Insights from the P.R. China
on
Multinational Intellectual Property Inflows

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Abstracts: Since China established its policy of intellectual property (IP) protection from the 1980s, the merits and drawbacks of the emerging IP system have been feverishly discussed in and outside China. However, a systematic study on the practice of multinational enterprises (MNEs) in China from an IP perspective is a blank spot. This article, based on a survey of 51 UK and US MNEs and their subsidiaries in China, is to evaluate the problems these companies have encountered as a consequence of their IP flows into different Chinese enterprises. It is also to analyse the causes of the problems and to suggest possible methods of avoiding future problems.

Key Words: Intellectual Property, Multinational Enterprises, and International Business in China

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INTRODUCTION

Under the "Open Door" policy since 1978, the intellectual property (IP) system in China was set up systematically but swiftly to meet the needs of economic development. IP protection (IPP) is the key to providing investors and technology owners with a secure environment, and thereby to attracting capital and technology. Consequently, China promulgated numerous laws and regulations to protect IP, i.e. patents, trademarks, industrial designs, utility models and other IP rights in just a single decade running from the early 1980s to the early 1990s. Administration and enforcement relating to IP were also established during this period. From the 1990s, China has amended its IP laws twice to keep in line with the regulations in the world.

Parallel to the development of IP itself, IP in China has also become a heated topic in the research world. However, as far as the subject is concerned, the research has not deviated from the mainstreams of IP- Law and Economics. Macro level of studies on IP is especially rife, particularly on the legislation, administration and enforcement (Bosworth and Yang 2000, 2002; Wang 1996; Wen 1996; O'Connor and Lowe 1996; and Zheng 1995-1999). Therefore, a systematic study on the IP practice of multinational enterprises (MNEs) from a management perspective is apparently missing.

This article empirically explores IP from the standpoint of corporate management based on a problem-cause-solution framework. After over a decade of experience of the IP system[1], the merits and drawbacks have become apparent and specific. This particularly concerns the nature and form of Sino-foreign IP co-operation. The rationale for the present work was the need for a systematic study, due to the lack of previous research and empirical work, of corporate IP inflows influenced by this emerging system. Additionally, the

[1] The IP system in China was systematically set up in 1990 when the *Copyright Law* was promulgated, which symbolised that a complete legal framework for major IP, including patents, trademarks, and copyrights was in place.

experience accumulated must be put into the context that China has amended 2300 regulations after the entry of the World Trade Organisation (WTO) in December 2001 (www.chinafair.org.cn). IP inflows here refer to the applications and grants of IP rights by the Chinese government to foreigners within China.

The research results are revealed with the following structure based on the afore-mentioned objectives and rationale.

1. Methods
2. Current IP System in China
3. IP Activities from Foreign Countries
4. Analysis of the survey results
5. Implications

1. METHODS

The empirical study combines various forms of bi-lingual questionnaires and interviews. Postal questionnaire responses from IP, technology and development managers from the UK, US and China formed the main source of information for the preliminary studies. In total, 183 questionnaires have been distributed, including 63 questionnaires to UK and US foreign-invested enterprises (FIEs) in China, 63 MNEs in the USA and 57 MNEs in the UK - with two follow-up questionnaires to non-respondents. The target companies for questionnaire distribution were sampled and screened from the *Top 500 FIEs in China, Fortune* 500 and *Times* 100. Telephone and email interviews were initially supplementary tools to the mail interviews to clarify the questionnaire responses. In the later stages, they also served to provide in-depth studies of the companies.

As a result, over 30 telephone interviews have been conducted, mainly in the UK because of the locational advantage. Personal interviews have been carried out in 18 companies, including ten in China and eight in the UK. More than 100 emails have been

exchanged with companies from the three countries. A total of 51 companies responded to the questionnaires (valid responses), accounting for 28 *per cent* of the total questionnaire distribution, but 51 *per cent* of the responses. The 51 companies include 23 FIEs in China, 18 and 10 MNEs in the UK and US respectively. All these companies were involved with IP flows into China.

This survey has targeted the UK and US MNEs, and their FIEs in China as a source of empirical research for a number of reasons. Firstly, the US and UK are two leading countries in advanced technologies in the world. Secondly, They have played a very significant role in IP inflows to China (Table 1). Thirdly, these two countries resemble in culture and share the same language making it easier and more convenient for the author to do the necessary empirical work and to communicate with interviewees. Fourthly, they represent the other extreme of culture *vis a vis* China implying that MNEs from those two countries are likely to face greater problems in dealing with IP flows into China. Finally, the US is the main advocate in promoting the development of IP in developing countries. The EU, including the UK, generally takes the US line in this respect. Thus, these two countries tend to be more sensitive to IP issues than any other countries.

** Take in Table 1**

The survey result shows that 90 *per cent* of the companies prefer to have their individual names and companies undisclosed. Therefore, in the analysis, the author will respect the wishes of those individuals and companies, and will conduct the analysis in anonymity.

