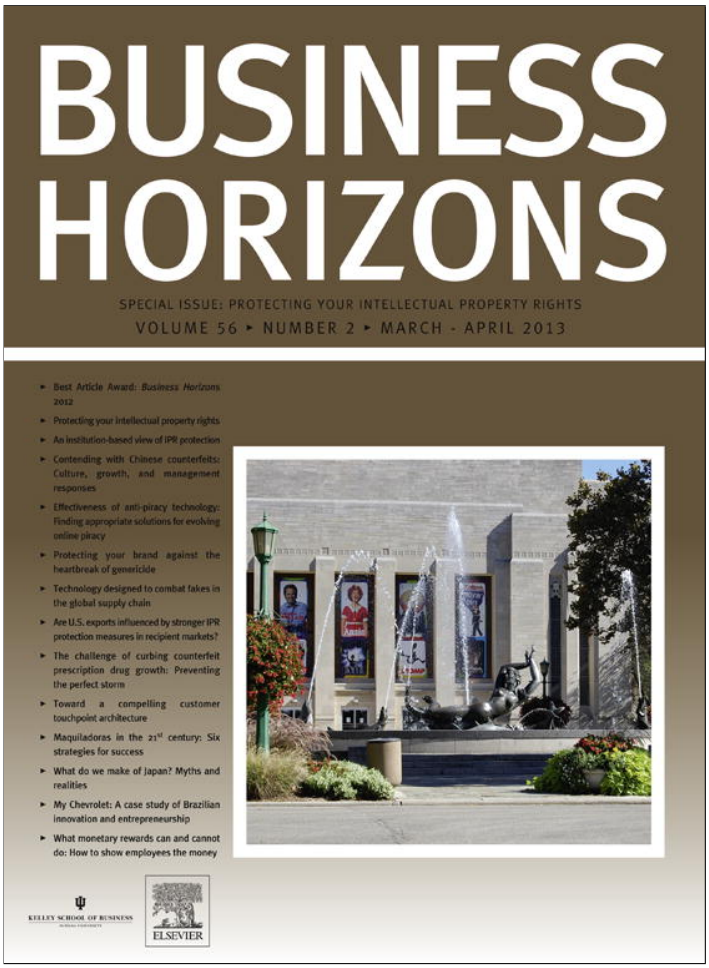

Business Horizons (2013) **56**, 135—139

Available online at www.sciencedirect.com

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EXECUTIVE DIGEST

An institution-based view of IPR protection

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KEYWORDS
Intellectual property rights;
IPR protection;
China;
Great Britain;
United States

Abstract There is a great deal of frustration regarding the lack of progress on intellectual property rights (IPR) protection in China. This article leverages the historical episode in most of the 19th century during which the United States was the leading IPR violator. Great Britain as the superpower of the time sought but failed to convince the United States to improve IPR protection. Advancing an institution-based view of IPR protection, I argue that both the U.S. refusal to protect foreign IPR in the 19th century and the current Chinese lack of enthusiasm to meet U.S. demands on IPR protection are rational. However, if history is any guide, the future outlook is not depressing. In 1891, the United States voluntarily agreed to protect the IPR of foreign works, because the U.S. economy became sufficiently developed and U.S. IPR started to be pirated elsewhere. Drawing lessons from this episode of history, I predict that IPR protection will significantly improve when Chinese IPR are widely pirated by foreign violators outside of China.

1. Name that country

Imagine some difficult intellectual property rights (IPR) negotiations between a superpower and an emerging economy. Negotiators from the superpower demanded that its IPR be respected. Their counterparts from the emerging economy shrugged: "Well, we are still a developing country, but we need to promote education and facilitate learning." In other words, IPR piracy had to go on in the emerging economy—never mind the protests from the superpower.

Which two countries are involved? If you think this scenario describes the challenging negotiations between the United States and China recently, you would only be given partial credit in my class. This scenario also describes the tough negotiations between Great Britain (the superpower at that time) and the United States (the emerging economy of the day) in most of the 19th century. Between the founding of the United States and 1891 when the Chace Act was passed, pirating British publications was the widely accepted norm for American book publishers, newspapers, and magazines. There was no shortage of frustrated British authors (such as Charles Dickens) and officials who sought to change Americans' behavior—and then became more frustrated by Americans' lack of willingness to honor and protect IPR (Tomalin, 2011).

