# The right protection

*Yiming Tang* looks at strategies used by businesses in China to protect their products.

The violation of intellectual property rights has been a major concern for businesses operating in China and finding strategies to effectively overcome these challenges has been a key issue for business in that country.

This study examines intellectual property right (IPR) protection strategies in a sample of foreign and local businesses in China. These strategies go beyond the conventional legal means by also including social responsibility programs, innovations, one-stop business-solutions, close cooperation with local business partners, market embargoes and production–process quarantines. They have produced very positive and seemingly long lasting outcomes.

The study conducted interviews with management staff – including the chief executive officer, managing director and vice president – in companies in five different industries – steel construction products, pharmaceuticals, telecommunication, chemicals and IT manufacturing. Four of the businesses are foreign-owned while the fifth is Chinese-owned.

Recent examples of IPR violations in China reported in the media include the cases of Business Software Alliance's (2005) estimate of 90 per cent software piracy rate in China in 2004 and the seizure in late 2006 of 58 million illegal publications and four pirated DVD production lines in China's 100-day anti-piracy campaign. The frequent and large-scaled violations have earned a top spot among the key concerns of executives whose companies conduct businesses in and with China.

While the Chinese government has made significant efforts to tackle this problem, reported cases of IPR violations are still on the rise. Figures revealed in the Chinese media show that during 2000 – 2006, 54,321 civil cases of IPR violations were heard by China's courts, up 145.9 per cent.

**All strategies have two unique characteristics: They enable companies to be one step ahead of counterfeiters and, if implemented successfully, greatly assist companies to improve their products/services market standing and position in China.**

#### CASE STUDY 1: THE PHARMACEUTICAL COMPANY
**Social responsibility**

This leading Sino-foreign equity joint venture (JV) has faced extreme challenges in relation to its popular over the counter (OTC) medicines in China. The interviewee revealed that over several years, the company had received an increasing number of customer complaints about the quality and efficacy of their products. Senior management was initially at a loss, given the company's reputation as a world's best-practice manufacturer and given its Chinese factory had been certified for having met world class quality control standards.

On investigating the problem, the company discovered that more than two thirds of the complaints came from counterfeited products. Several measures were taken to combat the pirates: holographic image and encrypted codes used on packaging; a customer service hotline started; closer cooperation with distributors; more policing in the retail market; and active pursuit of counterfeiters in court.

While such strategies did produce some positive outcomes, they were costly and time-consuming to implement and their impacts were patchy and not sustaining. In the meantime, the problem continued. The company traced the origin of the counterfeited products to some of the poorest regions in the province. The management of the company, a key contributor to the local economy in employment and tax revenue, held discussions with the local government and with their endorsement, initiated a 'social responsibility program'. The company invested in several environmental protection and improvement projects and launched an education campaign on drug safety and security, showing the danger of using fake drugs.

According to the interviewee, these measures increased the awareness of both the significance of the issue of drug safety and security and of the reputation of the company in the minds of local people. Having witnessed the company's commitment to the local economy through its investment in the local environment, some local people volunteered to monitor the market and to report any suspected counterfeiting activities to the authorities. Over a two-year period, the social responsibility program has produced better results than conventional measures in reducing the numbers of counterfeited products in that market.

### CASE STUDY 2: THE STEEL PRODUCTS MANUFACTURER
**Total solution and product innovation and speed-to-market**

This wholly-owned subsidiary of a major foreign steelmaker has built three plants in China since entering the country 10 years ago. The company has relied heavily on seminars and demonstrations to promote its key products which are followed up with a sales rep's visit to potential customers. Such visits turned out to be a major vehicle in discovering counterfeited products used on a construction site.

Chasing after the guilty party proved to be costly and time-consuming and counterfeited products continued to be discovered. The company decided to conduct a systematic analysis of the buying decision-making process of their primary target customers, owners of large construction projects in China. This analysis resulted in a much deeper understanding of the customers' needs and requirements for design and product quality, deliverability and services.

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The company then formulated a 'total solution' strategy, integrating the design-manufacturing-installation-service stages all into one contract for key customers. In addition, the company has also kept up their effort in both product and production process innovation and shortened the time it takes for new products to reach the market. The 'total solution' and 'continuous innovation' strategies have effectively prevented counterfeited products from entering the buying process of the company's key customers. Thus, these combined strategies are more effective than pursuing the counterfeiters in court. However, the interviewee thought that counterfeiting would remain a problem for the foreseeable future, therefore, a more effective way to win the battle against counterfeiters is for the company to be ahead of them through continuous innovation.

### CASE STUDY 3: THE TELECOMMUNICATION COMPANY
**Share the IP**

This leading global player has a long history of innovation in both processing and product technology. Due to local government regulation, the company entered the Chinese market via an equity joint venture (JV) with a local business. IPR protection in the JV was of particularly concern and initially the foreign partner closely scrutinised its local partner's business conduct, resulting in distrust between the two JV partners. The foreign partner also felt the local JV partner was not putting sufficient effort into combating local counterfeiters.