2. CURRENT INTELLECTUAL PROPERTY SYSTEM IN CHINA

The current IP system in China has a complete legal framework, administration and judicial enforcement, which has been in existence for just a little over one decade. In relation to the

legal framework, the meaning is two-fold. Firstly, it refers to the two-tier legislature, i.e. the National People's Congress and its administrative body – the State Council as the first tier, and the central government organisations and Provincial People's Congress as the second tier. They all have powers to promulgate rules, regulations and laws. Secondly, the legal framework refers to the IP mechanism. The IP laws and regulations began to take shape in 1982 when the trademark law was promulgated (State Council 1994:3). In less than ten years, a raft of IP laws and regulations were announced. These include *Patent Law* for inventions, industrial designs and utility models (1984, revised in 1992 and 2000), *Trademark Law* for trademark and service marks (1982, revised in 1993 and 2001) and *Copyright Law* for copyright, its neighbouring and moral rights (1990, revised in 2001).

In addition to the legislative guidance, administrative control was also established in the 1980s responsible for the examination of IP rights, interpretation of laws, supervision of activities, and administration of disputes. It comprises the State IP Office (1980, renamed from the Patent Office in 1998), the Trademark Office (1982), and National Copyright Administration (NCA, 1985). China Copyright Protection Centre under the NCA established in 1998 is responsible for the computer software protection and administration (Bosworth and Yang 2000). The administrative control has also been established at the ministerial and provincial levels to supervise IP implementation within their jurisdiction. For example, the State Drug Administration (SDA) under the State Council has the Office for Administrative Protection of Pharmaceuticals. China Custom has its own division for IP border control. The Ministry of Foreign Trade and Economic Co-operation (MOFTEC) has a department dealing with trade-related IP issues.

Legislation and administration of IP need judicial power to enforce the execution of IP – the Chinese People's Court system. The people's court system comprises four tiers- Supreme (central), Higher (provincial level), Intermediate (provincially administered cities),

and Basic-Level People's Courts (town and county level). Individuals or organisations can bring a lawsuit to a people's court. If they do not agree on the judicial verdict of the court, the case can be pursued to a higher court. The verdict from a court at the second proceeding is final, i.e. no further legal proceedings are allowed. Moreover, special People's courts or specialised IPP divisions dealing with IP disputes, have been established within and above the Intermediate People's Courts – since 1992, namely, the IP Adjudication Divisions (State Council 1994). These special courts have jurisdictional powers that enable them to handle IPP issues more efficiently.

3. INTELLECTUAL PROPERTY INFLOWS FROM FOREIGN COUNTRIES

The rapid establishment of the IP system in China shows its effect partly in the IP inflows from foreign countries. For patenting activities, in the 1980s, applications by foreign and local Chinese are roughly equal and steady, but from the 1990s, the overall applications increase tremendously with foreign applications outstandingly dominating. For example, in year 2000, foreign applications accounted for 79 *per cent* of the total 12,2306 (www.wipo.org). From 1985 to 1994, the foreign grants accounted for 60 *per cent* of the total in China, which implies the higher quality of non-residents patenting inflows (Bosworth and Yang 2000). However, the gap between foreign and local patent holders is gradually narrowing down from 1995. This indicates that residents are making progress in technology development under the influence of technology transfer policy.

Unlike patents, non-residents play a very insignificant role in the applications and grants in the case of utility models and industrial designs. The ratio for applications of utility models between foreign and local applicants is only 1:141 (Bosworth and Yang 2000). Utility model activity in China increased from 10,000 at the beginning of the period to 70,000 in 2000 (Yang and Clark 2002). This indicates the boom that has occurred in lower level of

inventive activities in China. For industrial designs, on the whole, foreigners only accounted for 12 *per cent* of the total applications, and 18 *per cent* of total registrations (Bosworth and Yang 2000).

Trademark activities show a much high activity level because the *Trademark Law* effective in1983 allowed the Chinese applicants to register their existing trademarks. Until 1995, applications for trademarks developed constantly at 20,000 annually. However, they have increased rapidly since then for both local and foreign applicants, but the proportion from foreigners is very small. Moreover, there is little difference in the ratio of registrations to applications between residents and non-residents. Foreign trademarks accounted for only 14 *per cent* (*op cit*).

Foreign IP inflows to China have been dominated by the triad powers – the US, Japan and EU. This is especially the case for foreign patenting activities in China. The three countries accounted for 86 *per cent* of the total inflows (Bosworth and Yang 2002). This shows the leadership of the triad powers in technologies. For the inflows of industrial designs, the three major developed powers still dominated the inflows, but with much less significance compared to patenting inflows accounting for only 36 *per cent* (Bosworth and Yang 2000). Trademark inflows by the triad powers are in between these two dominating 63 *per cent* of the total foreign activities (*op cit*). The overall trends indicate that the major developed countries have been substantially influential in pushing forward the technological progress in China.

4. ANALYSIS OF THE SURVEY RESULTS

The survey results are analysed based on a framework of identifying problems, detecting causes and isolating possible solutions. The empirical analysis does not attempt to cover all

the problems that the companies have experienced, but concentrates on some relatively common problems.