In today's discussion about IPR, few have bothered to draw lessons from the earlier history of IPR

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0007-6813/$ — see front matter
http://dx.doi.org/10.1016/j.bushor.2012.10.002

disputes between Great Britain and the United States (although this history is well documented—see Chaudhry & Zimmerman, 2009; Lohr, 2002). Without drawing lessons from *this particular episode* of history, the future outlook for better IPR protection around the world is not encouraging, and the future outlook for better IPR protection in China—widely noted as the leading violator of IPR of our time—is very depressing. Zimmerman's (2013) article is indicative of such thinking, which is widely shared by many authors. Zimmerman's (2013) lessons drawn from Chinese cultural history, economic development, and political development seem to suggest that Chinese are culturally and politically conditioned to engage in a high level of IPR violation. If we push this line of thinking further, then it is virtually hopeless to envision better IPR protection in China in the absence of significant changes to Chinese culture and politics.

I beg to differ from this pessimistic view. I argue that the history of IPR development in the United States—from a leading violator to a leading advocate of IPR—offers a great deal of hope regarding the future of IPR development in China and numerous other countries implicated by the United States Trade Representative (USTR) and the Organization for Economic Cooperation and Development (OECD), such as Argentina, Brazil, Chile, Egypt, India, Israel, Lebanon, Mexico, Paraguay, Russia, Thailand, Turkey, Ukraine, and Venezuela (see Chaudhry & Zimmerman, 2009). The key does not lie in culture or politics, which are enduring features of a country's institutional framework that cannot be changed quickly. Numerous British critics in the 19th century wrote extensively (and quite persuasively at that time) that Americans were culturally and politically conditioned to engage in a high level of IPR violation. Charles Dickens must be turning in his grave if he heard that the leading pirating nation of his time, the United States, would become the leading IPR *advocate* in the late 20th and early 21st century. The key, in my view, lies in institutions, which are known as the ''rules of the game'' (North, 1990, p. 32). While culture and politics can be regarded as informal institutions that change relatively slowly, formal institutions, especially laws, rules, and regulations as well as their enforcement mechanisms, can be enacted very quickly—literally with the stroke of a pen if there is sufficient determination. More specifically, what made Americans decide to change their IPR institutions by 1891? What are the lessons of this particular episode of history for today's discussion of (and frustration with) IPR protection in China and elsewhere? The goal of this article is to leverage this widely known but rarely appreciated historical episode of IPR development in the United States to advance an institution-based view of IPR protection.

2. The depressing outlook

Focusing on contemporary antipiracy efforts, Chaudhry and Zimmerman's (2009) excellent book, *The Economics of Counterfeit Trade*, has exhaustively reviewed governments' and firms' responses to IPR violations around the world. In their concluding section ''The Outlook,'' Chaudhry and Zimmerman (2009, p. 175) reach their conclusion:

> The price-performance ratio of technology continues to decline, meaning pirates can get the production and communications equipment they need at ever lower costs. Trade barriers continue to fall. . .Consumers do not see much harm in purchasing counterfeit product. Advertising attempting to change this perception is judged relatively ineffective by managers involved in fighting the counterfeit problem. . .Many consumers will not be able to afford to purchase a legitimate product. This will also be a force for the continued increase in sales of counterfeit goods. Managers surveyed by the authors generally do not see international bodies as particularly effective in slowing down the growth of pirated product. In addition, enforcement of local laws is uneven at best. Since other considerations often are far more important in multilateral negotiations, the enforcement of IPR rights in many countries will probably not improve much.

Depressing, isn't it?! It seems that the more efforts and resources expended on IPR protection, the worse the scale and scope of IPR violation around the world (Hill, 2007). Continuing this line of research, Zimmerman (2013) dives deeper into Chinese history and politics, and reaches essentially the same but more pointed conclusion regarding the depressing outlook of IPR protection in China.

As leading scholars, Chaudhry and Zimmerman (2009, p. 175) obviously are well aware of the history of IPR development in the United States. They do offer a glimmer of hope: ''Judging by U.S. history, it is possible that indigenous manufacturers will demand improved enforcement of IPR laws in these newly emerging markets and that could significantly slow local pirate activities.''

