

Combating Counterfeiting and Grey Market - A Challenge for Indian Corporates

December 22, 2008

KPMG IN INDIA

Foreword from FICCI

As the Chairman of the FICCI Brand Protection Committee (BPC), I feel privileged to write the foreword to this report, prepared by FICCI and KPMG, to assess the extent of counterfeiting of brands in Indian industry and explore possible solutions collaboratively.

Counterfeiting and piracy, is growing in every sector of Indian industry today. Apart from harming the reputation and the sales value of legitimate brands, fake products often pose serious risk to consumers' health directly, especially if the product counterfeited is a food item or a medicine. The Government also suffers losses as counterfeiters and pirates pay no taxes. A FICCI Study conducted few years ago by ACNielsen estimated that the annual loss to the Indian Exchequer in taxes was an astronomical Rs 870 crores by counterfeiters and pass off products in the FMCG sector alone !

India abounds in laws, but the aspect of enforcement needs to be made more robust. Sometimes the legal and the enforcement machinery takes time to react to the problem with the result that the brand counterfeiters and pirates escape from the scene and start their activities elsewhere. The menace is no longer limited by national boundaries. Movement of counterfeit and pirated products across political borders and jurisdictions makes law enforcement that much more difficult and challenging.

The need of the hour is to have stringent laws and enforcement mechanisms to swiftly and effectively enforce these laws. The Government, the Industry and other relevant stakeholders need to come together to jointly find solutions and chalk out strategies in this regard. FICCI Roundtable is a beginning in the long and arduous journey towards this goal.

FICCI's BPC has been the torch bearer of initiatives which have enlightened and inspired the Industry, the Government and the consumers on business evils like counterfeiting, piracy and pass-offs. It provides a platform to the industry to come together, share and discuss issues faced by them on counterfeiting, piracy and pass-offs.

We hope this study will serve as a useful backdrop both for the government and the industry while charting the way forward.

Bharat Patel
Chairman, FICCI Brand Protection Committee
FICCI

Foreword from KPMG

As we move towards becoming a knowledge economy our assets are also taking an intangible form. Ideas, brands, content and software are increasingly becoming more sought after resources than their tangible counterparts. This sentiment is reflected in KPMG's Fraud Survey 2008 released in March this year, where respondents have collectively stated that Intellectual Property (IP) related frauds are going to increase in the next three years.

In India, high growth industries that are contributing to the expansion of the economy, such as pharmaceutical, Information Technology and the biotech are heavily dependent on the IP. However, the survey indicates, almost 80 percent of the respondents were not satisfied with their current processes around protection of IP, implying that a lot needs to be done around this issue. Tackling this problem could be a challenge as theft of IP can take many forms including counterfeiting, grey market; under-licensing, under-reporting etc. Moreover, today's advanced IT environment has added to the complexities and magnitude of financial implication in such kind of frauds.

Infringement of IP goes beyond the profit and loss of a single company and can create wider economic, social and developmental costs creating a massive drain on the economy. Therefore it is important that India awakens to this major challenge that is likely to increase in the future.

Arpinder Singh
Executive Director
KPMG in India

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Executive Summary



Even as Indian corporates today scale to new heights and make their presence felt globally, the increasing menace of counterfeit and pirated products sourced from India remains a threat not only to their brands' but also the country's image.

Rapid advances in technology coupled with liberalization of the Indian economy have created an ideal market for misuse of existing brand values that have been created and nurtured over a period of time.

A recent study by auto industry bodies, Society of Indian Automobile Manufacturers (SIAM) and Automotive Component Manufacturers Association of India (ACMA) estimate the counterfeit/piracy market size to be between USD 1 billion and USD 1.3 billion, accounting for 32 percent and 45 percent respectively of the total replacement market¹. The Media and Entertainment is another sector largely impacted by piracy. Music and movies are among the worst affected segments by piracy in India. It is estimated that 50 percent of music sold on the streets and 60 percent of movies sold are pirated².

Despite the widely recognized contribution by the IT/ITeS industry to the country's economic development, estimates from Business Software Alliance (BSA) suggest that the Indian IT- ITeS Industry recorded a loss of USD 2 billion in 2007 due to software piracy compared to USD 1.2 billion in 2006³. The pharmaceutical sector has not been spared either, the Organization for Economic Cooperation and Development's (OECD) latest estimates suggests that approximately 75 percent of fake drugs supplied the world over are of Indian origin⁴.

While some may believe counterfeit and piracy is confined to technical fields alone, a study conducted by ACNielsen reveals that the FMCG industry in India loses around USD 500 million annually to counterfeit and fake products. Counterfeiting/piracy is said to impact 8-10 percent of revenues in the FMCG sector.

Although no one would like to buy a fake bottle of water, cold drink, medicine or an expensive digital camera, unknowing purchases of counterfeit products constitute a substantial percentage of total piracy in the domestic market.

In addition to the impact of counterfeit across sectors, grey market products are rampant in the Indian markets; right from mobile handsets to high end consumer durables. While grey market for consumer durables is growing at a rate of 25 -30 percent, they account for over 50 percent of the domestic market of branded electronic products like digital cameras and gaming consoles⁵.