4.1 Identifying Problems

The survey shows that 69 *per cent* of the companies have encountered different extents of problems in China in the process of IP activities. More specifically, 43 *per cent* of the companies encountered problems with their partners within the companies when dealing with IP flows, and 49 per cent of them reported that they had experienced problems with Chinese companies.

4.1.1 Flexible Contracts

Conflicts on Contractual Obligations

All the companies have reported problems of the loose and flexible nature of the contractual agreement. “Loose” contracts here refer to those which are very general, without sufficient range of specific stipulations. “Flexible” contracts mean that the items in a contract can be changed, based on the negotiation as and when the situation changes. Foreign partners have complained that breach of an IP contract has been frequent amongst Chinese partners. When a know-how contract is breached, it indicates that the know-how secrets may be leaked and their commercial value may be undermined. Foreign partners generally believe that a contract should be as specific as possible to avoid any future conflicts and wrongdoings. Chinese partners prefer a general contract and do business based on trust, which can facilitate further negotiation in the future. A partner might negotiate and change the rules of a contract after it is signed. Such practices have been a source of considerable frustration amongst foreign partners.

4.1.2 Non-Payment of IP-Related Services

Another problem with Chinese partners and companies is the non-payment for IP-related services. The non-payment for IP services was reported by 16 of the responding companies. It should be noted that most IP related services provided by foreign partners have not been very clearly stipulated in the contracts. In other words, separate payments should be made for each service. Chinese partners believe that once there is a partnership, everything should be shared – a view that is contrary to Western philosophy.

4.1.3 Difficult to Protect Know-How

Know-how or a trade secret is protected under the *Anti-unfair Competition Law* in China. It implies that they can be kept forever if there is no leakage. However, some interview companies revealed that, in practice, Chinese partners demanded a maximum ten-year secrecy term, emphasising that this ten-year limit is required under the Chinese law. However, there is no such stipulation in any of the relevant laws in China, and such demands inevitably impede the transfer of foreign know-how to China. One company indicated that, "… there is a general feeling that Chinese partners do not respect confidentiality as we do." Another company argued that, "… it can be difficult or nearly impossible to provide for trade secret confidentiality of indefinite duration, which is often required commercially." As a consequence, this method of protecting trade secrets and know-how hinders or prevents the transfer of advanced technologies and techniques.

4.1.4 Counterfeiting

Another severe but unsurprising problem associated with Chinese companies is counterfeiting and unauthorised use of protected IP. Responses from survey companies indicated that they had been the victims of counterfeiting and unauthorised use of their technology, techniques and trademarks, accounting for more than 51 *per cent* of the survey companies with IP problems. This validates the belief, found in many studies, that China is "… the centre of

counterfeiting" (Robins 1994). This research result is also compatible with statistics on counterfeit products from the US customs. In the first half of financial year 1999, for example, the US Customs Services seized 1,928 counterfeit products worth over $73 million. China represented the single biggest offender, as 38 *per cent* of the seizure was of Chinese origin. Taiwan and Hong Kong came second and third as counterfeiters at 11 and 9 *per cent* respectively (Anon. 1999).

4.1.5 Other Common Problems

Responding companies also pointed out other mutual problems in dealing with IP flows with Chinese partners. They include misappropriation of funds, difficulties in negotiating IP contracts, and miscommunications in the process of negotiation and co-operation. As these problems resemble the ones in ordinary partnership operations, we will not discuss them in details, but just mention them here in passing.

4.2 Detecting the Causes

4.2.1 General Analysis

The different causes detected by the companies are summarised in Figure 1. The majority of the companies responded indicate that culture is a fairly important issue when a company transfers its IP to China. As for "required royalties", majority of the interviewed companies did not have significant problems in this respect. It should be added, however, that companies should always pay significant attention to the issue of royalties when they design the associated contracts and undertake IP flows.

Figure 1 about here

The results with respect to financial constraints amongst Chinese recipients are the most evenly spread of all. Although most companies consider it "slightly important", eight

companies emphasise that this is "very important". They have argued that suppliers can successfully transfer their IP into a company if there is no financial constraint. Management differences have been stressed constantly as a "very important" element when problems occur. This indicates that different companies have different and potentially incompatible management styles, which can generate a range of different problems.

Figure 1 suggests that the recipients' capability to understand and absorb new technologies played an important role in ensuring the success of IP flows. The result is even more marked in the case of "technology control", with most of the companies regarding it as either "very" or "extremely" important. Most companies chose "moderately" or "very" important with regard to the inadequacy of Chinese IP legislation. This implies that companies should exercise stringent control over their ownership of IP, which prevents their rights from infringement. The results also imply that companies have a wide range of opinions about the adequacy of the Chinese IP legislation.

