

CASE 2-9 Coping with Piracy in China

Read the following two stories about intellectual property theft in China carefully, then answer the questions at the end of the case.

Monday, two fake Apple stores in Kunming were ordered to close. But Steve Jobs may have wished otherwise, since the Apple wannabes would have benefited Apple Inc.

Apple's glorious success in the Chinese market has to do with the scarcity of its products and the difficulty to counterfeit them, adding to the premium consumers are willing to pay.

The Cupertino-based technology giant has a total of four official stores in China—two in Beijing and two in Shanghai—which have become the most heavily trafficked Apple Stores in the world. According to *The New York Times*, they also generate the most revenue, outselling even the Fifth Avenue Apple Store in Manhattan, which is open around the clock.

Many of you may have not known the actual number of real Apple Stores in China until fake ones were reportedly spotted in Kunming, the capital of China's mountainous southwestern Yunnan province.

The fake Apple Stores in Kunming were outed after an American blogger discovered the store and posted her findings onto the Internet.

"This was a total Apple store rip-off. A beautiful rip-off—a brilliant one—the best rip-off store we had ever seen," the anonymous blogger posted...

Two days after the revelation, industrial and commercial authorities in Kunming launched a sweeping investigation not only on the alleged Apple Store, but on all the city's electronics stores, reports a Chinese news outlet Xinhua.

Business licenses, authorized permits of brand use, and the purchasing channels of each store were inspected, said Xinhua.

After inspecting 300 shops in the city, officials found five self-branded "Apple Stores" to be operating without authorization from Apple Inc, the *Metropolitan Times* report said.

Among the five, two fake Apple stores were told to shut down because they did not have an official business license.

China is notorious for counterfeited products such as watches, clothes, luxury items, electronics, and in this case, products from Apple stores. The fake items generally are sold for a fraction of the actual cost in retail stores, but the products in the fake Apple Store were selling for the same price as the real iPads and iPhones in Apple-authorized stores.

Interestingly, Apple Inc. declined to comment on the case that flooded the media and gave the original whistleblower one million page views within the first 72 hours.

"Are you listening, Steve Jobs?" was the title of the original blog post.... For sure, Apple, famous for sensitive control on its supply chain, would have been aware of the five fake stores.

"After all, how could one foreigner aimlessly strolling down the streets of Kunming with her husband find something that an obsessively protective company with hundreds of investigators and lawyers could not?" said Gordon G. Chang of *Forbes* in a blog post.... "Moreover, Apple had received a complaint about the fakes filed by a major authorized Kunming distributor."

Chang speculated that more than Apple was taking its time to figure out the source of the products sold by unauthorized sellers, the tech giant had not decided how to handle the situation. Aside from protecting the company's intellectual properties, Apple was benefiting from the renegade stores in Kunming that sell Apple goods at official prices.

"To be honest, Apple is the biggest winner in the current situation," Yunnan-based intellectual property lawyer Zhang Honglei was quoted by *Forbes* as saying. "It has many Chinese companies willing to help it sell products and increase the popularity of its brand for free. Why would Apple sue them? Why would Apple punish them for helping it sell more?"



Fake Apple Store in Kunming, China
Source: REUTERS



Exterior of the fake Apple Store in Kunming
Source: REUTERS

For Apple to build up China market share swiftly before counterfeiters enter the field, even the unauthorized retailers could help achieve that objective by gearing up the sales speed.

Especially now that Apple's presence seems to be outgrown by the development of the middle class in China, no wonder "China has taken rip-offs to a new level, pirating Apple Stores themselves," Charles Wolf, a securities analyst

who follows Apple for Needham & Company, said. "It speaks to the demand for Apple products throughout China."

What a happy worry for Steve Jobs. Finding a sweet spot to take over the Chinese market, Apple now faces a challenge of creating the best synergy with China's state-owned companies while avoiding competition.

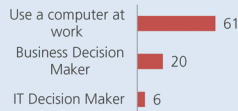
Apple's invasion into China seems to have no end.

