

Straight Talk About Intellectual Property in China

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Almost nothing elicits greater concern about starting a business in China than protecting a company's valuable intellectual property (IP). This fear is due to Westerners not understanding the China IP environment and how to adjust effectively to operate in a safe and commercially successful way. Some of the world's most technically advanced companies have decoded the challenge and are developing and producing highly sophisticated products in China today that incorporate their "crown jewel" technologies.

Is it or is it not China IP piracy?

It may be a surprise to learn that much of what Western companies believe to be IP piracy is not. Often Western companies choose not to patent technology in China that is routinely protected in the U.S. and Europe. This decision is generally because the Western company believes that Chinese patents have no value or are unenforceable. The facts are that even in the U.S., if you choose not to patent an invention, a competitor is not breaking the law if he copies your idea. If the idea is successful, it is good business for a competitor to copy it if a company does not intend to protect and defend the technology. This is the unfortunate position many Western companies find themselves in when they choose to enter the Chinese market but not file for IP protection.

Perhaps even more shocking is that even if these "supposed knock-offs" find their way into the U.S., where a company does have patent protection, the China company is not usually the party breaking the law. When products invade the U.S. market, it is usually because a U.S. company buys the counterfeits in China – where they are legal – and then imports them into the U.S. In this scenario, it is

the U.S. importer, not the Chinese company that is actually violating the law.

I am not trying to absolve Chinese companies from any involvement or culpability in IP piracy – far from it. The Chinese IP environment remains immature and presents risk to Western companies who do not understand how to manage IP effectively in this environment. However, the almost ubiquitous accusations leveled against Chinese companies only scratch the surface of what is a very complex issue.

Historical differences in IP concepts

To understand today's intellectual property rights situation in China, it is necessary to reflect for a moment on the history of IP concepts. The first known Western-like IP laws date back to a Greek island about 2,000 years ago. If a chef invented a recipe, no one else was allowed to duplicate the recipe for one year. From that simple beginning and with 2,000 years of commercial and legal concept evolution, modern IP concepts are instilled throughout the developed economies. The U.S. Patent Office was founded in 1790 based on English legal principles and it has taken over two centuries for the imperfect system to develop from an already established conceptual base.

In contrast, about 2,500 years ago, Confucius and his followers were laying the foundation for Chinese philosophy with concepts that included the notion that information is like the air and water, which no one can own. It was not until the late 1980's when Western businesses arrived in China in meaningful numbers, claiming that knowledge could be owned. Westerners are asking a country with an opposing philosophical foundation to adopt a new paradigm – one that took us over 2,000 years to assimilate. We are asking – even demanding – that this be accomplished in a very short time span in China.

There is a practical dimension of what can be expected. It is easy to write laws and China's written IP laws are similar to those of the West. But the reality is that it takes many years to develop a body of legal precedence in a society on which to run a regulatory and legal system; to train a national judiciary to be able to administer the laws; to train a

national bar to advise and assist in protecting the rights of companies and individuals; and to train an entire commercial class of business people to intuitively understand, accept and live by new knowledge ownership concepts. It is unrealistic to expect that China can navigate an IP development path completely in twenty years that took us centuries. Today, China still lags the “administrative” experience and does not yet have fully mature mechanisms to operate a sophisticated IP system as we do in the West.

China Adopting Solid IP Regulations

It is in China’s interest to adopt Western-like regulations as quickly as possible and they are doing so at a rapid pace. China will adopt solid IP practices for two reasons. First, Chinese entrepreneurs are developing their own IP that they want to protect. Second, China needs a continuing flow of higher technology foreign investment opportunities to fuel their economy to advance the nationwide standard of living for its people. China understands that Western companies will not bring their best technologies unless they believe their IP will be respected.

That doesn’t mean we shouldn’t push for IP reforms and better administration practices in China. We absolutely should. At the same time, we need to understand that there is a practical limitation to how fast China can actually accomplish this task. When I first began working in China in the early 1990’s, there was essentially no IP protection in China. By 2000, there had been great progress and Western companies were winning IP cases in China courts and arbitration. Today the progress is immense compared to the starting point and with a consistently positive trend line.

Practical Management of Intellectual Property in China

Today, the IP environment in China is not ideal. How does a company operate and protect its IP in China? The answer is with prudent management. Management techniques can be employed to minimize exposure, which center on the concept of compartmentalization. This is partitioning components of technology (hardware, software, process or application know-how) into “packages” and managing the exposure. We call this the Coca-

Cola® tactic. There are a number of ingredient “packages” that comprise the Coca-Cola® formula. Only a few people know the actual composition and total formula of Coca-Cola®. Even though there is no formal IP, the formula is a closely guarded secret. IP is not just patents, but it includes valuable process and trade secrets that enable a company to succeed.

Usually there is some form of compartmentalization that can benefit a product or process. Once a company has determined the form of compartmentalization, the next step is restricting access in such a way that the company is operationally and commercially effective yet sufficiently restricting access. In some cases, this could mean seeking multiple suppliers, each of whom only supplies a portion of a product. In other cases, it may mean supplying a critically sensitive component from outside China. Or, it could mean installing that sensitive “ingredient” functionality at the last moment before shipment, such as with software loads. In selected cases, it could mean segmenting your R&D department to partition access to core technologies even within your own company. There are as many paths to compartmentalizing technology. .

A company should insist that employees and suppliers with access to sensitive IP sign non-disclosure agreements and even non-competition contracts. These agreements are enforceable in China. Finally, with absolute certainty, companies need employees to understand the concept of IP or even what information a company deems confidential. Companies need to engage in active training and education programs to ensure that their workforce clearly understands the issues concerning IP.

Reports concerning IP in China are almost always oversimplified. China does not have the mature environment we have in the West; however, their legal system is developing quickly. Although not simple, Western companies can protect their rights in China courts today. These facts should not discourage businesses from entering the China market because with prudent management, a company can protect their IP and enter the China market with confidence.