While there exist laws in India against counterfeiting, their enforcement remains a challenge. Overall assessment of the gravity of counterfeiting through in-depth investigations will go a long way in finding and abolishing the loop holes in the system.

FICCI in partnership with KPMG has undertaken this background note to highlight the challenges faced by Indian corporates owing to counterfeit and piracy and suggest recommendations to mitigate the resultant impact.

1. The Mint, Dec 6, 2007

2. India steps up fight against piracy, BBC, August 22, 2007

3. 5th Annual global PC software piracy study released by Business Software Alliance

4. Times of India – May 14, 2008

5. Financial Express, June 2007

Overview of Counterfeiting and Piracy



Counterfeiting and Piracy- A key global concern...

Today, counterfeiting and piracy are among the most challenging issues faced by most of the industries globally. The marketplace is inundated with illegal replicas of branded products, thereby eating into legitimate corporate revenues. Rapid change in technology has been widening the basket of counterfeited products. According to the US Chamber of Commerce, the impact of counterfeiting and piracy on the global economy accounts for USD 500-600 billion, approximating 5-7 percent of world trade. However, USD 200-250 billion is lost in sales each year in the US alone on account of counterfeiting and piracy.

Key Facts:

- According to the US Food and Drug Administration's (FDA) estimate, 10 percent of all prescription drugs sold globally are counterfeited
- The US Customs and Border Protection estimates that 14 percent of drugs sold through the mail are counterfeit, mishandled, or dated
- The Federal Aviation Administration, an agency of the United States Department of Transportation, estimates that 2 percent of the 26 million airplane parts installed each year are counterfeit
- The Motor and Equipment Manufacturers Association (MEMA) cites that counterfeit auto parts are violating the safety of customers globally¹.

The issue of counterfeit is not restricted to a particular sector or country. The issue is widespread across economies.

...and India is not an exception

Successful brands are being counterfeited and sold on an unprecedented scale in India due to the sheer size of the domestic market, high price sensitivity, improper coordination among enforcement agencies, and lack of knowledge among customers. Rising brand consciousness among the youth is contributing to the growth of counterfeited products in India.

As multinationals (MNCs) enter India in the wake of World Trade Organisation (WTO) and Trade Related Aspects of Intellectual Property Rights (TRIPS) related reforms, their branded products quickly attract the attention of sophisticated counterfeiting syndicates who increasingly have access to hi-tech production and the latest facilities. This phenomenon is not restricted to MNCs only, there are over 400 companies beginning with the word 'Reliance' and around 136 companies with the word 'Tata' in India².

Counterfeit and piracy in India is witnessed across sectors; fake medicines are estimated to occupy between 15 to 20 percent of the total Indian market. The Indian market is not

1. <http://www.brandprotectionalliance.org/news/piracy>.

2. <http://www.nipo.org.in/nationini.htm>

only flooded with spurious competition from allopathic drugs, but also fake homeopathic drugs. The music industry has not been spared; 40 percent of its production ends up being copied and distributed illegally in India. It is estimated that 1 in every 3 automotive parts are copied. Spurious car parts take up an estimated 45 percent of the auto component market in India.

The impact of counterfeiting in the FMCG sector is around 8-10 percent of revenues, thereby, hampering the quality of goods as well as raising health concerns³.

Overall assessment of the scale of counterfeit market activity by conducting in-depth field investigations may help in determining the weakest link in the counterfeit supply chain. Attacking the weakest link by deploying the right management tools may help in finding a practical solution for the problem.

Key Reasons for High Piracy Rates in India

- **Cheaper than original** : Most of the replica counterfeited /pirated products are sold at 40-45 percent lesser value than the original market rate. Customers are tempted to purchase these owing to the price factor and therefore, there exists a high demand for them
- **Easy availability** : These counterfeit parts are easily available in the market.
- **Limited knowledge** : Usually a layman with limited knowledge would fall prey to these bogus products owing to the cheap or discounted prices
- **Product packaging** : These products are packaged just like the original products and are then sold to unsuspecting customers
- **Poor enforcement of laws against piracy** : Enforcement of laws against piracy is not so strict in India

Key Impact of Counterfeiting / Piracy

Manufacturers

- Loss of sales by the organized players
- Loss of goodwill and prestige by a brand
- Counterfeiting and piracy undermine consumer confidence in these brands
- Adds expense of monitoring the market and instituting legal proceedings against infringers

Consumer

- Extorting a higher price from consumers for the infringing product
- Consumer deception about the quality of the counterfeit product, with the consequent risk to health and safety

Economy

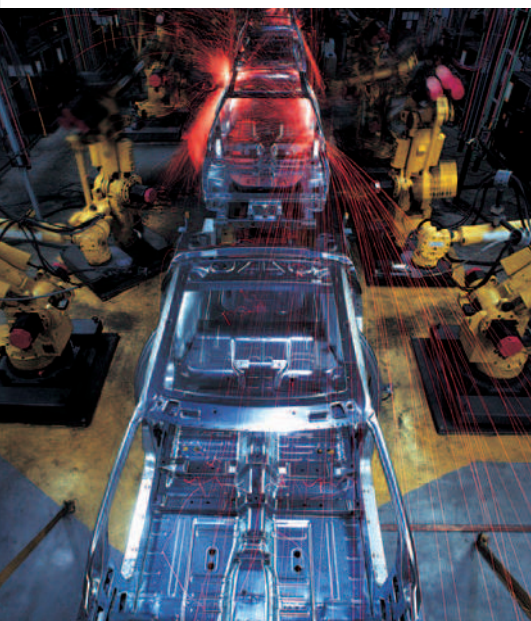
- Reduced tax revenues for government
- Loss of legitimate employment