Finally, insufficient judicial enforcement appears to be of significant concern; 46 *per cent* of the companies reported it as "extremely important" to reinforce IPP. The majority of the companies chose above "moderately important", which accounts for 89 *per cent* of the responses. These results clearly demonstrate that the judicial enforcement of IP laws has been a source of problems, even though there is some evidence that a relatively adequate legal framework has been established.

4.2.3 Topical Discussions

Non-Partner Involvements

Apart from the above common reasons, one notable feature of Sino-Western partnerships is the generally high level of involvement of relevant Chinese organisations. Most Chinese partners are state-owned enterprises (SOEs) and collectively-owned enterprises (COEs), which are to a greater or lesser extent affiliated with relevant Chinese government

organisations. Although such affiliations are becoming weaker with the open economy, company reliance on the government for leadership and directions is still common.

During a negotiation, it is very common that the Chinese negotiators do not reach a final decision on issues under discussion. They have to report back to their superiors in the government. Upon approval from the relevant higher authority, a contract can be signed with a foreign partner, after which, it has to be resubmitted to relevant government departments again for formal approval, depending on the size of the partnership. It is the Chinese government that draws up a model contract, not the different Sino-Western partners. Thus, it is not possible to negotiate a contract entirely based on the partners' requirements. As a matter of routine, Chinese partners have to report to relevant government departments and organisations about all aspects of their collaborative activities with foreign partners. Because of the involvement of government bodies, contract negotiations can be protracted, which can affect the efficiency and effectiveness of the enterprises concerned and operation efficiency can be severely affected.

The other form of non-partner involvement concerns Chinese lawyers. Chinese lawyers play a substantial role in the negotiation and drafting of contractual agreements. Western lawyers are also involved in the negotiation and drafting of international trade agreements. Western firms, especially large organisations have their own in-house lawyers and even law departments. For example, Arthur Anderson Consulting has its own legal consulting services in the company. These in-house lawyers are very active in such transactions either up front or behind the scenes. The difference is very clear here that Chinese lawyers are usually not part of the company involved in contracts and negotiations. This is less common in Western countries and often strange to foreign partners because the use of outside lawyers implies unnecessary costs. The considerable involvement of Chinese

lawyers from outside to some extent adds to the complexity of collaboration between Sino-foreign partners.

Polarised Views on Negotiations and Contracts

Breaches of contract and non-payments for services are fuelled by the existence of two extreme points of view about negotiations and contracts between Western countries and China.

- Western companies believe that contracts should be as specific and tightly defined as possible (i.e. as "complete" as possible) in order to avoid future problems and eliminate the possible influence of personalities from such deals. Thus, a great deal of effort is expended in negotiation and drafting of contracts and, once signed, the relevant parties are expected to abide by the contract stipulations. Any act or acts that do not conform to the contract are deemed to be a breach of contract.
- The Chinese view on contracts tends to lie at the opposite extreme, and posits that flexibility from all partners should be the "rule". In this case, it is customary that an IP contract should be simple initially. Future negotiations would modify the contract on a continual basis, "… with the benefit accruing to the party most skilled in the arts of commercial, political, and power manoeuvres and negotiations" (Interview data). Long term trust and good relationship are paramount for co-ooperation.

  A contract should only be valid when the conditions and environment in which it was negotiated remains the same. If one party believes that some items have changed since the contract was signed, no matter if the issues have been dealt with in the original contract, this party might not only claim the need to change the contract, but also act accordingly prior to the signature of another contract. Therefore, it is not surprising to hear and see non-payment for IP services because "…conditions have changed" (*op cit*).

Public *versus* Private Ownership

Sino-Western partners have a different sense of ownership, which consequently influences the way in which they conceive IP. The mentality of public ownership and collectivism had been deep-rooted in China for almost 30 years prior to the introduction of the "open door" policy in 1979. From 1949, the socialist regime had preached that everything belonged to the state and that there was no place for individualism in a socialist society. Therefore, even inventions made by individuals belonged to the state and, as such, everybody could share the resulting benefits.

The notion of public ownership is too ingrained for these policies to have an immediate change. The reality is that most JV partners are established with a mix of public ownership on the Chinese side, such as SOEs and COEs, and private ownership on the foreign side. Under such circumstances, problems are inevitable. IP itself is a private right, which is usually licensed from the foreign to the Chinese partner. This licence is as either part of a specified package in the partnership agreement, or a separate contract. However, the mentalities of the partners are too distinctive to be ignored in Sino-foreign cooperation.

Counterfeiting

The main reasons for counterfeiting has been summarised based on the survey.

Popularity

The more popular the foreign product or technology in China, the more likely it is to be imitated by other companies if protection is not stringent. Take the well-known trademarks for example, their popularity soars globally with time. It is not surprising, therefore, to see related business activities booming as well, because consumers want to feel a sense of identity with a brand-name.

"Small Men" are Exploiting

Even though purchasing power is low, the demand for products with brand-names and sophisticated products remains high in an increasingly consumer-oriented society. This is why there is a massive counterfeiting of famous brands in China, such as Pierre Cardin, Levis, Crocodile, etc. However, brand-names are so expensive that the majority of Chinese cannot afford. The annual income per person in China is under £2000. Thus, the "small men", as one manager calls the counterfeiters, have found opportunities to exploit potential market by manufacturing fake products, and this has led to the breaching of licensing contracts.