In other words, the outlook does not necessarily need to be so depressing if we can draw more optimistic lessons from the development of IPR in the United States. Yet, Chaudhry and Zimmerman have not expanded on this intriguing point. This is an

important missing point that the next section endeavors to fill, culminating in an institution-based view of IPR protection.

3. The United States as a leading IPR violator

From its founding, the United States had a conceptualization of IPR and a formal system of IPR protection—starting from the Copyright Act of 1790 and Patent Act of 1793 (Fisher, 1999). However, U.S. IPR protection would only protect U.S.-based inventors and authors (Lohr, 2002). By definition, the IPR of foreign inventors and authors was up for grabs. In his first tour of the United States in 1842, Charles Dickens was appalled by the widespread pirating of his work and called for better protection of IPR. Instead, the U.S. media, which made a living (and a killing) by using pirated British content to fill a sizeable portion of their pages, argued that Dickens should be grateful for his popularity and that he was greedy to complain about his work being pirated (Tomalin, 2011).

Calls for Americans to become more ethical and to be respectful of foreign authors and inventors' IPO issued by luminaries such as Dickens generally went nowhere. All the way till his death in 1870, Dickens had not collected a single dollar of royalties from U.S. sales. There was no shortage of British critics such as Dickens, who believed that Americans were culturally and politically hopeless in improving IPR protection. Threats by British negotiators to impose sanctions on the United States were met by Americans negotiators' more provocative challenge: "Invade us?" Unfortunately, the last time the British were able to gather their strengths to invade the United States was in 1812. After that, the British had neither the guts nor the resources to seriously contemplate such an invasion. Fast forward to today's IPR negotiations between the United States and China, to put bluntly, the Chinese negotiators essentially said to frustrated American negotiators: "Invade us?" Of course, the United States today cannot seriously contemplate such an invasion. So the IPR negotiations between the UK and the U.S. in the mid-19th century and between the U.S. and China in the late 20th and early 21st century typically went nowhere, despite diplomatic proclamation of some "progress and improvement based on a frank exchange of views."

4. Proposition 1 in the institution-based view

To the pleasant surprise of British critics, the United States *voluntarily* changed its IPR laws in 1891 with the passing of International Copyright Act (popularly known as the Chace Act after Senator Jonathan Chace of Rhode Island who sponsored the bill). The Chace Act protected the IPR of foreign works. What happened? Clearly, the U.S. government was deaf to both moral pleas called for by foreign authors and toothless threats made by foreign governments. It was not foreign pressures that led to this sea change; instead, it was pressures from indigenous authors, inventors, and firms within the United States that led to such transformation.

Proposition 1 in the institution-based view of global business strategy states that governments, firms, and managers *rationally* pursue their interests and make choices (Peng, in press; Peng, Sun, Pinkham, & Chen, 2009). By refusing to protect the IPR of foreign inventors and authors until 1891, the U.S. government had been perfectly rational. Given the low level of literary and economic development, protecting foreign IPR would simply benefit foreign authors, inventors, and firms (such as publishers) at the expense of domestic consumers who had to shoulder higher costs for books, media output, and innovative products.

However, toward the end of the 19th century, rapid economic development in the United States turned it from a net consumer of IP to a net producer (Fisher, 1999). As more Americans started to write books and more American publishers started to publish and market them overseas (a leading market was the UK), they demanded better protection from foreign governments. However, foreign governments would not grant U.S. authors copyright protection if the United States did not reciprocate.

Further, as the United States nurtured more authors, inventors, and publishers, their IP was pirated *elsewhere*—notably in Canada in the late 19th century. Taking a page from the U.S. playbook, the Canadians did not offer IPR protection to foreign (technically non-British Commonwealth, essentially American) authors and inventors. Therefore, unauthorized piracies of U.S.-authored books were widespread in Canada, causing an uproar among American writers such as Mark Twain.[1]

Given these changing winds, it is perfectly rational for the U.S. government—via the Chace Act of 1891—to start offering IPR protection in the United States to foreign authors and inventors. Only by doing that would American authors and

[1] For example, Mark Twain had to establish residency in Canada in order to protect his novel *The Prince and the Pauper*, which would then be registered as a Canadian resident's work that would have copyright protection in Canada. Given the tremendous costs involved, few authors could entertain establishing multiple residencies around the world.

inventors have any hope of having their IPR protected overseas.