Government

- Government spends more on enforcement procedures, product education to police and customs, on judiciary and convicts
- Counterfeiting and piracy may lead to more indirect dangers such as funding of anti-social elements

3. <http://www.nipo.org.in/nationini.htm>

Counterfeit and Piracy- Growing concerns in key sectors



Counterfeiting in Automobile and Auto Component sector

India's automobile industry has crossed the 10 million vehicles milestone in 2006-07¹. Today India is the second largest two-wheeler and fifth largest commercial vehicle market in the world. Growth in the auto industry is driving the auto components market thereby encouraging the counterfeit/pirated auto components business in India. In 2006-07, the size of the Indian auto components industry, including exports, was USD 14 billion². The replacement market alone was worth around USD 3 billion³.

A recent study by auto industry bodies, SIAM and ACMA estimate the counterfeit/piracy market size to be between USD 1 billion and USD 1.3 billion, accounting for 32 percent and 45 percent of the total replacement market³.

Counterfeiting of automotive products is a serious and rapidly growing issue, affecting automotive parts, accessories, packaging – and the vehicles segment as a whole. It is also relevant to note that sales of counterfeit parts directly affect the reputation and goodwill of manufactures.

| Most Commonly Counterfeited Parts and Accessories | | | | |
|--|--|---|--|---|
| Parts | | | Accessories | |
| Maintenance | Collision/Repair | Suspension | Automotive | Collection/Vintage |
| <ul style="list-style-type: none"> Oil Filter Air Filter Brakes Brake Linings Seals Rotors Flex Disks | <ul style="list-style-type: none"> Bumpers Covers Head Lamps Tail Lamps Sheet Metal Oil Pumps Water Pumps Mercedes Star Windshields | <ul style="list-style-type: none"> Steering Arms Tie Rods | <ul style="list-style-type: none"> Alloy Wheels Body Striping Decals Trim Plates Logos | <ul style="list-style-type: none"> Key Rings Caps Lighters Toys Model Cars Clothing |

Impact of counterfeited auto parts

- Counterfeit oil filters can cause sudden engine failure
- Counterfeit brake pads, made of grass clippings and saw dust, have caused fatal accidents
- Counterfeit windshields without safety shatterproof glass, cause injury or death

Impact of counterfeited accessories

- Counterfeiting and piracy undermine consumer confidence in these brands

Source: MEMA

1. SIAM
 2. Automotive Mission Plan 2006-2016 – Ministry of heavy Industries & Public Enterprises Government of India
 3. www.livemint.com, Dec 6, 2007

Original Equipment Manufacturers (OEM) are highly concerned over the issue of counterfeit products as the components business of OEMs is usually directly proportional to the profits of the company. A large chunk of the profits are therefore lost if counterfeit products are used in the after-sales service.

The cheaper alternatives not only affect the OEM profit margins but also put the vehicle using such products in serious potential danger; considering the fact that these counterfeit goods are not made in specialized workshops or factories which meet the standards of the original product. Further, the quality of the material that goes into manufacturing is compromised upon in order to sell it at much lower costs than the originals. The resultant profits are immense which is the primary reason that an increased number of counterfeiters are entering the market.

Media & Entertainment – Upgrading technology impacting the music and movie segment

According to a study conducted by the US – India Business Council (USIBC), the Indian economy loses approximately USD 4 billion in revenues and over 800,000 jobs as a result of piracy in the Indian entertainment industry⁴. The industry which already generates USD 11 billion annually, is growing at a combined annual rate of 18 percent⁵ could grow faster if the piracy was mitigated or stopped. Music and movies are among the worst affected segments by piracy in India.

It is estimated that 50 percent of the music sold on the streets and 60 percent of the movies sold are pirated⁶. The total loss to the music industry was around USD 140 -160 million in 2007 as a result of piracy alone. According to the Motion Pictures Association of America, the Indian film industry suffered USD 180 million in losses in 2005, owing to piracy⁷.

In the broadcasting segment, the total loss due to piracy in Asia Pacific was estimated to be USD 1.54 billion in 2007. India's pay-TV revenue leaks accounted for USD 985 million, a 44 percent increase than the previous year. In India, cable companies declared only 20 percent of their subscribers⁸.

There is a growing emphasis on curbing piracy by creating awareness and educating the industry on the means and methodology of deterrence to further reduce piracy. In addition to increasing awareness and improving policies, technology has also become a key part of the piracy solution with efforts gearing up to develop and implement effective digital watermarking, filtering and digital rights' management solutions.