After considerable analysis, the foreign partner decided to transfer the IPR for its products for the Chinese market to the JV in China. Furthermore, the foreign partner also relocated their home country R&D centre to China, providing the local partner with full-access to the result of both the existing and future R&D achievements of the new China centre. These measures effectively made the local partner a key stakeholder of the technology of the JV, significantly altering the nature of the cooperation between the two parties. The local Chinese partner was then highly motivated in joining the battle against the local counterfeits.

This has proven to be a very effective strategy for the JV in its battle against IPR violation in China, resulting in a win-win situation for both parties. The interviewee claimed that the experience showed that a better way to protect their IPR in China was to share it with their local Chinese partner, because the latter knows how to protect their JV's IPR in China much better than the foreign partner does!

### CASE STUDY 4: THE IT COMPANY

**Product quarantine**

This is a privately owned Chinese B2B supplier of printed circuit board (PCBS) and peripherals. By the Chinese standard, it is classified as an SME (small and medium-sized enterprise) despite staff of 1200. Its major clients include several global giants in both computer and household electronic goods industries. The company has been under severe pressure of ever increasing labor costs, heated competition and its key customers' frequent threats to renegotiate contracts or switch suppliers.

In response, the company has followed a risk-diversification strategy by capping any independent key customer's total contract value to a certain percentage of the company's total sales each year. This, according to the company's CEO, is to 'avoid putting all eggs into one basket'. The practice of having multiple key customers coming from closely related industries has also created a further potential conflict of interests in IPR protection among the key customers.

To bring peace of mind to each key customer, the IT company's top management has set up physically isolated work areas, often an entire building, with assembly workers, machine operators, foremen, engineers and the line management staffs designated to a specific key customer. The company also signs individual supply contract with each of its key customers, providing a further guarantee of not conducting R&D relating to any of the contracted product(s). In addition, training programs are run on a continuous basis to educate the employees, which is important considering the company's very high front line staff annual turnover rate. These measures have effectively prevented potential IPR violations to occur at the ground level, according to the IT company's CEO, earning high praises from every of its key customers.

In the initial years of each contract, a key customer often sent its engineers to the IT factory to monitor the production process. Gradually, this practice ceased, due to the company's strict IPR protection policy and quality control process. According to the interviewee, no IPR violations have ever occurred at the factory. In addition, the average defect rate from the factory's assembly line has been typically lower than that at a key customer's home-country factory, resulting in some of the key customers' decision to close down their home-country factory and to relocate production to China. Over the years, the IT company has won the trust of its key customers on the IPR protection front.

### CASE STUDY 5: THE CHEMICAL PRODUCT COMPANY

**Product innovation and speed-to-market**

One of the largest and most innovative players in its industry with a long established history, this company has set up its Asia Pacific headquarters and several wholly-owned manufacturing facilities in China. Once again, the company has faced significant challenges in the IRP protection front in China. Counterfeited products have been found in several coastal cities in China. Despite the company's continued legal battles against counterfeiters, the problem persists. So much so, the company's headquarter in its home country has finally decided to formulate a dual-front strategy.

## Strategies to protect IPR

### Passive

**Do nothing**

**Exit the market**

### Active

**Re-active includes IPR registration in a host country, dealing with counterfeiters through surveillance and litigation (although litigation is often costly)**

**Proactive includes at pre-entry to the market stage, elect to keep IPRs away from China or carefully select products taken into that market; surveillance activities during production; careful selection of employees; running employee education programs to raise awareness and nurture IPR protection culture; or cooperate with the offender(s)**

**For businesses operating in China, wholly-owned ownership structure is recommended over joint ventures (JV) for better IPR control and protection. If you must form a JV, due to government regulation, it may be necessary to closely monitor the JV's local partner.**

For its premium products using world's state-of-the-art technology, which could easily be adapted for military applications, the company forbids such products/technology ever to be sold in China. For its popular household products, the company's strategy is to continuously innovate both in terms of the product ranges and in shortening the time it takes to bring such product to market. According to the CEO of the China operation, the 'product-embargo' strategy for the high-end product(s) seem to have worked very well in preventing potential leakage of the proprietary technology to counterfeiters. On the other hand, the 'product innovation and speed-to-market' strategy for the popular household products has achieved some positive results, although the battle against counterfeited products continues in China.

### THE RESULTS

Results clearly show that all five companies have developed protection strategies to face their serious IPR challenges.

First, the conventional strategy of IPR protection via legal means in China seems to be both costly and time-consuming and have produced limited short-term results. In addition, conventional means can only address the problems already occurred, rather than being preventative.

Second, some companies have introduced very creative and preventative strategies – the 'social-responsibility programs in combination with a comprehensive educational program and total solution strategy' are truly unique in their own right and have gone beyond what were discovered in any previous studies. All strategies have two unique characteristics: They enable companies to be one step ahead of counterfeiters and, if implemented successfully, greatly assist companies to improve their products/services market standing and position in China. Thus, a successful implementation of these strategies would strengthen both the product/service specific competitiveness and the company's overall competitiveness in China.

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