



CASE **It's a Knockoff World**

I stride toward ground zero of counterfeiting—the notorious Silk Market of Beijing. As do more than 10 million people a year, I enter a 35,000-square-meter, seven-level piracy temple, packed with nearly 2,000 small stalls staffed by thousands of hard-charging, take-no-prisoner vendors offering cheap knockoffs of the leading branded products in the world. Navigating a surreal bazaar gone wild, I scan stalls boldly displaying bogus Louis Vuitton luggage, Prada purses, Hugo Boss shirts, and Hermes scarves; depending on how well you negotiate, each can be had for an absurd fraction of the price of the genuine version. Moving on, stall after stall offers infamous “copywatches,” Nike gear, Sony Jump Drives, Wii Remotes, Gillette razors, UGG footwear, Oakley sunglasses, Zeiss binoculars, Nikon lenses, North Face jackets—one after another, in a seemingly endless procession of premier brand names. Despite spot-on cosmetic resemblance, virtually all is counterfeit. Moving around, I come to digital zones, finding copies of software, music, games, and movies. Rack upon rack displays products from some of the best and the brightest minds of the world, now selling for ludicrously low prices—Microsoft Windows for about a buck, Microsoft Office for \$0.75, Call of Duty or Wii Guitar Hero for a buck, Photoshop for two bucks, AutoCAD for five dollars. Each stall is packed with an ever-changing collage of customers—Germans, Indians, Canadians, Brazilians, British, Americans, and on and on—each getting past the initial shock, and many buying multiple titles.

—Daniel Sullivan’s ramble through the Silk Market, Beijing, March 2012

Companies are dogged by piracy—the illegal imitating, copying, or counterfeiting of their registered products. It’s a tense issue given that it cuts to issues of innovation, history, culture, politics, and prosperity. Making matters worse is that pirates, besides being everywhere, come in every form: individuals making unauthorized copies at work, imitators laboring in dingy sweatshops, and hardened criminals running global networks.

The problem, basically, is this: IP in the form of books, music, product designs, brand names, process innovations, software, film, and the like is tough to conceive but remarkably easy to copy. Moreover, notwithstanding moral shortcomings, pirates do not lack initiative or imagination. In our knockoff world, if it’s being made, it’s being faked. Counterfeiters leave no product category untouched. Fair game includes virtually everything—from the humble aspirin to the flashy Ferrari.¹⁶⁴ And, for the kicker, knockoffs sell for a fraction of the price of the real thing to eager buyers worldwide.

Big Money, Big Risks

IP theft is big business.¹⁶⁵ Globalization and the Internet fuel the perfect storm, the former moving much of the world’s manufacturing to countries with poor IP protection, the latter providing cheap, easily accessible marketing platforms and distribution channels. The costs of counterfeit IP—e.g., lost sales, eroded consumer confidence, diminished brand reputation, dangerous products, enforcement expenses, and legal costs—is staggering. The International Anti-Counterfeiting Coalition (IACC) estimates that international trade in illegitimate goods runs more than US\$600 billion a year—approximately 5 to 7 percent of world trade. ASIS International adds that the annual value of stolen corporate IP at \$300 billion in the United States and over \$1 trillion worldwide. Not surprisingly, piracy has grown more than 10,000 percent in the past three decades—it was \$5.5 billion in 1982.¹⁶⁶

Piracy grows because counterfeiting is astoundingly profitable; gross margins of 500 to 5,000 percent are common.¹⁶⁷ Counterfeit medicines are more profitable than heroin, copywatches may run a couple of bucks to make but sell for \$20 in Beijing’s Silk Market and \$250 on Internet sites, and sales of high-end counterfeit software rival the return from cocaine trafficking.¹⁶⁸

The lucrative rewards of piracy entice even notorious drug cartels to diversify. Mexico's La Familia and Los Zetas, for example, generate hundreds of millions of dollars selling counterfeit DVDs. Their expanding operations have made Mexico the pirate capital of Latin America. The cartels export so many bootleg movies to Central America, for example, that some studios have stopped shipping their products there. Also, whether buying it in Cancun, Cozumel, Monterrey, or Tijuana, the bootleg DVD more than likely bears a stamp indicating it was distributed by La Familia (a butterfly) or Zetas (a stallion).¹⁶⁹ Similarly, the cartels pirate software. La Familia sells counterfeit Microsoft software through kiosks, markets, and stores in the Michoacán region. Adding insult to injury, it stamps counterfeit Office discs with its "FMM" logo.¹⁷⁰

Microsoft's predicament in China highlights common problems. Copies of the latest versions of Microsoft's Office and Windows programs are peddled in market stalls for a few dollars, a fraction of their retail price. Rampant software piracy means Microsoft's revenue in China in 2011 was just 5 percent of its U.S. sales—even though personal-computer sales in the two countries are almost equal. Explained its CEO, Microsoft's total revenue in China, with its population of 1.34 billion, is less than what it collects in the Netherlands, a country of fewer than 17 million.¹⁷¹ This situation is not Microsoft's particular problem; thousands of companies in dozens of countries struggle with the same challenge.