4. Piracy in India's Entertainment Industry Causes Huge Losses to Indian Economy, US India Business Council, March 27, 2008

5. The Entertainment and Media Industry, Sustaining Growth, 2008 – FICCI report

6. India steps up fight against piracy, BBC, August 22, 2007

7. India and China film piracy mars industry, Business of Cinema, October 08, 2007

8. India Facts and Figures, International Chamber of Commerce

Counterfeiting in IT-ITES sector

Being one of the fastest-growing industries in India, IT/ITeS is also greatly affected by counterfeiting and piracy. As the Indian software industry expands exponentially, so does the growth in software piracy – so much so that it has almost become an industry in itself. According to a study conducted by BSA, a Washington-based non-profit trade association; the Indian IT- ITeS Industry has recorded a loss of USD 2 billion in 2007 due to software piracy compared to USD 1.2 billion in 2006⁹.

| Software Piracy Losses in Selected Countries 2007 | |
|---|-------------|
| Country | USD Million |
| United States | 8,040 |
| China | 6,664 |
| Russia | 4,123 |
| France | 2,601 |
| India | 2,025 |
| Germany | 1,937 |
| United Kingdom | 1,837 |
| Japan | 1,791 |
| Italy | 1,779 |
| Brazil | 1,617 |
| Canada | 1,017 |

| Software Piracy Rates in Selected Countries (%) | | | |
|---|------|------|------|
| Country | 2007 | 2006 | 2005 |
| United States | 20 | 21 | 21 |
| China | 82 | 82 | 86 |
| Russia | 73 | 80 | 83 |
| France | 42 | 45 | 47 |
| India | 69 | 71 | 72 |
| Germany | 27 | 28 | 27 |
| United Kingdom | 26 | 27 | 27 |
| Japan | 23 | 25 | 28 |
| Italy | 49 | 51 | 53 |
| Brazil | 59 | 60 | 64 |
| Canada | 33 | 34 | 33 |

Source: BSA

Key Reasons For High Piracy Rates In Indian IT-ITES

- High cost of original software
- Poor enforcement of laws against piracy
- Under – licensing - company may buy one copy or a few copies of the original software, and then use the original to download the software on more than one computer at the workplace
- Easy availability of pirated software in the grey market
- High usage of assembled PCs in India, wherein unauthorized packaging of pirated software is rampant
- Growing availability of illegal software on the Internet
- Improper software asset management by organizations

India, as an IT leader, needs a concrete, all-inclusive anti-piracy education, engagement and enforcement plan to effectively lower software piracy. This could be achieved through the right mix of improvement at all levels, in particular, raising general public awareness,

9. 5th Annual global PC software piracy study released by Business Software Alliance

“Studies have consistently shown that reducing piracy further would deliver significant benefits for local consumers, local software and services firms, small businesses, government tax collections, and the society and economy at large.”

– Keshav S Dhakad,
Chair of the BSA India Committee,
May 14 2008

establishing specialized Intellectual Property Rights (IPR), creating uniform and equipped IPR Police Cells and fostering greater Government-industry private partnerships.

The latest International Data Corporation (IDC) economic impact study cites that a 10 percent drop in software piracy over a period of 4 years in India is expected to generate about 44,000 new jobs, USD 200 million in tax revenues and add USD 3.1 billion to economic growth .

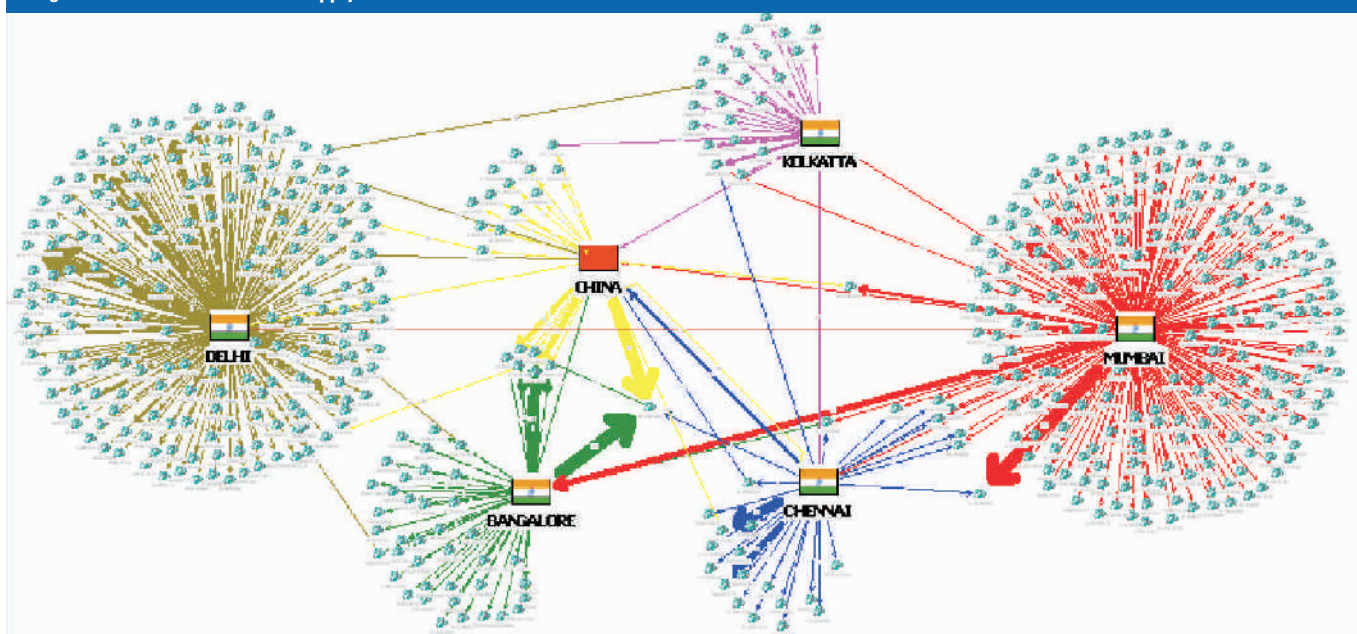
Case Study: Presence of large scale distribution network of high-end counterfeit software in India.