Distance Exerts Little Control on Management

Distance has created a severe problem between foreign companies and China. There are two perspectives of distance: firstly, with regard to the size of China; secondly, with reference to the distance between foreign countries and China. These two dimensions of distance underpin the difficulty of exercising control of counterfeiting in China. For example, when a counterfeiting activity is prevented in one area, another infringement activity occurs in some other part of the country. "Distance" has contributed to more serious problems when there is no involvement of foreign management and operations in China, especially for licensing, and sub-contracting. When problems occur, local agents or representatives will just deal with them. However, this tactic does not prevent or deter counterfeiting from happening, but only attempts to stop the existing counterfeiting problems. Additionally, the size of China further creates barriers for close surveillance.

Passive Chinese Government

The problem of distance has magnified the incidence and extent of counterfeiting in China, in the meantime, interviewed companies complained the passive attitude and actions from the

Chinese government. “The law in China is very local.”, stated one manager. Although China promulgated IP laws, its implementation regulations, driven by the open door policy, the laws are more oriented towards national than foreigners’ interests. However, to some extent, this is understandable, because law itself is nation-based. The Chinese government is passive in dealing with the issue of counterfeiting. They will take action if the aggrieved party finds evidence about infringement, but the penalties are relatively small and administrative in nature, such as warnings, public apologies, various fines and compensation. Consequently, it is not in most companies’ interests to bring the infringers to court because “The Chinese care about ‘face’. It is a very severe punishment for infringers to have to expose themselves in public.” (Interview data).

This passivity implies that the Chinese government has been co-operative only where victims can themselves find and provide sufficient evidence to prove behaviour constituting an infringement. Only at this point do the Chinese government organisations take administrative action to discourage the offending behaviour. However, if the owner of the IP rights avoids taking any action, it is inevitable that infringement will continue unabated.

Contracts were not Specific enough on Punishment of Infringement

Early description about the different views between Chinese and foreign managers tell us the nature of contracts in China. Therefore, unsurprisingly, this survey shows that the problems of counterfeiting often result indirectly from contracts when partner infringement occurs. The contracts cannot guide and safeguard IP flows because they are not specific enough and do not detail the necessary items for IP transfer and protection. It is often the case that there was no specific stipulation as to what action a licensor should take when licensees exceeded contracted production. Contracts should be an important tool to make partners abide by the rules.

Inadequacy of Penalties for Counterfeiting

The research shows that inadequate penalties apparently lead to ever increasing and destructive counterfeiting. While fines, confiscation, compensation, revocation of business licenses and criminal charges can be used by the authorities to combat infringement, it is clear that the existing penalties are too lenient to prevent counterfeiting. The fines, which are normally between one and three times of the illegal income (*Anti-Unfair Competition Law* 1993: Art. 21), are not punishable enough to counterfeiters. Confiscation only stops an existing infringement, but there is no preventive function. Additionally, the concept of "illegal income" leaves too much latitude for interpretation – as it is often too difficult to find evidence that the counterfeit products have been sold, technically there is no illegal income.

Moreover, there is little explanation in the IP laws as to what actions should result in a criminal charge. The counterfeit products are often returned to the IP owners and their licensed manufacturers. Consequently, counterfeiters are not punished in a way that could prevent them from infringing again. If, after a while, they play the same game again, IP owners and their licensees have to seek redress by taking the same administrative route, or legal proceedings, which are often costly and unpredictable.

4.3 Isolating possible Solutions

There is no universal panacea that would solve problems arising from IP, as they are usually very diverse, and need to be solved individually on a case-by-case basis. However, a number of strategies emerge from the questionnaire responses. Further insights can be found by analysing the experience of companies that have not solved their IP problems. Moreover, the companies that report no problems also have experiences that may contain lessons relevant to other firms. The following analysis endeavours to provide broad recommendations and general ideas with regard to solving the problems identified earlier.

4.3.1 Multilateral Relationships

The first possible solution for less conflictive partnerships is *via* the establishment of multilateral relationships, i.e. multilateral partnerships with more than two business partners and multilateral networks, such as those involving government organisations and relevant product associations working to enhance business from outside. The aim of the expansion from a bilateral partnership to a wider multilateral one is to pool the common "interests, involvement, influence and official capacity" to enhance collaboration and mutual benefit. Moreover, multilateral relationships involve the mutual supervision and control of any unilateral breach of contract because more than one party could be affected.

The second multilateral relationship takes the form of a multilateral network. "Guanxi" is part of the Chinese culture. Establishing a business-related network by incrementally moving the relationship from local- to state-level will facilitate the multinational partnership. This network could help partners to improve their relationships and to resolve problems by negotiation, and mediation. As one interviewed manager indicated, "We must maintain a regular presence in China and talk and talk and talk. … Relations [are important] – you must get to know the Chinese managers and scientists and this takes 'face' time. Letters or emails or fax, etc. do not work." (Interview data). This not only implies the importance of communication between Sino-foreign managers but also reflects the lack of communication that often exists in their co-operation.

