

Research Reports
Articles



Counter Counterfeiting

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The menace of counterfeits and fakes

Illicit trafficking of counterfeit goods is more profitable than other illegal activities, such as the trafficking and sale of narcotic drugs, people and weapons¹. Though often perceived as a 'lesser crime', it has far reaching consequences. Counterfeit goods not only hurt the customer and lead to lost sales; it gives a serious blow to the credibility of the original brands. A study by FICCI estimates that the industry suffers an annual sales loss of Rs. 1,00,000 crore.² To add to their woes, these companies have to bear the expense of monitoring the market and instituting legal proceedings against the infringers.

Industry Sector	Sale Loss to Industry* (Rs. Crores)
Auto Components	9,198
FMCG	35,413
Computer Hardware	4,725
Mobile Phones	9,042
Tobacco	8,965

Table 1: Extend of counterfeiting in selected industries

*Source: FICCI study on sale loss to selected industries due to counterfeits, figures for 2012

What more, the sale of counterfeit products and tax evasion in just seven key sectors, resulted in a loss of Rs. 26,190 crore loss to the exchequer, in only 2012.

Combating Counterfeiting: A uphill task

It is considered that counterfeiters are able to flood the markets due to the legal lacuna in the country. While there is a long way to go still, special police cells, CID and EOW of the central crime branch now proactively work towards eradication of counterfeiting. Over the past decade companies have also been working closely with law enforcement to bring these fraudsters to task.

Companies are further fighting this battle by conducting awareness programs about the harmful effects of these fakes and undertaking promotional programs in small towns and villages. They have also introduced cheaper variants or smaller packs to make the products more affordable. Brands also use new and improved packaging, new labels and copy proof holograms to make their products difficult to imitate.

Yet, despite the best efforts of individual companies and law enforcement agencies, the widespread sale of fake items has been increasing rapidly in the country. According to Assocham “the present size of counterfeit products in India is five per cent of the overall market size and growing at a rate almost double of that of genuine products”!³ What is puzzling is that the measures taken to combat counterfeiting seems to be (comparatively) successful in curtailing fakes in urban retail while the rural and urban areas are still flooded. With cheaper variants and smaller pack sizes eliminating the affordability issue and with increasing awareness, why are fake goods still so popular in these areas?

The analysis of the market share of counterfeits in various sectors (see figure 1) also show that the extent of counterfeiting in the industries with better reach like FMCG or Tobacco is less than that in industries which are known to have larger market penetration gap (eg. Auto parts)

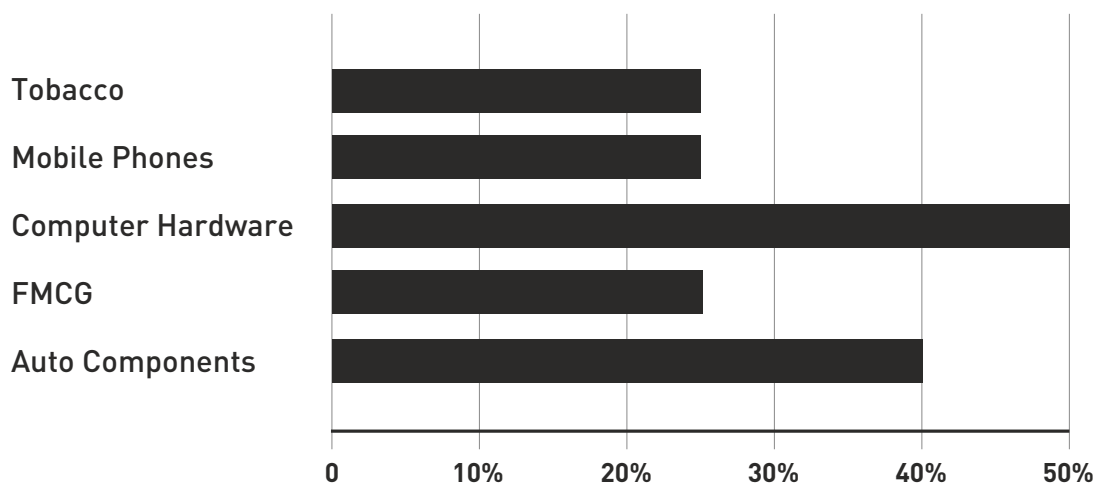


Figure 1: Share of counterfeit products selected various industries

** approximate estimations based on Assocham data and research @vector

This indicates that the answer to the 'stickiness' of counterfeiting with the small retailers could possibly lie in the 'reach' of companies. A closer examination of the behavior of these markets, help clarify why the prevailing practice of companies of not servicing small retailers directly and instead depending on wholesalers has created a Gordian knot for them.

Inadequate reach leave markets vulnerable

The “economically unserviceable” small retailers: Though the majority of the Indian population live in small towns and villages (over 86%), the distribution network of companies tend to be predominantly based around the big urban cities. Even large FMCG companies, which as an industry, has the best distribution, do not have extensive reach into the rural or even ru-rban markets.