A company in the business of development, marketing and selling of software products, had witnessed a substantial drop in their revenues and sales over the years in India due to counterfeiting.

In recent past, the company's distribution channels in India had picked up market intelligence regarding extensive supplies of high-end counterfeits of their numerous products in the open market.

A comprehensive anti-counterfeiting strategy was planned to target wholesale and retail software markets in two main cities. The investigation with intelligence based market surveys was carried out across multiple cities to identify individuals/entities selling the software media at 15 percent below the genuine price of the product, which resulted in the creation of a sample database of retailers and distributors.

High End Software Counterfeit Supply Chain in India



Business relationships were established and test purchases were carried out with key players to uncover storage locations and business links. Sources and market intelligence revealed common business links among key players with retailers and distributors based in multiple cities.

Investigations were expanded and substantial evidence was gathered to validate the intelligence collected during earlier investigation. Forensic linked analysis was carried out to capture intelligence and uncover various elements in the all-India supply chain.

The company was able to expose the modus operandi adopted at all levels in the supply chain viz. importing, assembling, storage, transportation, distribution, sale and consumption. After uncovering the modus operandi prevalent at various levels of the supply chain, a specific model was developed to capture intelligence on dynamics of the high-end counterfeit software market in India. The dynamics included price, availability and ease of purchase of high-end counterfeit software.

Subsequently, individual target portfolios of key players identified in the supply chain were prepared for subsequent enforcement actions. A well-coordinated effort with various Indian enforcement agencies helped in conducting simultaneous enforcement actions across cities.

The enforcement actions created a strong fear factor amongst the individuals dealing in high-end counterfeit software. The company also witnessed a sharp rise in sales of their genuine products after the enforcement action. After experiencing success in India and through intelligence gathered on manufactures/exporters of counterfeit software, similar investigations were expanded to other Asian countries.

Pharmaceutical - Counterfeit drugs to raise health and safety issues

Counterfeit drugs are estimated to account for about 10 percent of the global pharma market, expected to touch USD 75 billion globally by 2010 as against USD 50 billion currently¹⁰. The Organization for Economic Cooperation and Development's (OECD) latest estimates suggests that approximately 75 percent of fake drugs supplied the world over are of Indian origin¹⁰. The Indian health ministry estimates that 5 percent of drugs in India are counterfeit and 0.3 percent spurious¹⁰. Both the Indian and the global figures highlight the urgency of the matter and the need for immediate action in order to curb counterfeit drug trafficking and circulation across nations.

On account of ambiguity and loopholes in the current regulatory environment, these counterfeit drugs are sold to consumers in a number of ways. Illegally operating internet



10. Times of India – May 14, 2008 article

pharmacies are one of the major sources of counterfeit drugs. Apart from this, the supply chain and distribution dynamics also play an important role in contributing towards this offence. There are wide occurrences of counterfeits in solid dosage forms; mostly tablets and capsules since their Active Pharmaceutical Ingredients (APIs) can easily be manipulated. Also, specialized treatment related products like injections, intravenous liquids and surgical consumables are reported to have high incidence of counterfeiting¹¹.

The increasing incidences and easy accessibility of counterfeit and spurious drugs is a cause of concern globally. Apart from the health and safety hazards caused by these drugs, they also tend to hamper the growth of the pharmaceutical industry as well as reduce the government revenue to a large extent.

Retail – Counterfeit products to impact brand image and brand

Counterfeiting has emerged as a vital issue across consumer product segments like cosmetics, toiletries, soft drinks, books and garments. Packed foods and the packaged water are the significantly affected segments by IPR violations in India.

Counterfeiting/piracy is said to impact 8-10 percent of revenues in the FMCG sector. Around 10 percent of the total soft drinks sold in India are fake and over 30 percent of the cosmetics, toiletries, and packaged food are counterfeit. There exist over 60 companies starting with the word 'Nike'; 65 companies starting with the word 'Rolex'.¹²

A study conducted by ACNielsen reveals that the FMCG industry in India loses around USD 500 million annually to counterfeit and fake products. Apart from loss of revenue, the company's brand image and brand loyalty could also get impacted negatively.

