Microsoft Should Welcome Piracy in India and China

By prosecuting copyright infringers in Asia, it drives consumers into the Linux camp. Better to ease up and build market share—for now

by Henry Chesbrough

On July 25, in a rare collaboration between U.S. and Chinese law enforcement, the FBI and China's Public Security Bureau raided a southern Chinese operation that had allegedly pirated Microsoft Windows Office and Vista software. Microsoft praised the raid, saying it was a milestone in the battle against pirated software.

Two months ago, 350 independent computer dealers in Gujarat, India, held a one-day strike, protesting Microsoft's (MSFT) raids of their stores. In these raids, Microsoft sent fake customers to request that the dealers load Windows onto their computers. The dealers did so at no charge—using pirated versions of Windows. Microsoft sent notices to six of the offending Gujarat dealers demanding substantial payments and fines.

Around the same time, Microsoft's general counsel, Brad Smith, publicly alleged that open-source products Linux and OpenOffice infringe no less than 235 of Microsoft's patents. Smith further announced that Microsoft was prepared to meet with offending parties to discuss the alleged infringements.

In these situations, Microsoft is striving to obtain full benefits from its substantial investments in innovation by seeking enforcement of its intellectual-property (IP) rights.

DIFFERENT STROKES

From Gujarat, India, to Santa Clara, Calif., Microsoft is simply doing the right thing for the company and its shareholders, as any company should. But is the giant shortsighted in treating these two situations in the same manner? The answer could be yes. It's a mistake to manage IP the same way during different phases of a technology's life cycle rather than adjusting along the way. It's a fumble that many companies, not just Microsoft, would be wise to avoid.

In the earliest phase of any technology—and this holds true for the introduction of an established technology to a new territory—it pays to be very open. At this point, neither the maker of a new technology nor observers know the best use of it, and no one has an appropriate business model to commercialize applications either (the Creation Phase).

As the technology starts to take hold some key applications develop, and the technology enters the Growth Phase. The key here is to drive growth so a technology becomes the "dominant design"—the standard everyone uses. It still pays to be open because the most important task is to win the battle to be the dominant design. Openness can help enlist allies and fellow travelers to tip the market in a favorable direction. Remember the Betamax vs. VHS video-recording showdown? While many factors led to the VHS format winning the popularity contest, it's key that JVC was willing to license its VHS technology broadly, including to other manufacturers, while Sony allowed the Betamax format to run only on Sony machines. So VHS won market share.

Focusing narrowly on protecting IP interferes with that most important task. There's little value in taking a strong IP position for a technology that loses the race to be the dominant design and can wind up being a lame duck before it has had a chance to prove itself a winner.

RIDE THE WAVE

As the technology matures and the Growth Phase starts to slow, the focus on being open must change. New impetus for IP protection emerges, and tightening the protection of ideas becomes more important. In a technology's Mature Phase, growth is largely over, so stricter enforcement of IP is less likely to swing the market away from a product. At the same time, more enforcement helps companies harvest the investment they made in a technology.

Still, companies shouldn't be too demanding—or licensees will either go out of business or find another technology that avoids strict enforcement actions. Eventually the technology will become obsolete, and the market for that technology will go into the Decline Phase. In this final phase, companies can aggressively harvest the fruits of their earlier investments in IP protection. Since the market is going away anyway, they can be even more demanding. IBM (IBM) was able to negotiate payments of tens of millions of dollars from Dell (DELL) once it left the PC business, and from Cisco (CSCO) when it withdrew from the router business. GE (GE) has exited many white-goods businesses, but it still takes in many millions of dollars by licensing its
Microsoft Should Welcome Piracy in India and China

With this simple idea established, let’s return to the problem Microsoft is facing with pirated copies of Windows. In the U.S. and Europe Windows has become the dominant PC operating system, with a market share in excess of 90%. So growth in those regions is now quite flat, placing Windows squarely in the Mature Phase of its life cycle. In China and India, however, the picture is quite different. Rising economic prosperity has created a boom in PC sales, so in these countries Windows is just now moving from Emerging Phase to Growth Phase.

NUANCED VIEW

One-size-fits-all thinking would suggest that Microsoft should employ the same weapons against software piracy in India that it uses in the U.S. This would mean vigorously policing the use of its software and undertaking prompt legal action against any and all illegal use wherever in the world such activities are found. And that seems to be the path Microsoft took in Gujarat this spring. A more nuanced view would suggest a dramatically different approach, shown in Figure B.

While Microsoft leads in India and China, Linux is mounting a strong challenge in both nations. The Linux community has signed a deal with Beijing to make Linux the default operating system for computers used by the Chinese government and many parts of the Chinese educational system. In India, the prices of Windows and Office are so high that Linux is the only practical, affordable choice for most of the population.

In this context, applying Western IP enforcement policies to stem the flood of illegal copies of Windows in China and India risks winning the battle (to deter and punish IP infringement) while losing the war (to become the dominant standard operating system on the desktop). As long as Linux remains a serious rival in China and India, Microsoft should welcome pirated copies of its software. Illegal versions of Windows are free, which helps Microsoft offset the initial cost advantage of “free” open-source software.

Every pirated copy installed on a Chinese or Indian computer brings one more person into the Microsoft ecosystem. This strengthens Microsoft’s market for third-party developers of applications, tools, and other complementary products. Equally important, it denies Linux that next new customer who would strengthen the open-source ecosystem against Windows.

HELPING LINUX SPREAD

If Microsoft succeeds in discouraging piracy of Windows in China and India, it is far more likely to drive the user of the pirated software into the Linux camp than it is to steer them into the land of paid-up Windows users. Microsoft’s IP management strategy in China and India should instead focus on securing the victory of Windows on the desktops of all PC users. That may require deliberately lax enforcement efforts against pirated copies of Windows for the short and medium term. Only after the Linux threat lessens might Microsoft have the luxury of tightening up piracy protections, as it is now doing in the West. Microsoft can afford to be patient.

Bill Gates has hinted that Microsoft may be open to this way of thinking—and willing to give China’s PC users a break. As reported in an article by Charles Pillar in the Los Angeles Times in April, 2006, Gates suggested in a talk at the University of Washington that if Chinese consumers are using pirated software, he wanted them to be using Microsoft’s.

So Microsoft would be well advised to take a different approach to managing its Windows IP rights in India compared with its approach to protecting its Windows IP rights in the U.S. IP management must be driven first and foremost by the business objectives of the company, not by a narrow legal perspective.

And remember, Microsoft has won the war in the U.S and Europe. The growth there is gone. The next billion Microsoft users will come from markets like Brazil, China, India, and Russia—if Microsoft’s IP management policies and lawyers don’t drive them into the Linux camp instead.

Henry Chesbrough is Executive Director of the Center for Open Innovation at the Haas School of Business at UC Berkeley. He is the author of Open Business Models: How to Thrive in the New Innovation Landscape (Harvard Business School Press, 2006). He is an authority on open innovation, open business models, and open approaches to intellectual property management.