4.3.2 Quality Contracts from the Start

A second way forward is to have well-specified, high quality contracts from the very beginning. Chinese business practice of adopting a general contract, which then forms the basis for negotiation on a continual basis, can only give rise to problems and be detrimental to future collaboration. In order to avoid this, it would be best to go through the pain of eliminating differences and specifying a more tightly defined contract from the outset. In

other words, a foreign partner should emphasise the need for as “complete” a contract as possible in order to avoid future wrongdoings by any of the parties, whether partners, licensors and/or licensees.

4.3.3 Internal Management

Product Management

Modern technology has made IPP more advanced. For example, some companies have taken some technological measures to prevent counterfeit products from being sold. For trademark protection, an ample light test[2] is undertaken to check for counterfeits. Fake products show differences from genuine ones under ample lights because genuine trademarks have expensive signs on them for which counterfeiters do not have the money to spend. Moreover, some companies have also used a kind of secret blockade on their products to effect the same purpose. All of these represent an increased, but, in the light of the counterfeiting activity, a necessary burden on companies in terms of additional manpower and costs. In addition, these companies have applied stringent controls on the supply of the trademark badges to the Chinese producers. Therefore, when the products are imported into the UK market, proper inspection is conducted to prevent fakes from entering. However, the product control above indicates that counterfeiting can only be prevented in the country where action is taken against infringement. Unless there is an action in the producing countries like China, counterfeiting will still continue to damage “rights” holders’ interests.

Licensing Management

Many companies feel helpless about licensees who exceed the required amount of production. Only insiders know the extent of this kind of counterfeiting problem. However, licensee counterfeiting to some extent, is controllable in two ways. Firstly, licensors can stipulate very specific punishments to their licensees, who breach the contract by exceeding

the production amount the licensor requires. A number of specific areas of potential future conflict between partners can be specified in a contract. The contract should stipulate what actions a party should take if the other party breaches the contract. Secondly, companies with IP flows into China should increase inspection and supervision of the production and marketing of their products. A British IP manager indicated that they were very keen to establish a good working relationship with China, but there were difficulties to overcome because of the distance and, therefore, costs involved.

Some companies, especially some licensors reply on their agents, who might locate in large cities in China, to deal with their problems. Therefore, these companies have not organised their operations in the best way. There are grounds for believing that this is not sufficient to solve the problems companies have encountered in China, as most agents do not work for just one company, and they have limited time to commit to just the issue of counterfeiting prevention for one particular company.

Brand Protection Communication

Another useful strategy is for companies to establish communication networks with other "brand name" companies operating in China. Some counterpart company managers, such as Levis, Puma, etc. meet regularly to discuss their experiences of counterfeiting in China and other countries, including the problems they have encountered and the measures that should be taken to solve these problems. This alliance helps companies learn from one another and plan joint actions.

[2] An ample light test refers to ultra-violet light test to trademarks in order to tell the fake products from the genuine ones.

4.3.4 External Control

Supervision and Inspection

The purpose of exercising vigilance over the Chinese market is to find out if Chinese manufacturers are licensed, and if products that are manufactured and sold in China are legally based on licensed inventions and/or trademarks. The recommendation here focuses on the passive role of government and the related agents' limited responsibilities. It is not in the interest of many companies to deal with counterfeiting problems by taking infringers to court. This is because, on the one hand, it is too costly in time and finance, and on the other hand, it is not necessary to exact criminal penalties because financial punishment and public apologies are more effective ways to deal with the problem and educate infringers. Thus, many companies prefer administrative solutions, such as warnings, injunctions, public apologies, fines, etc.

Administrative and Judicial Support

Relevant government organisations in China have been passive and have limited manpower to spend time on investigating specific misdemeanours. Nonetheless, where sufficient evidence is available, they are very co-operative in taking action to punish infringement. Therefore, it is important that, before a company asks the government to move against infringers, it should find enough evidence to motivate the relevant government organisations to take action. Inspectors are needed to supervise production and marketing activities. These people may only be assigned from the licensing companies and must be dedicated to this one task, otherwise, it is very difficult to prevent and stop infringing activities in China. This policing strategy seems to work better in China in countering infringement, especially in preventing intentional infringing activities. In order to prevent and stop infringement in China, companies must work closely with the manufacturers and with the Chinese government, as well as educating consumers not to buy fake products.

4.3.5 Operational Involvement

Doing business in China forms an important long-run strategy for many companies. For example, some companies have been involved in loose contractual business relationships with Chinese firms for almost 30 years. However, these relationships have been based on licensing, and sub-contracting, they have not had any significant direct involvement in production and selling in China, and agents from China are involved in the business.

