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# Defining and measuring counterfeit goods

**Counterfeiting poses a real threat to companies around the world, but one that is not always clearly understood. Brand owners need to define the nature of the threat, tailor a response and measure their success in order to secure sustained funding**

Conventional wisdom holds that counterfeiting of branded physical goods tends to decline as countries become more economically developed. This belief can lull brand owners into dangerous complacency. While counterfeiting penetration tends to be far lower in developed countries, it is not negligible. What is more, the barriers between developed and developing economies for counterfeit sales are becoming porous, thanks to international trade and online sales.

A great deal of counterfeit production today is centralised in several global locations, from which counterfeits are exported worldwide. The quality of counterfeits can be shockingly similar to that of originals, to the extent that for some products it takes an expert to tell the difference.

This is a result of counterfeiters using large-scale, sometimes capital-intensive production techniques and drawing on the same suppliers of raw materials and components as original goods-producing industries. E-tailing websites allow small, unorganised traders to sell counterfeit products to customers directly, bypassing organised retail channels which are more amenable to enforcement action.

Counterfeits play a vital role in sustaining the finances of organised crime networks which are also involved in other kinds of socially corrosive activities – so curbing the trade in counterfeits is a social concern. The key for brand owners is to define the nature of the counterfeiting threat, tailor a corporate approach to this and, crucially, measure success in order to secure sustained funding.

## Defining forms of counterfeits

The nomenclature of deceptive versus non-deceptive counterfeits is widely used by IP professionals as a way of differentiating between two parts of the counterfeit industry with very different dynamics. Deceptive counterfeits are products which are sold to end consumers without them realising that the products are counterfeits. Non-deceptive counterfeits, on the other hand, are sold with some degree of knowledge and collusion on the part of end consumers, who typically accept a counterfeit product (or a product of dubious authenticity of some sort) in exchange for a lower price or some other similar benefit.

Different categories of product are susceptible to non-deceptive counterfeit penetration to different degrees. The table opposite depicts the typical market realities in this regard.

The line that separates deceptive from non-deceptive counterfeits is not hard and fast. Certain consumers have a nebulous notion of what IP rights are and may not view a fake product as illegal or disreputable, but rather as a separate and lower class of original product. For example, we have come across complicit retailers selling counterfeit products as ‘locally made’ versions of an original brand. Exploiting this, makers of counterfeit products have even taken to creating different tiers of ostensible quality among counterfeit products. Where surveys reveal such a climate of opinion – and the incidence of this tends to be higher in emerging markets, in our experience – consumer education is clearly called for and this should be part of a brand owner’s strategy.

## A three-pronged approach

As regards the corporate response, then, brand owners can pursue three broad and non-mutually exclusive strategies.

### Enforcement

The advantage of enforcement is that any resulting damages awards may be used to cover legal costs. Raids to seize stocks of counterfeit goods or packaging may remove quantities of inventory from circulation. Moreover, the publicity attendant on legal action tends to have a deterrent effect on the production and sale of counterfeits. Sales of counterfeits have been known to see brief dips in response to well-publicised legal actions or seizures of counterfeit inventory – although this does not always happen.

However, enforcement also has its limits. The extent to which the courts can provide timely redress to plaintiffs varies from jurisdiction to jurisdiction, as do the damages awarded and penalties brought to bear on offenders. Such legal action may not always have the desired effect in terms of crippling networks of counterfeiters – particularly if inventory is frequently replenished, production locations are diversified and the real business owners are well concealed at the higher echelons of the organisation structure.

### Channel certification and audits

This approach is useful in cases where a large share of original product goes through a relatively small number of organised retailers. Large retailers tend to be more amenable to cooperation with manufacturers to check the penetration of counterfeits in their inventory, so as to limit their legal liability and reputational risk.

Table 1. Prevalence of non-deceptive counterfeits by industry

Product category	Extent of non-deceptive counterfeits out of total counterfeits	Remarks
Luxury apparel and accessories	Moderate	Certain consumers may be amenable to purchasing counterfeits of branded products (or products positioned as parallel imports) to gain price advantages, perhaps from less organised or online channels.
Consumer information communications technology or industrial products (business-to-business sales)	Moderate	Collusion on the part of corporate buyers may lead to non-deceptive counterfeit sales.
Consumer information communications technology products (business-to-consumer sales)	Low	Most individual consumers would not be attracted to buying counterfeits collusively, as legitimate non-original products are generally available; the incidence of deceptive counterfeiting is relatively higher.
Fast-moving consumer goods, including food, alcoholic beverages, tobacco	Low	Most individual consumers would not be attracted to buy counterfeits collusively, as legitimate low-quality/priced products are generally available and fakes may pose health hazards. Counterfeits should be differentiated from illegally imported duty-unpaid tobacco and alcoholic beverage products, which may be collusively purchased.
Automotive parts	Negligible	Once again, consumers generally would not knowingly purchase fakes at a premium; however, decisions are often made by mechanics with limited knowledge and engagement from the end consumer (ie, the motorist).
Pharmaceuticals	Negligible	Consumers would not knowingly use fake drugs for therapeutic purposes, for obvious reasons.

Channel certification and training should always be backed up by a programme of mystery shopping audits to test the integrity of the channel's anti-counterfeit processes. As the retail sector becomes more concentrated among large, organised retail chains, such programmes become more attractive. However, where retail is highly fragmented and disorganised, as is the case in many emerging markets, the job of auditing the channels through which goods are sold to end consumers may seem a Sisyphean task.

Audits of channels can be useful even in cases where original products are sold in own-brand stores, as even these may not be 100% immune from counterfeits. Audit work may even lead to the detection of illegal stores masquerading as own-brand stores – as Apple discovered in China.

