



## **IP Protection in China: Dueling with the Pirates: Seven Successful Strategies**

How U.S. technology-based companies can stay ahead  
of the “China Curve” and prosper in the China market

By

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There is real money to be made exporting to China. China has more than \$3.24 trillion in foreign currency reserves. It can pay for whatever it wants from the West.

There can be no denying, however, that there are serious obstacles to prospering as an exporter to China. And no obstacle is more widespread or worrisome than the matter of intellectual property (IP) rights violations—otherwise known as pirating.

Chinese piracy threatens the profitability and, in some cases, even the survival of U.S. companies. Still, some firms have developed creative ways to beat the pirates. There is no reason to surrender to fear and unfamiliarity and not sell in the China market. Those who do will lose major business opportunities and let competitors in Europe, Japan, and

even Chinese companies dominate that marketplace. In other words, to tap the riches of the China market, you have to know how to fight the pirates.

As a China-born American citizen, I have served as a consultant to a wide range of U.S. firms to help establish them as successful exporters to China. From more than 30 years' experience, I have found that there are seven key strategies to follow in dealing with the piracy challenge:

1. Always assume that your product or technology will be pirated. The more successful your product, the faster it gets pirated.
2. Don't let fear of piracy keep you from introducing your product in the China market. If the product is attractive to China, some people there will try to pirate it.
3. Travel to China and study the weaknesses of the pirates and the real needs of your customers. Based on such field knowledge, design and improve your product and technology to stay ahead of the pirate's capabilities.
4. Don't compete with the pirates on price. If the pirate's price is 20% of yours but his product is only 80% of your quality level, focus your marketing effort on the quality-conscious segment of the Chinese market.
5. Discerning China customers want foreign-made products once they see how much better they are than pirated products. Educate your customers and make them see the difference.
6. Find creative ways to keep the secrets of your technology to yourself. How you keep such secrets should itself be a secret.
7. Pick the most talented people whom you can trust to work the China market and duel with the pirates. Don't send to China your weakest link.

The following stories of success in selling in the China market, along with a few cautionary tales, illustrate the application of these strategies.

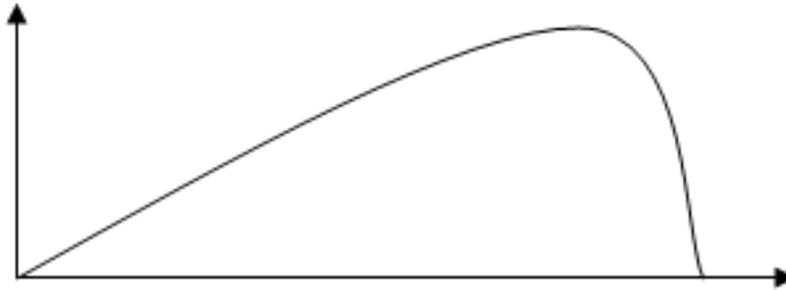
### **The China Curve**

The best first step is to be mindful of how your pirate-competitors in China think and act. This mindfulness—and your own ingenuity as you travel in that marketplace—will help you come up with the right solution to stay ahead of the China curve—a pitfall that confronts all exporters.

I worked with a scientific database company that invented a unique method to index global scientific literature. The product enables scientists, scholars, engineers, and researchers in all sciences, arts, and professions to know, within minutes, what articles have been written by their peers. The database tool enables them to retrieve such articles instantly so that they stay up to speed in their fields.

At the start of our marketing efforts for these databases, there were zero sales in China. We traveled to China, gave seminars, and visited research and development institutes and technical libraries of top-ranking universities. Within 16 months, we started to get orders. Sales grew dramatically year after year for the next four years. China bought more from us than we could imagine. We got visitors from the highest scientific authorities in China. The leaders who saw our operations, as I was told by an insider later, convened a national meeting. They wanted the nation's scientists and engineers to create a company just like ours to index Chinese-language scientific literature so that it could be commercialized and made known to the Western world.

After four years of increasing success in selling our database products in the China market, we noticed that our sales began to plummet precipitously. The sales chart



looked like an asymmetrical line that went up gradually, then plunged. A client called this the “OS Curve.” (I call it the China Curve because the long form of OS is not polite). The appearance of the China Curve is often the first sign that your products are being pirated.

All U.S. technology-based companies that want to succeed in selling their products in China must find ways to react when the treacherous China Curve appears. There is no way to avoid it. But, if you enter the China market with full awareness of its inevitability, you will be mentally prepared to lay down rules, precautions, methods, and proprietary measures to ameliorate the damage.

