Chapter 2
A Comparison of Pricing Strategies for Digital Goods

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ABSTRACT

This chapter is a review of pricing strategies for digital goods. The basis for a number of such strategies is analysed. Using the case of online music, some lessons for the practice of digital pricing are derived.

INTRODUCTION

The world of media business has entered into an era of Interactive Digital Media (IDM) marketplace. The significant increase in possibilities for interactivity especially over large distances brought by the broadband internet boosted the thriving interactive digital media. Digital goods such as e-books, online music, movies, and multiplayer role playing games are produced, consumed, repackaged and traded via the Internet (Garcia, 2006).

Digital goods that are categorized as information product grow rapidly with the penetration of Internet and the advancement of info-communication technology. As the Internet platform becomes more open and interactive with Web 2.0 technologies, the traditional distributional channels are being disrupted and restructured. With the movement from previous dedicated distribution channels to today's P2P or social networks, consumers can easily obtain their online digital products and services at very competitive prices, or even for free (Anderson, 2004).

Moreover, as digital media products possess unique cost structures and characteristics, it is neither feasible nor optimal to adopt the traditional pricing strategy, cost plus. Evolution in digital media and changes in consumer demand have affected current business models. As an important

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aspect of market strategies and business plans, pricing strategies are targeted and investigated in this chapter.

BACKGROUND

IDM Market

The fast development and wide coverage of broadband networks has become a catalyst for the growth of interactive digital media. Today children as young as two years old learn new words and play online games to accelerate their learning curve. IDM has penetrated into people's life at their much earlier age. For adults, social networking platforms such as Facebook, My spaces and Twitter, have gained a huge popularity among people. It helps them look for missing old friends, and network with people from all around the world. Within such a virtual network, people communicate freely and interactively through sending messages, sharing photos, videos, and playing games together. The success of Facebook not only lies on being a social networking tool, but also in continuously adding interesting interactive new applications to improve the user experience.

Interactive digital media deals with digitized goods such as e-books, online music, movies, and multiplayer role playing games. Digital goods refer broadly to anything that can be digitalized (Krishnamurthy, 2002). Choi and Whinston (2000) defined digital goods as any knowledge-based and knowledge-enhanced products which include various forms of human creation such as information, knowledge, news, databases, software, literature, and arts, etc. Moreover, digital goods not only include products but also include something what can be called as "services" in the traditional market. However, IDM is very general in concept and is not restricted to entertainment industry only. In Singapore, the IDM R&D Programme Office has identified four key focus areas: Education, Animation, Games & Effects, Media Intermediary Services, and "On-the-Move" Technologies (National Research Foundation). Increasing lifestyle services such as e-learning, e-health, e-banking and government services have become dependent on IDM for its advanced efficacy.

In the IDM eco-system, there are typically five players which are classified into three groups: producer, intermediaries (including syndicator, aggregator and distributor) and consumers. A generalized IDM eco-system is depicted in Figure 1.

In the first stage, producers such as game developers, movie and animation studios, music artists, book publishers and etc produce digital goods. Next, these digital goods will undergo aggregation; syndication and are finally distributed to customers. This is a process of adding values to services and goods before their final delivery to end-users. Aggregators perform a specific distribution role in which the same intermediary distributes content from different provid-

Figure 1. IDM eco-system (adopted from Morales-Arroyo & Sharma, 2009)