There are grounds for believing that stronger operational relationships should be established in China. The purpose for doing so is to be involved in the day-to-day supervision of production processes, and in the examination of products from different factories to make sure they are genuine, as well as the investigation of infringement and the education of consumers. The result of direct involvement would be that, in the long term, counterfeit manufacturing and selling problems would be less severe.

4.4 Success in Cross-border Intellectual Property Flows

A good deal of effort so far has been made on the problem-cause-solution analysis. However, although companies have encountered varying degrees of problems – in some cases without them being fully resolved, this does not imply that the companies have failed to transfer IP to China. On the contrary, companies that did not report any problems of IP flows in this survey have discussed their successful experiences. The following discussion summarises them with regard to the factors leading to effective IP flows.

4.4.1 Patience

The importance of patience was identified by 63 per cent of the responding companies. It is pointless for IP providers to be in a hurry when Chinese partners wait and see. Although modernisation of China in many areas is initiating an acceleration of the pace of business, it is hardly “fast” by Western standards. Patience is important in Chinese culture.

There is saying in China, that, “Men in a hurry do not succeed.”. Thus, when foreigners become involved with IP flows into China, it is important that they accommodate the slower cultural pace of the domestic firms.

4.4.2 Good-Partners and Good Relations

In the present survey, 63 *per cent* of the respondents further emphasised the importance of good partner relations in the context of IP flows. There are two aspects to a “good partnership”. The first concerns the need to select a suitable partner. In China, the pace and extent of economic development is diverse across sectors and geographical areas. In some regions, highly sophisticated and well-developed enterprises have adopted a westernised approach to business, have the internal capacity and ability to absorb and utilise new technologies, and have the necessary political influence to “get things done”. A Chinese company with these characteristics is likely to result in a more successful Sino-Western partnership than one without them, other things being equal. The success of the relationship also depends upon the existence of well-placed trust. For example, in licensing, one interviewee argued that it was important to “… get to know the prospective licensee to determine if it can be entrusted with know-how and keep the business reputation for the licensed technology.”. It is crucial for partners to know the background of the co-operation, and have the required business and language knowledge. Because many Chinese partners have been abroad for further education, their presence helps to increase the efficiency of co-operation.

The other important aspect in a "good partner" relationship from the point of IP flows is that they work to “develop” the relationship. The development of harmonious and forward-looking relations does not happen through distant instruction, superiority, and domination. Such relationships require communication and commitment to the mutual business, as well as

involvement in cultural learning. Success in these activities lays the foundations for future co-operation.

4.4.3 Vocational Training

According to 70 *per cent* of the responding companies, vocational training and education are vital for IP recipients. Vocational training should cover IP and IPP, outlining its significance in the management of technology and the relationships between the partner companies. As stated earlier, public knowledge of IPP in China is relatively weak as a consequence of the Chinese cultural inheritance and the political effect of the Communist regime. Although this mindset is changing, it is a slow process. Therefore, vocational training can accelerate awareness from the top to bottom of the partner companies, eventually becoming embedded in company routines and structure. In this kind of corporate environment, Chinese partners would be aware of the consequences of leaking IP. In particular, Chinese partners would realise that protecting their partners' IP is for the benefit of mutual business. Until this happens, the corporate management of IP will always be an up-hill struggle – as one manager said, at the present point in time, educating licensees and partners is "a constant battle".

4.4.4 Transfer of Intellectual Property Ownership

Fifteen *per cent* of the companies interviewed cited the transfer of the ownership of IP as a strategy that might be used to safeguard and, thereby, obtain immediate benefit from their IP. There are two principal reasons underlying this argument. Both turn on the fact that, while it is vital to protect IP from being known to (or used by) rivals, the current environment in China is sometimes unpredictable with regard to the "safety" of IP. The first reason lies in the fact that the technology supplier receives an immediate return and any losses from leakage then fall more heavily on the Chinese firm purchasing the IP. Second, that the ownership of the IP by the Chinese enterprise persuades it of the need to protect it in order to

obtain a better return on the investment that the company made in purchasing the IP. While these arguments appear reasonable, however, Western suppliers may not be willing to wholly relinquish their title to ownership because their R&D and patenting efforts might be blocked or challenged in the future.

4.4.5 Consultation

When problems arise, it is important to attempt to solve them by good-faith discussions. This consultation should be continued until the problems are solved. When, given sufficient time and effort, consultation does not appear to be working, the company should try to enter into a dialogue with the supervising authorities of the Chinese partners.

4.4.6 Multilateral Relationships

It is beneficial to expand from a bilateral to wider, multilateral relationships between organisations and companies that have common interests, influence, involvement or access to official networks. This can further benefit from incrementally expanding these relationships from local to state level. However, this process requires a significant degree of commitment, involving continual negotiations and investments in relationship development. The potential benefits for the company in terms of business development and providing solutions to problems can be considerable.