I remember the scene vividly. The head of a top-ranking Chinese university was willing to take me and a client into the stacks of her library, which were off limits to outsiders. She pointed at the hardcopy versions of our database products and stacks of other pirated books, journals, newspapers, and magazines. She started to smile rather uneasily and said: “Look, we can buy pirated copies of your products at 20% of what we normally pay you. Not only that, we don’t even have to jump through the hoops to change the yuan into U.S. dollars and remit them outside of the country—which is difficult and costly.” I could see that my client was writhing with anger and frustration. On another trip to China with yet another leading database company, I was present when a Chinese pirate-competitor said blithely to the Vice President of Sales of the firm (my

client): “Who cares, we just pirate your publications and sell them.” My client screamed at him in disgust: “I care!” In the meantime, the pirate still expected that the Vice President would choose him to be our agent. He had chutzpah.

To beat the pirate, and to overcome the inevitable China Curve, companies need to spend time traveling in China to speak with current and potential customers. Aside from learning about the nature of your specific piracy problem, you will inevitably also gain critical market information. The library director mentioned earlier told us that pirated products, though cheap, are intrinsically flawed. The paper used in counterfeit books turns yellow and decays within months. Thus, the pirated “collections” have no archival value. Also, the copying of the scientific literature was done by illiterate, low-paid workers who had no respect or understanding of what they were doing. They missed pages, photographs, and charts. Furthermore, as a prestigious Chinese institution, the leaders of the library could not bring themselves to let Western scholars and scientists see what they were using. It was not too surprising, then, that within a few years of the confrontation, the university began buying original hardcopy publications. These were proudly displayed in open book stacks for all to see—including distinguished Western scholars, scientists and business executives. People care about “face” when they are no longer cash-strapped.

To continue fighting the China Curve, my client instituted a number of measures. We started demanding that each and every subscriber to our database product submit the name of a contact person, the name of the subscribing institution, and provide the institution’s complete mailing address. Having this information cuts through the anonymity shield that import agents provide for their pirating clients. Our leverage to

force the release of this information is that we will not provide updates or after-sales service if the importer does not provide it.

I know of an engineering database company that installed a software program in its product sold in China. This software can detect if the user is a student or faculty member on a particular network. One time, the software detected an intruder. The company shut off data supplies. Within days, the library customer found the culprit and asked him to write a letter of apology to the company in the United States.

A procurement expert told me he saw a sophisticated, enormous piece of German-made machinery used in making paperboard for the packaging industry. To guard against piracy, the manufacturer sends a different password everyday from Germany to China in order for the machine to work.

China has its good Samaritans. A library director tipped me off when I was marketing high-value scientific literature there. She confided in me that any monograph that I was selling in China would be pirated automatically if it exceeded 75 copies per title. The information allowed me to change my sales strategy. Instead of hoping to sell many copies of a “best-seller” title, I switched my goal to selling limited quantities of the hundreds of titles that we published. China was an extremely profitable market for us as a result.

### **Conquering Fear and Unfamiliarity**

It is unfortunate that rampant and chronic piracy of U.S. products has intimidated some U.S. companies from exporting their proprietary products to China. Owners and managers fear that once they enter that marketplace, their products will be instantly

copied. This may well be true. But executives should keep in mind that their products can still be copied in China even if they don't try to export them.

A Chinese scientist told me in confidence that he grew up in China using pirated scientific CDs as he trained to become a physician. He said that there are people copying these information products in the United States and sending them to China regularly.

But we should not be deterred by visitors from China buying up everything while they are visiting the United States and duplicating everything upon return to China. I hope the following case will be a good cautionary tale.

A prestigious manufacturer invented a type of rotating equipment that was very successful. For at least 80 years since the company's founding, its products and brand recognition were beyond compare. The Chinese contacted this company and wanted to buy its technology. The company management decided that it would sell only an older version of its technology to its Chinese customer. They structured an agreement by which the Chinese customer would pay a lump sum at the outset to buy the older technology as a licensee plus a royalty per machine set that would be made in China. The agreement was signed. Money changed hands. The Chinese started producing the machine. But, the U.S. manufacturer did not believe that they would be able to monitor production at the factory of its Chinese licensee. The company did not put in the time and effort to collect royalties.