Price Differential between Counterfeit/Fake products and Originals

| Category / Brands | Original Product Price | Counterfeit / Fake Product Price |
|-----------------------|------------------------|----------------------------------|
| Watches | | |
| Rolex | 55,000 - 6,00,000 | 2,500-5,000 |
| TAG Heuer | 25000-1,30,000 | 1,500-3,000 |
| Sports Apparel | | |
| Nike | 600-2,000 | 150-300 |
| Adidas | 800-2,500 | 200-400 |
| Shoes | | |
| Nike | 1,800-5,000 | 800-1,500 |
| Adidas | 2,000-5,000 | 800-1,500 |

Note: Figures in INR.

Source: KPMG Research

Counterfeiting in consumer products has raised health and safety issues. Duplicate merchandise is more dangerous when it comes to cosmetics. Talcum powder, face creams, lipsticks, perfumes; all of which are spurious can be bought at inexpensive rates, but

11. Express Pharma – July 2008 article

12. <http://www.nipo.org.in/nationini.htm>

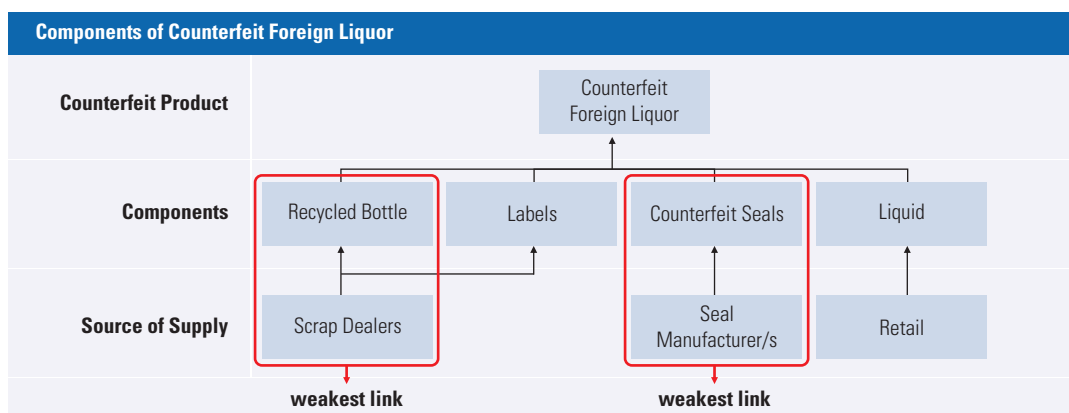
at the risk of allergies and other health concerns. From watches and handbags to electronics and cosmetics, India's fake merchandise market is thriving with grey market goods and products bearing names similar to those of well-established brands.

Case Study: Counterfeiting of premium brands of a multinational liquor company

One of the premium whisky brands had witnessed a sharp drop in their market share and revenues despite the fact that an independent brand loyalty survey conducted by the company revealed that their brand close to the top in terms of brand loyalty.

The company conducted external investigations into the Indian liquor market, to gather intelligence on individuals/entities indulging in sales of their premium brand at prices 20 – 30 percent lower than the retail price of the genuine product. A market survey strategy was also planned.

The market surveys and test purchases carried out with multiple retail and institutional establishments confirmed that there was large scale penetration of counterfeit and genuine grey market products of their premium brand in Mumbai.



Price analysis of the samples purchased revealed that the counterfeit product was found to be selling at 40 percent lower and the grey market product at 30 percent lower than the genuine retail price of the product. Focused investigations led to the identification of key players involved in the sales and distribution of grey market and spurious liquor in Mumbai.

Analysis of the information gathered gave details of key players involved in the sales and distribution of the counterfeit and grey market products of the company in major cities.

The company was successful in exposing the modus operandi adopted at all levels in the supply chain viz. manufacturing, packaging, assembling, storage, transportation, distribution, selling and consumption. After analyzing the different methods operated by the counterfeiters/traders, it was identified that all the components of the counterfeit product are recycled except for the seal, which was manufactured locally. Next, necessary intelligence was gathered on the seal manufacturer, scrap dealers and the large re-fillers based out of Mumbai for subsequent legal action.

Grey Market in India



In addition to counterfeiting and piracy, grey market products are a serious issue faced by organized players and customers. Grey market sellers may advertise products as new, authentic, and branded goods, but customers may end up receiving goods ranging from used or remarketed products to those that have been wholly or partially counterfeited or mislabeled. In a world where the lowest price is often a customer's top priority, an organized player finds it difficult to compete with deeply discounted grey market products.

At present, India is flooded with grey market products right from mobile handsets to high end consumer durables. The grey market for consumer durables is growing at a rate of 25 - 30 percent. Grey market products in India account for over 50 percent of the domestic market of branded electronic products like digital cameras and gaming consoles. These products are 15 - 40 percent cheaper than those in the organized branded products segment, thereby forcing local players to reduce prices by 20-30 percent¹.

According to industry estimates, the grey market accounts for over 20 percent of the total color televisions (CTVs) market in India, 30 percent of GSM mobiles, 90 percent of VCD and DVD players and 70 percent of car stereos. Parallel importers smuggle branded durables from other Asian countries like China, Japan, Singapore, Hong Kong and Nepal and sell them to select retailers who then refurbish the smuggled products with new packaging.

Higher taxes are largely accountable for the flourishing grey market in India. Branded products with their tax burden find it difficult to compete with smuggled products in the grey market.

