



## 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.<sup>164</sup> 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.<sup>165</sup> 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.<sup>166</sup>

Piracy grows because counterfeiting is astoundingly profitable; gross margins of 500 to 5,000 percent are common.<sup>167</sup> 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.<sup>168</sup>

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).<sup>169</sup> 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.<sup>170</sup>

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.<sup>171</sup> 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.”<sup>172</sup>

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.<sup>173</sup> 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.<sup>174</sup>

### 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.<sup>175</sup> 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.<sup>176</sup>