We visited the licensee and learned that it produced 3,000 machine sets without paying the U.S. licensor royalties. A purchasing manager of the Chinese firm told us that it was foolhardy for the U.S. company to lose heart and not ask for royalties. He said: "If the U.S. manufacturer were more China-savvy, they should have budgeted the cost of

hiring a Chinese person to keep track of the production at our factory. With a person at the factory checking, we would have paid them the royalties. But, since they never insisted that we pay; we never paid.”

### **Marketing Precision-Engineered Machine Components**

In 1984, I began helping a manufacturer to sell in the China market a precision-engineered machinery component that it invented. The founder’s invention made the modern steam and gas turbines possible. We recruited a capable Chinese agent who helped us visit with China’s largest original equipment manufacturers (OEMs) in the power-generation, petrochemical, and paper and pulp industries. We quickly found out that our components were pirated. A Chinese expert said to our agent: “Your product is so expensive that we will buy just one set of your components. We will reverse engineer your products, manufacture them locally and sell them at 30% of its cost to buy from you.”

Those were discouraging words but we didn’t lose heart. We continued to visit with current as well as potential customers. We researched power plants and mailed thousands of letters to educate Chinese engineers and end-customers on the superior quality and performance of our components. We learned that our low-cost pirate-competitors were able only to duplicate our less sophisticated models. Chinese nuclear power plants bought our most sophisticated and costly products because they didn’t want poorly-machined components to jeopardize their operations. We realized from talking with prospects that they were not confident using domestically-made products if the load and speed conditions are high. Furthermore, we discovered that there is a particular type of new engineered material that will bring down the temperature of the component. This

new material is not available in China. With this market information in mind, we used the new material in our product to ensure that our new designs are difficult to duplicate.

We also noticed that our Chinese OEM customers often incorporate our products in their equipment if they want to export them to India, the Middle East, or Latin America. By installing our components, they can demonstrate that their equipment works reliably and command a higher price. We hit hard on this advantage every time we give a seminar in China.

Contrary to what the Chinese expert told us 24 years ago, we have been selling our products steadily there ever since. In recent years, orders have come in such volume that we have a one-year backlog for delivery.

The biggest secret of our continuing success is simple and basic: our engineers and technical people who visit in China are fully aware of rampant piracy. They have been forewarned what they can or cannot divulge during technical and sales seminars. We won't tell even our best customers what is the tolerance of our component. We won't release internal, company standards on how to manufacture the product and control quality. We won't let people stick their USB flash memory drives into our laptops. We smile but we stay awake.

Recently, we got an order from one of our largest pirate-competitors. The pirate started out as a government-owned job shop to repair and maintain rotating equipment that China had imported from Europe, Japan, and North America. They made pirated copies of our products as well as those of other Western suppliers. After years of producing home-made components and servicing foreign-made equipment, the erstwhile pirates got smart and decided to become an OEM rather than a job shop. They realized

that, with knowledge gained from fixing so many different machinery types, they could make whole machine sets and sell them at higher profits. Our pirate-competitor has been trying to copy us, but they can't hit the spot. They've finally become a customer.

### **Dueling with the Pirate**

Not all companies are afraid of China. After hearing too many horror stories about pirates and the unbeatable "China price," a company that makes a specialty metal part decided to take the China market by the horns. We identified a representative in China, went to a trade show, took advantage of U.S. Government trade services, and visited current and potential customers on a trip to China.

Several months after our first trip to China, pirated copies of our metal parts and our products began to show up on a Chinese Internet website. A pirate lifted pictures and descriptive passages in English from our website. He even put his company's own logo and water marks on our pictures.

We contacted our pirate-competitor and asked for samples, which he sent. We called him on the phone and talked to him for 90 minutes. He told us that he wanted to "cooperate" with us. He did not have the moral forthrightness to admit that he is pirating our products, but he did say one thing that illuminated the global nature of piracy. He said that he started making the same product because someone in South Africa (a customer of our) had asked him if he could produce our product at a lower cost. That got his entrepreneurial juices flowing. The closest he came to admitting pirating our product was: "Oh, I've finally found the ancestor (he means us, the inventor) of my product!"

Right after our telephone conference, he sent me an e-mail declaring that he planned to target the American market in a big way. A few days later, he added even

more products and pictures on the website, including pictures of the products of our competitors in the U.S. He demanded that he should become our supplier.

We are not fazed by the moves of our pirate-competitor. One thing we know is that his products are badly made in certain critical places. We are not in a hurry to teach him how to improve his quality. We know the real secrets that make our products better.