4.4.7 Support from Chinese Organisations

When conflicts arise between different partners and/or between companies and infringers, one alternative is to go to relevant Chinese organisations. Although this process can be very bureaucratic, it is still considered to be a better route than immediately instigating legal proceedings. However, this route is only likely to be productive if it is proceeded by the collection of detailed and persuasive evidence regarding the problems, which can be presented to the Chinese organisations. This is because government organisations would not have the time and manpower to investigate the details, only to confirm or prove the

truthfulness of the presentation. However, given the relevant evidence, government organisations would be willing to take action to co-ordinate or solve the problems.

4.4.8 Commercial Settlement

Commercial settlement is another potentially effective route, which enables the IP owner to recoup losses incurred through pirating and infringement by unauthorised firms. This can be achieved by negotiating with the infringers or piraters, either directly or through a third party. When this does not work, a commercial settlement can still be sought using the assistance of relevant government organisations. Direct negotiations also provide a mechanism for the aggrieved company to collect evidence and construct a case that, if necessary, can be presented to the government organisations at a later date.

4.4.9 Contractual Surveillance

Planning with careful attention to detail in the IP contract is likely to reduce the probability that IPRs will be violated. This is because strictly worded agreements and contracts often help in resolving IP disputes. However, the limitations of litigation should be borne in mind, even given a tightly worded contract. As two of the IP managers said, "Litigation is not viable …" and "… conventional legal processes often won't work well". Therefore, partners should be creative and pragmatic in stipulating the resolution mechanisms in the contract to prevent future wrongdoings.

4.4.10 Direct Involvement

A higher level of direct involvement means more "on the spot" supervision. The rationale is that it is impossible for companies to ensure that its IP is well-protected and secure without surveillance. Importantly, this should also apply to companies without direct investment activity, such as investment in sub-contracting, and licensing. A higher level of involvement can involve product control, supervision of operations, inspection of IPP and factory visits in China. With this kind of involvement, the extent of pirating and

infringement, as well as other IP problems could be reduced. However, the increased costs of higher direct involvement have to be weighed against the benefits.

4.4.11 Technology Control

This issue was emphasised by all the responding companies. If the official enforcement mechanisms are weak, companies should take their own measures to protect their IPRs. One strategy is to exert stringent control on the ownership of their technology. One British manager stated that IP owners should, mark "all pages with know-how or other IP as 'proprietary and confidential'". The manager emphasised the importance to place "detailed information like process design packages in a format that is difficult to reproduce" in order to maintain control over the technology. It is also crucial to limit IP distribution and prevent IP transfer without signing a specific contract.

5. IMPLICATIONS

The survey has provided four implications by empirically analysing the problems, causes, possible solutions and 11 important elements in cross-border IP flows into China. Firstly, although there is no doubt that the Chinese government has been evidentially positive in improving the system, improvement to the system requires the government to fine-tune the current legislation, and reinforce judicial and administrative protection. Meanwhile, it is necessary to accelerate the educational process to increase the awareness of IP and promote the significance of IPP. It is equally important to increase the penalties for IP infringements. Taken together, these measures represent a potentially viable route to reducing IP misbehaviour. The future development of China greatly relies on foreign capital and technology, but sustainability of the flows hinges on the government's determination and action in improving the enforcement environment.

Secondly, the empirical results also have implications for the governments of developed and developing countries. The findings of the present research form an external

source of information that foreign countries can utilise to persuade China to improve its existing IP system, especially from an enforcement perspective. The research results also have implications for the governments of developing countries, especially when their IP enforcement and legal safeguards are inadequate to support corporate IP flows.

Thirdly, the survey has implications for foreign companies who are interested in, or have already carried out IP flows into China. It is important for foreign firms to establish an effective management of IPP at a corporate level with business establishments in China. The purpose of corporate measures is to create small but strong IP defences against the big but weak IP environment. These empirical results may shed some light on the existing problems of investors. These findings may also provide a better understanding, allowing current and future investors to take preventive measures in order to avoid repeating the same mistakes as their predecessors in the process of IP flows.

Finally, for Chinese domestic enterprises and Chinese partners, the research results have two implications. Firstly, they may provide a better understanding of Sino-Western relationships in dealing with IP flows. This understanding may engender better communications amongst partners, improving the basis for future co-operation. Secondly, the results may provide some insights to Chinese managers and manufacturers in their practical understanding of the need to encourage IPP. Such an understanding may boost IPP and, thereby, ITT from foreign countries to China.

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Table 1: IP Flows into China from the UK and US (% of total IP flows)

Form of IP	**US (%)**	Rank	**UK (%)**	Rank	Other Countries*
Patent	**29.04**	2	**3.41**	7	1.Japan 3. Germany 4. France 5 Netherlands 6. Switzerland
Industrial designs	**9.86**	2	**1.79**	7	1.Japan 3. Germany 4 Switzerland and Korea 5. Netherlands 6. France
Trademark	**18.95**	1	**5.19**	7	2. Japan 3 Germany 4. France 5. Italy 6. Switzerland

* *Note*: numbers indicate the ranking for the country in terms of IP inflow into China.
Source: Based on Bosworth and Yang (2000: 470).

Figure 1: Causes of Problems