Nothing Is Off Limits

Most think piracy is the problem of snobbish, expensive brands. Certainly, counterfeits target high-end brands—the top 10 brands counterfeited are Microsoft, Nike, Adidas, Burberry, Louis Vuitton, Sony, Lacoste, Reebok, Viagra, and Benson & Hedges. Luxury fakes, however, are just 4 percent of the counterfeit problem. The remaining 96 percent include every-day products. Nothing is off-limits; "If it's making money over here in the U.S., it's going to be reverse-engineered or made overseas."¹⁷²

Increasingly, counterfeiting threatens global health and safety—counterfeit medicines annually kill tens of thousands and it's anyone's guess how much fake medicine is floating around the world today. Evidence indicates that the drug supply chain is a pirate's paradise. The Food and Drug Administration estimates that counterfeits account for 10 percent of all drugs sold in the United States. Studies of anti-infective treatments in Africa and Southeast Asia peg up to 70 percent as fake.¹⁷³ The United Nations estimates that half of the anti-malarial drugs sold in Africa are counterfeits. Imitations of Pfizer's best-selling drugs have been found in the legitimate supply chains of at least 44 countries.¹⁷⁴

Waging a Multifront War

Companies, industry associations, and governments use a battery of weapons to wage war on counterfeiters. An enduring approach relies on dispatching squads of lawyers to search and destroy. Big companies lawyer-up to train customs officials on the nuances of their products, monitor the Web, prod Internet providers to take down copycat sites, and file injunctions against illegal sellers. UGG Australia began enforcing its IP upon realizing the prevalence of counterfeit boots. The company has shut down thousands of websites selling fake UGGs and blocked many thousands more online listings. Liz Claiborne Inc., owner of the Juicy Couture and Kate Spade brands, fight legions of websites selling counterfeits; it removed 27,000 auction listings of counterfeits in just a few months.

Some companies prefer high-tech assault. One approach embeds radio frequency identification (RFID) chips in the product packaging to allow precise tracking; IBM, 3M, and Abbot Laboratories are pacesetters. Others, like Oracle, provide software programs that track products from factories to consumers. In Ghana, mPedigree lets consumers use their mobile phones to check if the product is genuine or fake; buyers call in a special code embossed inside the package to the vendor, who then verifies its authenticity.¹⁷⁵ Moving forward, some anticipate weaving microscopic markers into the product's packaging.

Governments, fearful of losing tax revenues as well as pressures from legitimate businesses, aggressively enact tougher protection. The European Union ranks IP theft as a high priority.¹⁷⁶

The United States has elevated software piracy from a misdemeanor to a felony (for 10 or more illegal copies made within a six-month period with a worth more than US\$2,500) and boosted enforcement efforts by threatening to sanction notorious pirates with records of “onerous and egregious” IPR violations (including countries such as China, Russia, Argentina, India, Thailand, Turkey, and Ukraine). Likewise, its Federal Drug Administration has opened offices in China, India, South Africa, and Mexico, among others, in effect taking the fight to the frontier. On other fronts, rhetoric escalates. The U.S. Trade Representative, for instance, declared, “We must defend ideas, inventions, and creativity from rip-off artists and thieves.”¹⁷⁷

MNEs, officials, and trade associations lobby transnational institutions to devise stronger weapons. Industry associations, like the International Anti-Counterfeiting Coalition, spearhead efforts to toughen laws. Governments worldwide provide global services in public policy, business development, and consumer education. WIPO fortifies IP treaties and spurs members to bolster antipiracy efforts. Likewise, the WTO applies TRIPS to regulate enforcement, which requires all member nations of the WTO to protect and enforce IPRs according to global, not local, standards.

This fusillade of legal assaults, novel technologies, smarter investigations, diplomatic efforts, industry initiatives, consumer education, stronger IP policies, aggressive law enforcement, and concerted political, commercial, and institutional action, one would think, should prove more than sufficient. Then, to make things a bit more interesting, add in the firepower of the global reach of vigilant MNEs, high-profile legal proceedings, increased government cooperation, criminalization of piracy, and tougher trade agreements. Such a shock-and-awe campaign should devastate the pirates, right? Surprise, surprise: Piracy continues to grow at an increasing rate. For instance, in January 2009, Pfizer found counterfeit versions of 20 of its medicines in 81 countries. In July 2012, it found 60 such fakes in 106 countries.¹⁷⁸

“The Bandits Are Everywhere”

The global cat-and-mouse game between MNEs and pirates, far from winding down, escalates. Booming piracy in big, fast-growing emerging markets like China and India spells big, fast-growing trouble. As more people enter the global market, many of them are eager to consume Western brands despite income constraints. Experts warn that the resulting quest for low prices turbocharges piracy.

