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Where has all the IP gone? – Challenges in China

This case focuses on Intellectual Capital (IC) and Intellectual Property (IP) protection in China. Tied to the IC/IP is the selection of a site for an R&D center for Phidel Corporation.

Dave Cooper, the Chief Technology Officer must determine the site location for an R&D center in China while taking into account Intellectual Capital (IC) and Intellectual Property (IP) protection. In addition, Dave must help Heri, the plant manager in charge of the newly established manufacturing plant in China protect his IC/IP and retain employees.

Introduction

As the plane levels out and the pilot turns off the “*fasten seatbelt*” sign, Dave pushes back his seat and places his drink order with the flight attendant. He takes in a breath and lets out a sigh and wonders what new challenges await him upon his arrival in China. He has made this trip for five years and each year he notes that the country side has changed from the previous trip developing at an amazing pace. Resting his head back and closing his eyes he remembersthat Monday morning.

Monday morning, June 13th 2006 the Phidel Company Executive Staff convene to discuss the latest China business opportunities. Dave Cooper, Executive Director and Chief Technology Officer is presenting a proposal for business opportunities in China. Seated around the table are:

Morgan Worthing – Chief Executive Officer and President
Michael Winslow – VP, General Counsel & Chief Compliance Officer
Bruce Thomas – VP, Chief Financial Officer
Sarah Wilson – VP, Chief Information Officer
Robert (Bob) Atkinson – Human Resource Management
Wesley Johnosn – VP, Internal Audit Services & Security
Owen Weatherbe – President, Asia Pacific
Marilyn St. Angelo – VP, Global Supply Management
Rachel Stevens – Chief Tax Officer

“This decision is really about staying competitive in this new global market. China has entered into the WTO and in my opinion will become a country to recon with. I suggest we look beyond three years and out into 2015 to determine if this is a good strategic decision for Phidel.”

Dave continues, “Our opportunity to manufacture our electronic products as well as establish an R&D Center in China would be supported by Panda. Currently Panda is a small vehicle manufacturer with low volumes but they predict to grow and become China’s 3rd largest small vehicle manufacturer. We could set up a manufacturing site and then grow as Panda grows. Also, as our global market expands, we could use this manufacturing site to supply to other parts of the globe. Labor is very inexpensive and we would have the opportunity to train and keep our workforce as it grows.”

“I don’t know, Dave.” Robert says as he shakes his head slightly. “Remember Mexico? Our labor force still is experiencing high turn over and the labor costs have risen higher and faster than we predicted. I am not sure we even understand how to operate in China.”

“I agree, Bob.” Dave responded. “However, not entering China soon will cost us. We will miss the opportunity and we know that our competitors have plans to enter China this year. If we wait too long it will be too late for us to establish a profitable manufacturing facility and Research and Development Center in China.”

Dave got word that the project was approved and the manufacturing site was constructed near Panda in Jinan (Ji’nan) the capital of Shandong Province, China. It took less than a year after construction was completed to run the first parts off the manufacturing line.

Now the China R&D center project decisions needed to be addressed. Dave started to think about R&D locations, workforce,and then drifted off to sleep.

Understanding the Challenges

As the flight attendant removes Dave’s breakfast tray, he thinks about his upcoming morning meeting with Heri. Heri has been the manufacturing manager of the China manufacturing site. Dave knows that Heri is the best manufacturing “guy” the company has, but the reports from the manufacturing site have been poor at best. Dave reflects on what he needs to find out from Heri so that he can learn from him and make the “best” recommendation for the RD center in China.

Dave walks off the jet way and looks for Heri. “Dave!” Heri shouts. “Glad to see you again. How have you been?”

“Just fine, Heri.” Dave replies.

“Well, let’s go back to the office and we can discuss your new R&D center.” Heri offers.

At the manufacturing site, Dave notes that it is very clean and appears to be well run. “So, I understand you are interested in the challenges of running a manufacturing site here in China.” Heri glances at Dave. As they continue walking around the manufacturing site, Heri starts “Well, we have a high turnover rate for employees, and it seems that we are always finding “knock-offs” of our products. These counterfeit products just are not of the quality ours are. The problem with IP infringement is that it weakens our brand and potentially we could loose our market position. We continue to seek restitution through the Chinese legal system, but the fines for counterfeiting are small compared to the financial gains for the counterfeiters. The counterfeiters are becoming more sophisticated and we have reason to believe that international counterfeiting and IP infringements are also gaining here as well. As the products become more complex, these guys use new technology in the production and distribution of counterfeit goods. It is actually a real challenge to pursue IP infringements.

To go through the legal system here in China, we have to set up a raid and confiscate the counterfeit products and then turn them over to the government. Sometimes the “stuff” just disappears. Without the actual confiscated goods, there is no legal action that we can take because the fines are based on the value of the confiscated goods. And believe it or not, sometimes the counterfeit manufacturing equipment is returned to the counterfeiters!

It seems the central government is in support of enforcing Intellectual Property Rights (IPR) here in Jinan (Ji'nan) but the local government officials often just turn their heads. Counterfeiting in some of the rural areas is actually the revenue generating industry for them. You know, sometimes I think the government officials may actually fear retaliation by the counterfeiting organizations. When a raid happens, the counterfeiters are so well connected they just move to another location and continue their operations. It seems that the attitude of the Chinese consumers and some authorities are that we are setting profit margins too high and that the profits are sent outside of China.

Dealing with this is one of my biggest challenges.” Heri looks down and shakes his head. He knows he has been dealing with this issue since they started production.

“I know that my employee turnover does not help either because when an employee leaves the company, they take knowledge with them.” Heri sighs wondering if he has overlooked a solution to his high employee turnover rate and IP protection.

As they walk around the manufacturing site the power goes out and Heri states, “We will need to go back to my office. When these outages occur, we find they are usually down the rest of the day. The outages are less frequent these days, but we still experience them about once a month.”

That evening back in his hotel room, Dave sips his tea and thinks about where to locate the new R&D center in China. He believes that China offers great opportunities for Phidel Corporation and he has put his reputation on the line for this project. Dave knows he will need to develop a plan and strategies to protect the R&D Intellectual Capital as well as help Heri out with some recommendations to improve the IP protection for his manufacturing site.

His mind drifts back to the evening hours and dinner with Heri. Heri filled him in on all the new buildings, roadways and transportation construction going on in Shanghai and Beijing. The speed at which these changes happen never cease to amaze Dave. High rise buildings constructed and occupied in places that had previously been filled with small run-down homes. He wondered what happened to the people who lived in those homes before the construction. And where are all the people moving into the cities coming from?

Dave tries to refocus and get back to his project and the challenges that lay before him. He thinks about what types of information he will need to gather and what actions he should tackle first.

He takes the pen and small pad of paper that he finds in the desk drawer and begins to make a list of things to do over the next several days. As he goes back over his R&D center project he knows that protection of the IC/IP will be critical, so selecting his workforce will be paramount on the list. He will look at cities to determine where universities or other industries like his are located. The universities will be a good source for human resources with the right skill sets. He will rely on Heri's knowledge of working with the Chinese to establish his IC/IP protection strategy.

Dave knows that there is a risk associated with being in China and he will need to make sure he weighs the benefits vs. risk as he makes decisions regarding site selection and IC/IP strategies. Tired from his long trip and full day with Heri, Dave puts down his pen and decides to finish his list in the morning.