In summary, only when the U.S. economy became sufficiently developed and the U.S. IP production became more competitive overseas did IPR protection improve in the United States. As the United States became the new superpower with more of its GDP (and export earnings) driven by IPR, not surprisingly it took the banner from Great Britain in the 20th century to become the most vocal advocate of IPR (Fisher, 1999). Any argument that Americans were culturally and politically predisposed to engage in a high level of IPR violation would collapse when being confronted by the 180 degree change of IPR protection in the United States circa 1891. Is culture important? Of course! Is politics crucial? Yes! But what matters more in this case? None of the above! It is institutions. Proposition 1 of the institution-based view regarding players' rationality indeed offers a great deal of insights into how institutions matter in IPR protection.

5. Neither American exceptionalism nor Chinese exceptionalism

Previous work has advanced an institution-based view of international business strategy (Meyer, Estrin, Bhaumik, & Peng, 2009), an institution-based view of corporate diversification (Lee, Peng, & Lee, 2008), an institution-based view of entrepreneurship (Lee, Yamakawa, Peng, & Barney, 2011), and an institution-based view of corporate governance (Jiang & Peng, 2011). This article contributes to the literature by being the first to advance an institution-based view of IPR protection and broadening the domains covered by the institution-based view.

How generalizable is the American experience in the 19th century to today's IPR debate concerning China (and other counterfeiting nations)? If one believes in American exceptionalism, then this discussion is not relevant to China's current and future IPR protection. Likewise, if one believes in Chinese exceptionalism, then this episode of U.S. history is not relevant either.

I believe in none of the above. As great as the United States and China are, they belong to the global family of nations. The international exchange and diffusion of ideas and practices have scaled new heights recently. Neither of these two countries—nor any other country for that matter—can evolve its own IPR system in total isolation. If we embrace a more global and longer view of history, we see that IPR violation started at least during the Roman times (Zimmerman & Chaudhry, in press). In the 1500s, the Netherlands (an emerging economy at that time) were busy making counterfeit Chinese porcelain. In the 19th century, Americans improved their literacy level by feasting on pirated British works. In the 1960s, Japan was the global leader for counterfeits. In the 1970s, Hong Kong grabbed this dubious distinction. In the 1980s, South Korea and Taiwan led the world. Now it is China's turn (Peng, 2005, p. 138).

An institution-based view of IPR suggests a clearly discernable pattern: as these economies developed, indigenous industries grew, and IPR protection was enhanced—such development was rational and made sense. Anyone believing that Chinese are culturally and politically conditioned to engage in a high level of IPR violation will need to confront the evidence that during the Beijing Olympics, *not* a single case of IPR violation of Olympic logos and mascots was reported. Perhaps the counterfeiters became more patriotic—although not a focus here, informal norms are another often researched area in the institution-based view (Peng, in press; Peng et al., 2009). Perhaps IPR enforcement was beefed up. More likely the answer was "all of the above." The usual Chinese negotiators' defense when facing foreign pressures that Chinese IPR enforcement capabilities were weak simply does not hold water in the face of shining accomplishments of zero (reported) IPR violation during the Beijing Olympics. When there is a will, there is a way. Currently, there is little will on the part of the Chinese government to satisfy U.S. IPR demands because foreign (and primarily U.S.) IPR holders would benefit more from such enhanced protection. If history around the world is any guide, someday China and other leading counterfeiting nations will hopefully follow the same path by offering better IPR protection.

How long do we have to wait until this "someday" comes? In 1870, Dickens died at the age of 58, knowing that his IPR would not be protected in the United States in his lifetime (Tomalin, 2011). But had he lived another 21 years, he would have seen the arrival of that "someday." Given the rapid development of the Chinese economy, I think (and I certainly hope!) most readers of this article will see the arrival of that "someday" for better IPR protection in China before we die. Specifically, when will China be serious in offering better IPR protection to foreign authors, inventors, and firms? My prediction from the institution-based view of IPR protection is that the day will come when Chinese IPR are widely pirated by *foreign* violators outside of China.

Acknowledgment

I thank Peggy Chaudhry for her able guidance and Alan Zimmerman for his helpful discussion. Support

from the Jindal Chair is greatly appreciated. All views and errors contained herein are my own.

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