BSA 2010 BSA Global Software Piracy Study China Support for Intellectual Property Rights

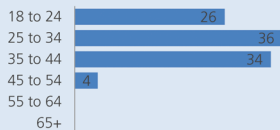
Survey Details

- All respondents installed software in the last year
- 61% use a computer at work
- Gender break 50/50 male/female
- Survey conducted face to face Jan 20- Feb 23, 2011

Work use

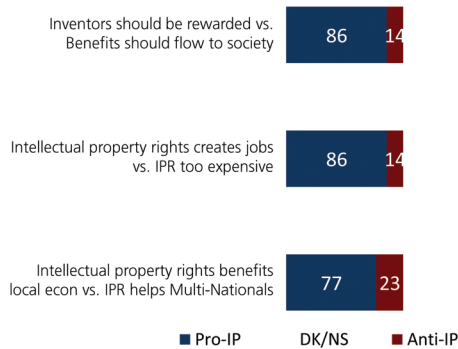


Age of Respondents



Support for IPR

- Chinese respondents show very strong support for innovators and intellectual property rights.
 - 86% say innovators should be rewarded vs. the global average of 71%. Likewise 86% say intellectual property rewards creativity vs. 73% globally.
 - Most also say IP promotes local jobs (86% vs. 61% globally) and IP benefits local economies (77% vs. 59% globally).

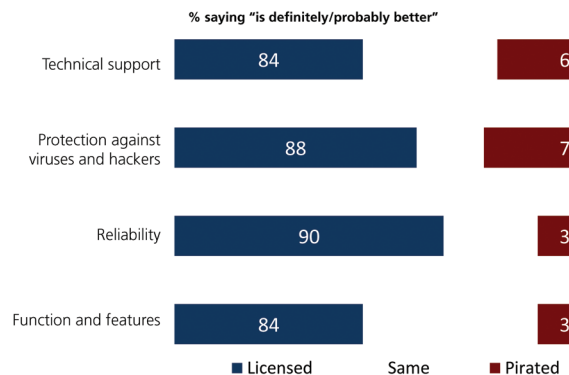


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BSA 2010 BSA Global Software Piracy Study China Preference for Licensed Software

Licensed vs. Pirated Software

- There is also a broad acknowledgement that licensed software is superior to unlicensed software.
 - Chinese consumers believe that the reliability of licensed software (90% vs. 81% global) is the biggest advantage licensed has over unlicensed.

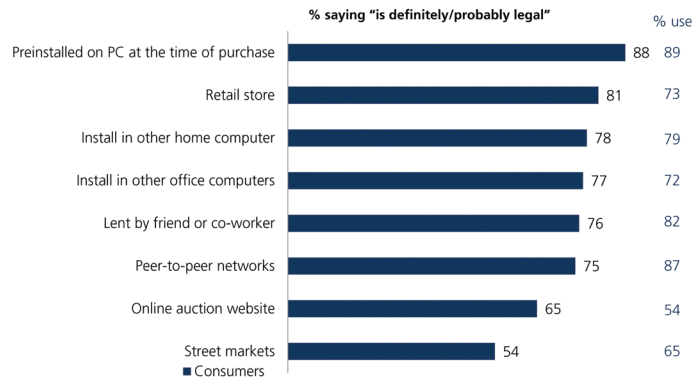


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BSA 2010 BSA Global Software Piracy Study
China Awareness of Software Acquisition Channels

Channel Legality

- Chinese consumers exhibit some of the greatest confusion over what are legal vs. illegal ways to acquire software.
 - More than half of Chinese respondents say that all forms of software acquisition are legal – including software “loaned” by friends (76% vs. 39% globally), peer-to-peer networks (75% vs. 36% globally), and street markets (54% vs. 26% globally).
 - Most Chinese respondents also say they would use these forms of acquisition



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QUESTION

Assume you are the CEO of a new firm that has perfected a package of software applications for medium- and large-sized companies to help manage intellectual property applications (patents, trademarks, copyrights). Licenses for companies in the United States have sold briskly, at \$2,000 per company for more than a year. Now you have heard rumors that your software is being pirated in China. Ironic, isn't it?

Write a briefing for your board of directors with a specific plan of action to address this leakage of your intellectual property into the Chinese market.

Source: "Why Fake Apple Stores in China Can Make Steve Jobs Happy," *IBTimes New York*, July 25, 2011.