In addition, crafty pirates quickly overcome IP defenses. They crack licensing codes, duplicate holograms, falsify email headers, set up anonymous post office boxes, and devise cryptocurrencies like bitcoins. Staying one step ahead of the IP police is a widespread competency. “Like drug trafficking, the counterfeiting problem is so massive [that] you don’t know how to get a handle on it. The bandits are everywhere.”¹⁷⁹ Worrisomely, successful pirates evolve into sophisticated entrepreneurs. “When you are dealing with high-end counterfeits, you are talking about organizations that have a full supply chain, a full distribution chain, a full set of manufacturing tools all in place and it is all based on profits.”¹⁸⁰ Lamented one analyst, “Counterfeiting is like a balloon filled with water. You push it on one side but when you remove your hand, it bounces back even stronger.”¹⁸¹

Piracy gets a huge boost from the increasing availability of counterfeit goods through Internet channels, such as P2P file-sharing sites, mail order sites, or auction sites. Outgunned and outfoxed, some companies surrender. Foley & Corinna, a high-end handbag maker, explained that as it noticed more and more Internet fakes, it stopped looking altogether. “It’s just too frustrating. You can try to do something, but it’s so big and so fast.”¹⁸² Then again, there are those who treat IPR as the price of doing business. Despite everyday piracy of his products in the Chinese market, an executive reasoned that the profitability of his legal sales more than offset the losses due to counterfeits.¹⁸³

Is Piracy Inevitable?

The pervasiveness of piracy, in the face of aggressive lawyering, sophisticated tracking and tagging technologies, database software, and security controls, poses profound questions

for protecting IPRs. Some worry that different legal legacies and political ideologies among countries complicate basic issues. TRIPS, by standardizing codes and norms, should have settled such troublesome issues. Legal and operational boundaries have limited its impact.

Others fear that the antipiracy war may already be lost. Evidently, a not-too-small number of consumers and businesses around the world have few ethical qualms about using counterfeits. Take software, for instance. Global software piracy is rampant. In 2011, the worldwide PC software piracy rate hit 42 percent. Put differently, of all the packaged software installed on PCs worldwide, 42 percent was obtained illegally, at a cost of US\$63.4 billion in lost revenue (up from losses of \$29 billion in 2003). For many nations, such as Armenia, Libya, Ukraine, Bolivia, China, and Zambia, software piracy rates top 80 percent. Even the best-behaved nations, like the United States and Japan, report software piracy rates north of 20 percent.¹⁸⁴ Consequently, Microsoft's biggest rival is not another software company—it is counterfeiters.

The global financial crisis has pushed more people to seek counterfeits. Similarly, some in collectivist cultures reason that IP holders should honor society by abandoning their profit-maximizing business models. Sharing knowledge, not protection, is the moral imperative. But, counter others, without protection, ultimately there will be no IP to share or, for that matter, steal.

QUESTIONS

- ★ 3-3. Collectivism and individualism, democracy and totalitarianism, rule of law and rule of man: What do these concepts say about IPRs and the legitimacy of protection?
- 3-4. What is the relationship among governments, transnational institutions, and MNEs fighting piracy? Do they share similar or different motivations?
- 3-5. Can MNEs stop piracy without government help? Why would they prefer greater government assistance? Why would they oppose it?
- ★ 3-6. Do you think consumers in wealthier countries versus those in poorer countries justify piracy with similar rationalizations? Why?
- 3-7. Can you envision a scenario where developers and consumers of IP develop a relationship that eliminates the profitability of piracy?
- 3-8. Put yourself in the place of a poor individual in a poor country struggling to improve the quality of your life. What thoughts might shape how you interpret the legality of IPRs?

ARY

and legal systems converge and vary across countries in terms of guiding principles and practical routines.

Standards anchor the assessment of a political system: the degree to which it emphasizes individualism vs. collectivism and the degree to which it is democratic vs. totalitarian.

Individualism endorses the primacy of personal freedoms in the political, economic, and cultural realms. It champions the interests of the individual over those of society.

Collectivism holds that the needs of society take precedence over the needs of the individual. It encourages state intervention to promote the welfare of the group at the expense of the individual.

Government officials and agencies play an extensive to all-encom-

group freedoms are guaranteed, the legitimacy ascribed to the rule of law, and the existence of freedom of the press.

- Democracy champions the authority of the many over the few. A democratic government protects personal and political rights, civil liberties, fair and free elections, and independent courts of law.
- Totalitarianism champions the authority of the few over the many. The government exercises control over many to all aspects of life, the individual is subordinated to the state, and opposing political and cultural expression is suppressed.
- Recent data on the spread of democracy indicate it is in retreat. Democracy's retreat coupled with growing stagnation of freedom signals resurgent authoritarian governance.