The grey market is also largely responsible for the weak links in supply chain management. Establishing effective processes to identify and monitor the grey market diversion is a challenging task. Thereby, effective channel management is critical in combating this market.

Case Study: Creation of grey market for CDMA handsets across multiple countries by a telecom service provider

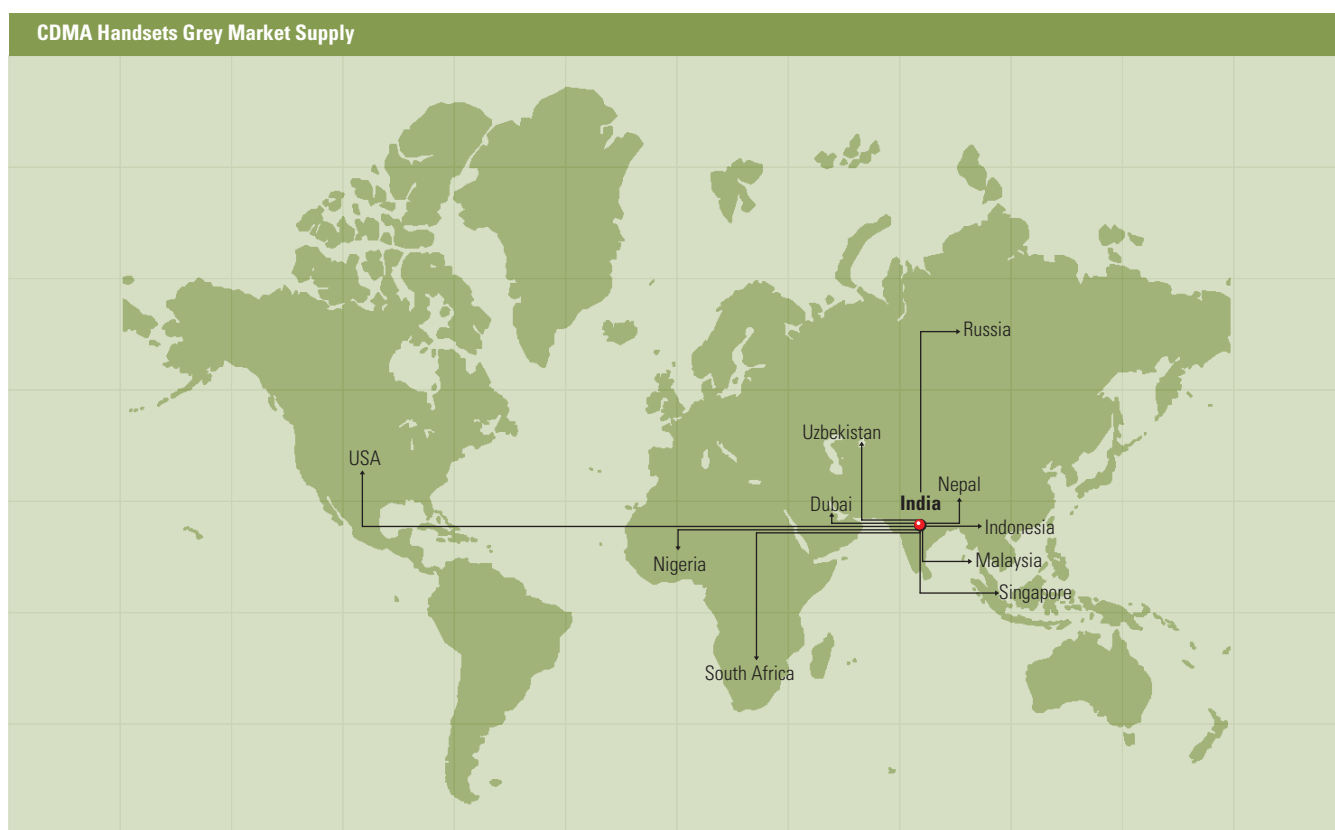
One of the large telecom service providers in India received purchase requests from traders of CDMA mobile handsets from select Asian countries. Subsequently, similar requests came from traders based in a few African countries.

The company had a suspicion that handsets sold to Indian customers at subsidized rates were being exported to foreign countries. The company subsequently conducted an investigation to validate these suspicions for understanding the scale of the grey market supply chain.

Interviews were carried out with players associated with the import and export of telecom products. Feedback gathered from various players revealed that CDMA handsets offered by Indian telecom service providers were in great demand in some of the Asian and African

1. Financial Express, June 2007

countries. The upfront subsidy on the handsets given by various telecom service operators in India to customers was distorted by exporters.

