

# Piracy Helps

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If imitation is the sincerest form of flattery, Microsoft chief Bill Gates may have millions of admirers in China alone. Software developed by Microsoft is so popular in China that for each legitimate copy there may be tens, if not hundreds, of illegal copies powering the increasing number of personal computers.

The odd thing is that in all the trips Mr. Gates has made to China, he never seems to bring up the subject of piracy. He's either seen enjoying himself with his wife and friends like Warren Buffett, shaking hands with Chinese leaders or giving lectures to university students. Never is he spotted railing against the legions of pirates. Why then is Mr. Gates, the one person who would stand to lose the most from software piracy, apparently less concerned about this issue than U.S. Trade Representative Mickey Kantor, who's leading a push to close down plants making pirated CD-ROMs in China?

Because Mr. Gates realizes that he's also the one software developer who stands to gain the most from continued pirating.

Don't get us wrong. Software piracy is a major problem for the software industry. Despite clear warnings against copying on software packages, piracy exists both in advanced countries like the United States and in emerging ones like China. According to the Software Publishers Association, a U.S. industry group, there were 25.7 million pirated copies of software packages in 1993 alone.

There are attempts to protect programs through coding, fingerprinting and other devices, but no system is completely effective. Software piracy happens primarily for two reasons: First, the cost of policing consumers and enforcing laws is extraordinarily high; second, the cost to reproduce computer software is almost nothing when compared with the price of a legitimate copy. Illegal software packages sell for at most \$5, or one-tenth the price of the legitimate item. Bootlegging among friends, where the copies are free, also accounts for a large share of software piracy.

Piracy, as everyone knows, reduces retail demand for a product, but this may only be a short-term effect. There is, however, a critical, positive effect one cannot ignore: Piracy increases the total number of program users. People who would not be able to buy software if protection against piracy were strengthened can easily obtain pirated copies.

Because software piracy increases the size of the user base, it improves the quality of a software program in the eyes of potential consumers. In other words, the number of legitimate buyers increases as more and more people use the same system, or one that is compatible. Therefore, software piracy increases overall demand

for software, and that eventually goes to the software company's bottom line. In the end, both software companies and consumers benefit from less stringent piracy protection.

China's personal computer market is small, with annual sales of just half a million units in 1995. This represents less than 1% of total world personal computer shipments, which are put at close to 60 million units. But China's market is expected to

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grow at a rapid clip; sales of computer units are expected to increase around 40% annually for the next few years.

That, however, depends on the continuation of piracy. The average software package represents one month's wages for the average Chinese worker. This means that complete eradication of piracy would limit demand for software—and for hardware, much of which is imported from the United States.

The reason Mr. Gates smiles when he comes to China is that he knows that at a certain stage of the industry's development, piracy can help software developers set the industry standard, which will lead to market domination in the future. This benefit accrues primarily to the current industry leader, in this case Microsoft. The propagation of software, pirated or not, can be one of the best ways for a firm to strategically build up its market share and lay the seeds for future harvest. The mistake that Apple Computers made was to keep its software proprietary for far too long; Netscape Communications, on the other hand, freely allows users to download its software.

To be sure, though piracy helps with market penetration, further development of the market requires a sound legal system that owners of intellectual property can rely on once their standards have been adopted. Therefore, it is in the long-term interest of software publishers to encourage China to develop a strong and transparent legal framework that provides effective protection of intellectual property.

Building such a system is much more important, and much more difficult, than simply shutting down a few plants where pirated CD-ROMs are manufactured and raiding a few more shops selling illegal copies. Once a legal system is set up, market participants will have an incentive to protect their own rights and to bring the

violators to justice. Building such a system is not in conflict with the objectives of the Chinese government. If the Chinese government wants its domestic software industry to take off, it must eventually enforce laws that protect intellectual property.

There are indications that the Chinese government is looking down the line. In a court case earlier this year, a Beijing-based software firm was ordered to pay \$1.6 million in compensation for pirating the copyright of a domestic competitor. This amount was the largest ever awarded in a software copyright-violation case in China. Such development shows a healthy tendency and should be encouraged.

There are many measures that can be taken to accelerate this process. It will be constructive to provide legal expert assistance to help China further develop its legal framework to protect intellectual property. Threats, such as the imposition of trade sanctions, may be counterproductive. Such actions certainly hurt Chinese consumers and may damage the long-term interests of U.S. software companies.

The friendly conversations Mr. Gates had with Chinese leaders and university students were probably more helpful to the long-term welfare of his company than anything Mr. Kantor can achieve with his present demarche.

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