### **Safeguarding Software in China**

Not all piracy problems have immediate solutions. I worked on a case recently with a software company that has a sophisticated product that can be applied in a wide range of technology-based industries. The company received an unsolicited order from a customer in Taiwan. A couple of years later, the general manager of the software firm had an opportunity to lecture at a top-ranking university in China. His host led him into the computer facilities of the school. There, he discovered that his company's program—which he did not recall selling to China—was duplicated and sold to a nationwide network of Chinese polytechnic institutes. In fact, just about all major electrical engineering departments in China had a pirated copy of his company's software.

His representatives in China and Hong Kong were unable to get the top-ranking Chinese university to stop using the software. The university claimed that they paid top dollar to buy it from a Taiwan firm, who pirated and sold the counterfeit program without the U.S. company's permission. We appealed to both the highest authorities in the U.S. Government and the Chinese government in vain. Some of the authorities did not bother to respond to our certified letters.

Armed with knowledge gained from failure in dueling with that particular software pirate, the company instituted a set of procedures to safeguard future sales in

China and other Asian markets. The general manager adopted a more prudent mindset. He said: “Now we know that we are operating in a ‘frontier’ environment and we need savvy, dedicated, trustworthy staff in the U.S. that will keep a tight rein on our Greater China employees and distributors.” The company now questions everything that has the slightest potential of being suspicious. It has become less trusting of its distributors and even its own employees in China and Taiwan. The manager took to heart the fact that someone who had shown an interest in being his distributor played a significant role in harming his company financially. “You should know you will get very little if any help from anyone at any level of authority in business or government in China or the U.S. government if your business is small,” he said.

All software sales to Asia are put on “red alert.” The company now visits China and other Asian markets more often. It has put in place additional restrictions on software shipped to Greater China. It questions any and every discrepancy in communication or paperwork and holds orders or requests until it obtains clarification.

### **Piracy Is An Endemic Activity**

Whenever a product has a market, it will be pirated somewhere in China. Chinese companies have to fight off pirates in their home market. The Chinese people aren’t flabbergasted by piracy because everyone grows up knowing piracy as a fact of life. This is the downside of a society where the rule of law is neither always predictable nor enforceable. People learn how to profile one another. They must play mind games, which slow down commerce and make every little decision a chore. A client often says to me: “You can’t do anything in China with a fight.” He is perceptive.

Chinese people who grew up in Hong Kong, Taiwan, Macau, and, of course, Mainland China know how people there think and act. In fact, even people in South Korea and Japan—who have lived and traded with the Chinese for centuries—know how to handle the psychology of people they must live with. It is not accidental that these other Asian nations and territories have a trade surplus with China.

Americans grow up in a law-based, individual-based society as opposed to a patriarchal, clan-based society. As a result, Americans are less ready to handle the cultural intricacies of the Chinese marketplace. A client once said to me after a few days in Beijing: “I need to unlearn everything and re-learn something else.”

### **What If You’re Not Chinese?**

There are two more things American companies can do to beat pirate-competitors and overcome other market-entry barriers in China.

The first and foremost task is to identify and cultivate an “insider” in the China market. This person should be skilled in dealing with the thinking and behavior of customers and partners. You need people like these to communicate to you what is going on in the market on a day-to-day basis. You need them to negotiate with the Chinese—negotiation in China is a separate occupation all on its own. You need them to wine and dine people, to interface with local and national government agencies, to interact with all kinds of people—the good, the bad and the ugly.

### **The Advantage of Not Being Chinese in the China Market**

The second task is to put in time to study the market in person. In this effort, being a “non-Chinese” person frequently has its advantages. Your customers and contacts in China may be more than willing to communicate with your country insider. But, they

equally want to see people from headquarters show up in China. They desire to see non-Chinese policy-makers and technical professionals for a number of reasons. Some want to make sure that what your insider tells them is consistent with what you tell them. Some want to see the right corporate authorities show up in China so they can be convinced that your company is serious in building a relationship with them. Others want to probe into the technical details and seek technological help that no one in your China office can handle. Some genuinely want to know the state-of-the-art developments in their fields. Dueling with the pirates in the China market and beating them at their own games is possible. The secret is to build a team of Chinese insiders and non-Chinese players who work together and apply the proven strategies I have described.

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#### **About the author**

James Chan, Ph.D., president of Asia Marketing and Management (AMM), advises U.S. firms in marketing American-made products and professional and technical services to China and Asia. Go to <http://www.AsiaMarketingManagement.com> for more details.