registration of copyright ownership, thus removing uncertainty, it is unlikely to fulfill the initial claims made for it (Hargreaves, 2008).

Both transactional and multi-territorial licensing for digital use necessitate changes to ‘front’ and ‘back’ office procedures and their interaction. New licences call for new ‘back office’ procedures and investment in IT. Economies of scale are reducing licensing costs but revenues per item for streaming in particular are very small and do not cover the marginal cost of administering them.

Economic incentives led big players in music industry to instigate their own arrangements for cross-border licensing (front office) using various national collecting societies’ back office facilities for processing revenues and their distribution, for which the society charges and administration fee (thereby assisting with economies of scale and the sunk costs of investment in IT). Thus there has been some debundling of front and back office procedures. In addition, ‘big’ collecting societies have joined together to supply compatible back office services, developing common standards for data in so doing. The PRS for Music and STIM’s ICE system is expected to be the prototype for CISAC’s Global Repertoire database (GRD).¹

8. The digital dream for rights management

Various documents and enquiries have suggested that DRM (digital rights management) can achieve two objectives: offer more ‘transparency’ and introduce competition into rights management. The UK’s Hargreaves Report (Hargreaves, 2010) and its follow-up reports by Hooper (2012a,b) took this line as did the European Commission’s 2012 proposed Directive on collective rights management (EC, 2012).

Data requirements for a fully digital system are massive: a global standardised database of unique titles of works (GRD), a global standardised database of unique names of writers and publishers (International Standard Name Identifier, ISNI), detailed information about the contractual share of royalties between joint rights holders (writers/publishers) for every territory for each work, user adopting the same system of work and name coding in its transmission of data to the cs. Each element must be uniquely coded for every transaction along with the rate relevant to the usage. These are just the technical requirements. On the economic side pricing is necessary for transactions requiring negotiations and knowledge of products and markets. Even if the back office procedures were able to work smoothly internationally (a very big ‘if’), front office functions cannot be automated. Also rights need enforcing – actions that are not solved by technology.

Without collaboration between at least the major collecting societies to share their data on all the items listed above, data requirements for a centralized Hub could not be fulfilled and the need for collaboration raises the question of the incentives to competition within the collecting society community. If instead big data companies were to enter the market for rights management services, would they be able to obtain the necessary data without collaboration?

9. Competition in rights management and contestability of the collecting society monopoly

¹ STIM is Sweden’s national collecting society for composers and music publishers. CISAC is the international association of collecting societies.

‘Competition’ is not well defined in the policy documents referred to above: they simply assume it is a ‘good thing’. It is vaguely linked to lower administration costs of licensing and greater transparency in distribution. However, costs would not be lower if a natural monopoly is split up. The issue for economists is whether monopolies are contestable, that is, if competitors can enter the market. The Schumpeterian view is that new technologies assist the process as new firms adopting new technologies can compete with and even drive out of business incumbent firms that fail to adapt (the acknowledged story of the sound recording industry).

Indeed, as mentioned above, there have been changes in rights management services for online uses and digital rights management is developing. New firms now exist for servicing artists’ copyright management, offering services of interpreting complex information about copyright law and tracking collecting society pay-outs. Large publishers can choose between copyright licensing service providers. However, these moves have not challenged the dominance of the collecting societies.

There are significant barriers to contestability, however. Ironically, the greatest barrier to competition is copyright law itself with its complexity of multiple rights, national laws and lengthy duration.

Collecting societies specialise in managing one right in many markets and there is little joint servicing of different rights (an exception is mechanical and performing rights in music). Some new licences are now offered for online use eg. a joint PRS/PPL licence for small-scale uses such as using a sound recording in a wedding video. Blanket licensing is still more efficient for some digital uses including broadcasting. Cherry-picking is widely regarded as reducing efficiency and it disadvantages small earners.

Moreover, collecting societies are non-profit membership organizations with tradition of solidarity and cooperation. Their databases are their commercial assets so there has to be mutual benefit for them to open access to their data. Pooling data creates club good and restricting access is necessary to preserve value. Regulating for open access to data could open the system up to ‘disinterested’, for profit big data organizations.

10. Conclusion

Does digitization change the natural monopoly case for collecting societies? I do not think so – in fact, I believe that the underlying economic forces suggest even greater cross-border monopolies could develop. In my view, centralising multi-territorial licensing risks the development of an even greater monopoly.

Collective rights management is a spontaneous market outcome in response to the problem of secondary markets in copyright works and collecting societies have propelled collaboration in international markets that enables copyright law to work. They are non-profit cooperatives acting for members to enable them to obtain reward for their rights. That is what copyright law is meant to do and it does so via the market for products embodying copyright protected works. Many of the objections voiced in evidence submitted to the various official enquiries that have taken place seem to be more about paying anything for some services rather than the way in which payments are organised.

The demand for licensing services is derived from the use of products and changes in product markets are reflected in licensing procedures. Markets in the creative industries are dominated by superstardom and blockbusters. These features result in a highly skewed distribution of

royalties/revenues. For instance, 10% of PRS members earn 90% of online income. The nature of the market for products impacts on collecting societies: economies of scale and scope in larger markets lead to lower administration costs. Collecting societies operating in small market are likely to suffer if their repertoire is not competitive on the international market and administration costs will be higher. They are required to service foreign copyrights but most must inevitably have a negative balance of payments. Moreover, IT for licensing requires huge investment in systems and know-how on the part of a collecting society but requires also standards and compatibility in the whole market. Smaller societies will therefore have to turn to the larger ones for multi-territorial and transactional licensing, thereby increasing the latter's economies of scale. It all points to greater concentration not competition.

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