Company Name (FMCG)	Total Retail outlets covered (Rural plus Urban*)
Marico	60%
Godrej Consumer Products	57.5%
Nestle	46.5%
Britannia	45%
Dabur	42.5%
Glaxo Smithkline Consumer	10%

Table 2: Reach of selected companies in the FMCG sector

* includes direct and indirect coverage

*Source: : www.equitymaster.com; How far-reaching are FMCG companies?,8th April 2013

This lack of direct reach (ie. distributors’ sales team servicing retailers in an assigned territory) into these markets is not because of lack of market potential but because distribution decisions are always based on “cost to serve”. Faced with a cost trade off, most small retailers especially in the rural or urban areas, are abandoned as not “economically serviceable”. Instead companies sell in bulk to wholesalers at cheaper rates with the hope that they will help the company get sales from these unserved areas. Unfortunately wholesalers are passive sellers who sell only to those who approach them.

Retailers' Dilemma creates fertile ground to foster counterfeiters: This lack of direct attention of companies creates a serious dilemma for the small retailers who are forced to make a trip to the nearest wholesaler whenever they need merchandise. In order to save on transportation cost (and the sales lost when they shut their stores), these visits are necessarily infrequent. And with their limited capital, the range they can pick up is also minimal. Moreover, very often there are slow moving products which have gone stale at their store that the wholesaler is unlikely to accept back. So a retailer who picks up merchandise from a wholesaler has to pick up a small range, in large lots by paying cash! The further the retailer is from the wholesaler, more aggravated is this conflict.

Counterfeiters' appeal: Over time a community of agents has evolved to solve this dilemma for the retailers. These agents, who are purveyors of counterfeits, service the small retailers frequently at their stores. The retailers do not have to close their shop, lose sales, transport the merchandise back or invest in buying bulk. They get credit and their merchandise yields them a higher ROI, to boot. They are also saved from lost sales on going out-of-stock of a popular brand since they are now able to suggest a look alike or knock off instead to their customer. Soon they stop visiting the wholesaler altogether or does it very infrequently. The small retailers' customers may be tolerant of fakes either out of ignorance or because they have no other choice. Over period of time some these fake brands may even develop a loyal following!

Reach -a necessary condition to counter counterfeits

The counterfeiter's distribution network can only be effectively countered by direct distribution. This is the first step required to prevent the growth of this menace. Any other action taken- on the legal front or through marketing activities- while important, would be futile if taken without the retailer's being serviced directly. Moreover, with a direct distribution system in place and the distributors' sales team visiting these retailers, market intelligence can also be easily gathered. Negligible reporting of counterfeiting is a major huddle in tackling this menace. Further the distribution system pushes into the country; the smaller would be the opportunity for counterfeiting.

Companies want to increase reach of their direction distribution. They are intuitively aware that their dependence on wholesalers is dysfunctional. But since these companies believe that it is "cost inefficient" to try and plug the market penetration gap, they have resigned themselves to live with this. But what is generally not realized is that this decision to save on costs by not reaching out with an organized distribution network could actually be costing big time!

Brands end up competing with itself!: The wholesaler's modus operandi plays havoc with the company's sales. Wholesalers tend to compete for the same market as the companies distributors-retailers attached to these distributors. This forces distributors to erode their margins since they are threatened by the wholesalers who buy the same brands at deep discounts. With poorer ROI, the distributor finds it unaffordable to service the retailers in his territory with regular beat plans, further eroding sales for the company.

Excess Inventory due to erratic ordering: Bulk sales to wholesalers, while attractive in the short term (to meet sales targets), backfire on both the wholesalers and the companies often. Sporadic large orders from small retailers motivate the wholesalers to place even larger orders on the company. When these small retailers don't come back, the wholesaler is stuck with this inventory and gets into credit lock with the company hurting future sales.

The combined impact of these two alone (without even counting the evils of counterfeiting) is far more damaging than the costs the company would have to incur for direct distribution! This makes it imperative that organizations discard wholesaling and quickly build up their direct distribution coverage. But letting go of wholesaling is scary for most companies. Old habits die hard. Many companies are wholesalers, themselves i.e. they differentiate the unit price of the product based on who they are selling to and how much is being bought. It is an accepted norm for companies to give lower prices for bulk purchases. This in turn makes wholesalers in the network a necessary evil for most companies. Moreover, the transition, wherein, wholesaling is abandoned and a direct distribution is developed would see a short term drop of sales. This is difficult for top management to accept. But once the direct distribution is established and the beat plans followed conscientiously, the organization would not only curtail fakes but leap ahead in sales as well. The hesitation of companies to handle the necessary transition holds them back from handling the menace counterfeiting and fakes effectively.

¹ The Illicit Trafficking of Counterfeit Goods and Transnational Organized Crime by United Nations Office of Drugs and Crime ; Europol, "OCTA 2011: EU Organized Crime Threat Assessment", p.48, 2011. Available at <https://www.europol.europa.eu/sites/default/files/publications/octa2011.pdf>. ; Organization for Economic Cooperation and Development (OECD), "The Economic Impact of Counterfeiting and Piracy: Executive Summary", p.12, 2007, OECD Publishing. Available from <http://dx.doi.org/10.1787/9789264037274-en>.

² "Strategies to counter spurious products" available at http://www.academia.edu/3633529/Strategies_to_counter_spurious_products_with_reference_to_FMCG_in_Rural_market

³ http://articles.economictimes.indiatimes.com/2014-12-17/news/57154166_1_electronics-indian-standards-products

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