China – Legal Service Providers

Preparation And Monitoring: The Keys To Brand Protection In China

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In contemplating doing business in China, companies tend to gravitate to one of three approaches to intellectual property risk. Some avoid the country altogether out of concern about counterfeiting, the black market or product diversion. Others view the advantages of the labor pool and the consumer market to outweigh these concerns, which are viewed as the price of doing business and nothing is done to counter them. Still others deal with adverse events in the country with a very defensive approach, reacting to each event as it occurs and scrambling to keep up.

Avoiding the market doesn't tend to be a winning strategy though, because China is simply too big a market characterized by both an expanding middle class and an increasingly large, educated labor base. The opportunities for significant business growth in China eventually prove to outweigh the risks. The latter two approaches are problematic as well in the long term, as they do not serve to protect the bottom line, and thereby diminish the benefits of entering the Chinese market.

However, a fourth approach is gradually emerging, and it is by far the most advisable for long-term business success in China. Companies have now started to develop strategies for entering the Chinese market that include sensible long-term plans for them to mitigate risks to their brands and to their bottom lines.

Before we explain how such plans are developed, it is helpful for context to examine the country's evolving business environment. The challenges associated with doing business in China are commonplace in economies pushing through industrialization and developing a capital market.

Entrepreneurs in a developing economy need a starting point when it comes to devising their own products and technologies. That starting place tends to be in borrowing liberally the ideas and technologies of those that have developed products in more advanced settings. This was true of the United States 200 years ago and of Japan mere decades ago.

As the economy continues to develop and Chinese companies gain ground both in the market and in the intellectual property arena, the drive to protect intellectual property and brands will become increasingly strong. We are seeing signs of this already.

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For instance, last year the Chinese company Huawei Technologies settled an intellectual property dispute brought by Cisco Systems (*Cisco Systems, et al v. Huawei Technologies Co. LTD., et al, No. 2:03CV27-TJW (E.D. Tex.*). Interestingly, now Huawei finds itself in a position that smaller Chinese companies are using Huawei's own technology to compete with them. This company, and others like it, will have much more influence in encouraging the Chinese government to tighten enforcement of intellectual property protections than would a multinational company based outside of China.

Another fact that bears significantly on the business environment in China today is the recency of the society's shift from socialism to capitalism. The concept of brand and intellectual property rights in those two political systems are completely opposite, so it's no wonder that the culture has not fully embraced the idea of exclusive rights to intellectual property. Under socialism, all things developed by one entity would be expected to be used for the benefit of all.

China joined the World Trade Organization in December 2001, at which point country officials agreed to implement the Trade Related Aspects of Intellectual Property (TRIPs) Agreement. TRIPS sets down minimal standards for copyright and related rights. A recent presentation by Elaine Wu of the U.S. Patent and Trademark Office noted that China has amended its IP laws substantially, but that enforcement of those laws is weak because of lack of coordination as well as local protectionism.

However, in the last year to 18 months, the Chinese government has considerably stepped up the attention it is paying to intellectual property rights. Vice Premier Wu Yi has discussed attempts to improve in this area before audiences around the globe. There have been efforts to educate the public and industry on the substance of the laws, changes have been made to some laws and there is increased enforcement of those laws already on the books. This last area is the one that presents the most challenges in China at this point, but the environment is better for business this year than it was last year. And we believe it will be even better next year than this.

One of the first steps in pro-actively protecting intellectual property in China is filing for a patent in the country – a step that is necessary even before making a final decision to enter the market. Because U.S. patents are public information, Chinese companies with the basic capabilities and the technology identified in the U.S. patent are able to replicate the product in China and secure their own Chinese patents. These Chinese patents are seen as valid rights in China, despite the origin of the technology in a U.S. patent. Pfizer learned this lesson when it entered the Chinese market with Viagra and discovered Chinese scientists had already patented the active ingredient there and were selling it. Pfizer's Chinese patents have been challenged under Chinese law and so far the company has not prevailed in court (MarketWatch, May 18, 2005 "Pfizer Hopeful on China Viagra Patent: Appealing China's Decision to Overturn Patent").

In deciding to initiate or expand business within China, many companies have rushed in to beat the competition or capitalize on the emerging market as quickly as possible. This may explain why so many have encountered problems in protecting their products and brands. More careful consideration of the various aspects of this decision can go a long way to protecting brands and intellectual property – and therefore the bottom line – over the long term. Among the considerations is that the Chinese frequently require that a company not only manufacture its basic products in the country, but must also introduce its cutting-edge technologies. Accordingly, executives at large multinational corporations are very concerned, and for good reason, that the intellectual property will be taken and used in competition with their products. This is why we believe the best bet is to take a "total product protection" approach.

By carefully considering the company's strategy in China and choosing to introduce only those technologies that are critical to that plan, the risk to corporate intellectual property and branding can be greatly reduced. With less to watch, there will be less chance to miss a nascent threat.

Another common risk area when doing business in China is entering into a joint venture with a Chinese company. This can be beneficial as an expeditious way to enter the market, but has been the source of many problems for non-Chinese companies when their partners have not proven to be as trustworthy as they seemed at first. For instance, a manufacturing partner with a contract to run two shifts per day could potentially order excess materials from the suppliers, run a third shift making the company's product and sell that product into another market where the company does not do business.

By finding a trusted Chinese partner, risks related to IP theft are greatly reduced. However, this can only be done through proper due diligence to vet prospective joint venture partners, suppliers, distributors and customers. Many companies have found that in their rush to enter the market, they have joined forces with companies or individuals who they ultimately discovered had a reputation for underhanded operations. Had they stopped to ask questions before sealing the deal, they may have avoided considerable headaches, loss of intellectual property, time and expense.

Additionally, like much of the world outside of the U.S., business in China is dictated much more by relationships than it is by contracts. By cultivating personal relationships through social interaction and community involvement, the likelihood of business arrangements coming through is greatly enhanced. If a company is solely relying upon a contract, it may be able to recover its losses through contract enforcement efforts, but it is not protected from sustaining losses in the first place.

No matter how many protections a company has in place when it enters China – or any other developing economy for that matter – someone who is motivated to take advantage of newly introduced intellectual property will find ways around the countermeasures. For that reason, corporations must constantly monitor the marketplace for new competitors to analyze how the products were developed and whether they are too similar to protected products to avoid infringement. With an organized monitoring system and a reaction plan in place, action can be taken swiftly and much more effectively than it can if a company is operating solely in reactive mode.

In sum, four elements should be included in plans to effectively protect a company's brand and its intellectual property in an emerging market such as China:

- The business plan: Understand exactly what you want to do and what you don't want to do in China, so as to best balance the risk of exposing your technology with the costs of not bringing it in to the country.
- The partnership plan: Invest in adequate due diligence to determine which service providers, suppliers, distributors, partners, and manufacturers you will be able to work with at the least risk.
- The protection plan: Determine the risks the company faces by entering the market and proactively act to mitigate those risks.
- The control plan: Diligently monitor the operation from both the country and the corporate levels.

China is an emerging market that is only going to continue to get stronger and more appealing for multinational companies. It is simply too big to be ignored. But, as an emerging market, China does present inherent risks to brands and to intellectual property. By properly mitigating those risks and being vigilant in monitoring the controls, multinational companies can realize great success for years to come.

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