#### Consumer education

An increasing number of brands have resorted to education programmes in an attempt to enlist end consumers as allies in the struggle against counterfeits. Such campaigns can include both mass media and in-store advertising. Some brand owners have taken to printing instructions on product packaging in order to help consumers to authenticate their products. Some manufacturers have resorted to devices such as online authentication codes, mobile authentication and a variety of holographic and other anti-security labels.

The challenge facing such campaigns that of motivating consumers to authenticate goods themselves. Another limitation is the associated cost.

#### Striking a balance between anti-counterfeiting and consumer confidence

Implementing a consumer education campaign raises the thorny issue of the extent to which publicly discussing the issue of counterfeit penetration may undermine consumer confidence in the brand.

In the past, the conventional stance that many brand owners

adopted was that consumer education should be considered a last resort, when counterfeit penetration became so high that there was little to lose in taking this step.

However, our experience suggests that some degree of consumer awareness is useful even when counterfeit penetration levels are relatively low. The key lies in the manner of communication. Campaigns should stress that brand owners do not want consumers to be harmed, and that consumers can take certain simple and accessible steps to ensure that they are buying genuine products (eg, buying only from certified channels). Skilful communication can convey the message that counterfeits are a non-mainstream phenomenon that is easily avoidable if one takes certain basic precautions. Consumer education campaigns should also be implemented in a way that encourages consumers to share information that would feed into and support enforcement programmes against non-compliant channels or counterfeiters.

#### Measuring counterfeit penetration

Considering all of this, no anti-counterfeiting programme should be designed without in-built measurement systems. What techniques of measurement can be used to assess the return on investment for anti-counterfeiting programmes?

Measuring counterfeit penetration through quantifying cumulative seizures of counterfeit inventory can be problematic, as this assumes – unwisely – that the proportion of seizures out of total counterfeits entering a market remains constant over time. In fact, the volume of seizures may reflect the investment in enforcement to a significant degree.

Counterfeit penetration can also be measured through consumer surveys. However, in the case of both deceptive and non-deceptive counterfeits, this may lead to inaccurate findings for different reasons.

In-store inspections provide another avenue for measurement.

However, our experience has been that retailers of counterfeit products may not display counterfeit stock openly in an in-store environment. The counterfeit stock may be kept in a separate room or even a separate location outside of the shop, but within the same building.

The least risky approach to counterfeit measurement is mystery shopping to simulate genuine customer purchases, followed by physical inspection of the products purchased. This approach tends to be viewed as the gold standard for counterfeit penetration measurement in the pharmaceuticals industry, where the stakes are extremely high.

The key point about counterfeit measurements is that they should include a robust approach to deriving the value of revenue that has been regained as a result of the anti-counterfeiting programme, which would otherwise have disappeared into the counterfeiting value chain. Such results serve to demonstrate the impact of anti-counterfeiting programmes on the corporate bottom line, thus ensuring their sustainability.

#### Turning penetration data into an anti-counterfeiting return on investment measure

How can counterfeit penetration data be converted into a model that demonstrates the value of anti-counterfeiting programmes to management?

The first step lies in taking the data generated by whatever research model is being used to measure counterfeit penetration and then extrapolating this to an entire country or region.

Take the example of a large region with different countries, such as the Europe/Middle East/Africa region, or Asia-Pacific. Typically, counterfeit penetration patterns vary according to the level of development, channel structure and extent of rule of law prevailing across different countries and cities. Data on counterfeit penetration needs to be analysed and fed into a model that extrapolates region-level counterfeit penetration data from the cities in which the research was conducted, while taking into consideration the characteristics of different cities and countries within that region. The model must also adjust for the fact that any research programme is conducted at a particular point in time. The data needs to be extrapolated into a whole-year view reflecting seasonality patterns. In our experience, counterfeit penetration rates do show seasonal patterns in some countries, which can be discerned only through periodic research.

Next, the data must be used to derive the foregone revenue and profit from the level of counterfeit penetration that the research has determined. This involves imputing prices to the volume of counterfeit product being sold to end consumers, which amounts to foregone revenue to the brand owner. The more sensitive the analysis, the better. For instance, it would be ideal to derive counterfeit penetration numbers by stock-keeping unit (SKU) number and then calculate total foregone revenue for the entire product category by modelling foregone revenue by SKU number.

The last step would be to look at the foregone revenue number in light of the fact that not all of the end consumers who bought counterfeits would buy a genuine product if counterfeits were not readily available. For deceptive counterfeits, the research should establish whether there is a significant price difference between counterfeits and genuine products in the market.

If not, then the foregone revenue figure we have already derived can be used as it is. If so, then a coefficient needs to be applied to that foregone revenue to account for the fact that, were the supply of counterfeits to be disrupted, some of the end consumers now buying counterfeits would switch to different brands or products altogether, so that only a portion of the foregone revenue figure is

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in fact a loss to the brand owner. This coefficient needs to be derived from research on price sensitivity among end consumers.

What we should end up with is a robust set of numbers indicating foregone revenue (and hence, derivatively, profit) associated with counterfeit penetration in each sub-region.

By measuring the extent to which this foregone revenue number moves up or down, we arrive at a measure of the return on investment for anti-counterfeiting programmes. It is particularly useful to run counterfeit penetration research before and after major anti-counterfeiting campaigns are executed.

With the right mix of anti-counterfeiting measures and the right tools for performance measurement, brand owners can defend their market share against counterfeits, defend their brand image and demonstrate the impact of anti-counterfeiting programmes on the corporate bottom line. <sup>WTR</sup>

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