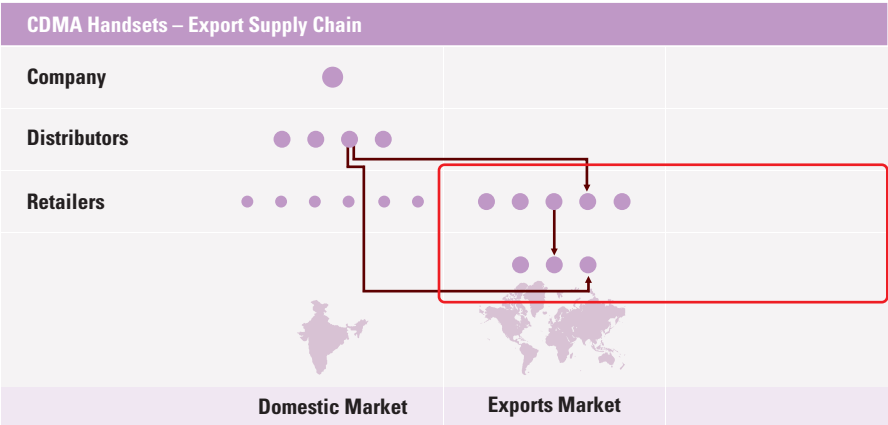


Note: Export markets identified are based upon information collected from various sources

The company conducted investigations in multiple cities by building interfaces with key elements in the supply chain. Majority of their authorized distributors were aware of the illegal exports of CDMA handsets outside India. Intelligence gathered from various sources indicated that exporters of CDMA handsets procure handsets from various wholesalers/aggregators. The aggregators procure handsets from distributors across India at best possible prices and sell in bulk to the exporters. The aggregators within the grey market supply chain help absorb the risk of price fluctuation existing in the market place at the time of purchase of a particular model of CDMA handset.

The exporters were identified through desktop research and sources like distributors, aggregators and employees of distributors. The company discovered that CDMA handsets were exported to countries like Indonesia, Nigeria and Russia on an extensive scale. The distributors were supposed to sell handsets along with starter kit or SIM card to various retailers in a particular telecom circle. However, the handsets and starter kit were sold

separately in the market. The handsets were being sold in bulk to aggregators, whereas the starter kits were being sold separately to the retailers. Further, the distributor availed commission from the telecom operator on the basis of the number of connections activated in a particular month. The commission ranged from INR 100 to INR 400, depending upon the slab which distributor was able to reach in a particular month. Hence, in order to reach the highest slab and to avail maximum commission, the distributor had to activate a corresponding number of connections. However, as the demand for connection in the market was not that high to support the required number of connections to reach the highest slab. Therefore, the distributors were indulging in activating multiple connections on the basis of fictitious/fake Customer Application Forms (CAF) to avail maximum amount of commission from respective telecom operators.



A part of the incentive earned by the distributor on activation was also passed on to the retailers by selling activated connections at a subsidized amount. In this way, the distributor sold maximum amount of connections, which were used as recharge vouchers by the end customers. The corresponding handsets were sold to aggregators, who in turn sold them to exporters.

The modus operandi was uncovered for export of CDMA handsets outside India. Link analysis helped in uncovering the business relationship between the different exporters operating in India. Subsequently, the company launched various projects to tighten the controls for activation of a connection which helped in restricting the exports of subsidized CDMA handsets.

Regulatory landscape in India



IPR in India comprise of copyright, trade mark, domain name, patents, designs, plant varieties, and others. With the adoption and ratification of the TRIPS Agreement, India needs to keep itself abreast of the international IPR standards and norms. Information and Communication Technology (ICT) has also given IPR in India a new meaning and shape. IPR in the digital era requires a diverse outlook and protection owing to which traditional methods are not always effective. IPR issues in cyberspace come with additional rights and liabilities for both the owner as well as the person dealing with them.

Though India's IPR laws are strong, enforcement continues to remain weak. In the recent annual report issued by the Office of the United States Trade Representative (USTR) on IPR violations; India was placed ninth on the Priority Watch List in 2008. The report cites that IPR protection and enforcement remains a serious concern in India. India's criminal IPR enforcement regime remains weak, therefore, improvement is needed in terms of police action against counterfeiters, expeditious judicial dispositions for copyright and trademark infringement and additionally, imposition of deterrent-level sentences for IPR infringers, and stronger border enforcement against counterfeit and pirated goods.

Recommendations



The following recommendations have been compiled based on a survey conducted by FICCI and KPMG among various industry players prior releasing this note:

- Conduct awareness and educate customers against piracy and counterfeiting through interactive events, PR and advertising. Consumers need to be made aware of the perils of using counterfeit/pirated goods
- Stricter laws and heavier punishments for counterfeiters should be implemented. Policy level changes with the Central and State government must be put into practice. Tightening and amendment of laws and enforcement, including setting up of fast track courts for trying IP crimes
- Enforcement agencies must get incentives for their efforts in surveillance of suspicious use of intellectual property by awarding them a share of benefits
- Tax authorities like Income Tax, VAT and Excise officials should also get involved and commence investigation for breach of laws and recovery
- Create a mechanism to intimate all government agencies of cases being filed either in court or to the police, etc.
- Involve and empower big consumer associations and fund them
- Effective anti-counterfeiting programs should be initiated at strategic level within the organizations. Industry needs to use more technology to develop, trace and track systems. Superficial enforcement actions against the counterfeiters alone are not likely to resolve the problem. Thorough investigations, detailed knowledge of local enforcement policies and understanding of the mechanism of the local counterfeit supply chain are essential in breaching counterfeit trade.

Recommendations to avoid grey marketing of products

- Include grey market mitigation on the board agenda and review channel compliance with the audit committee
- Develop solid strategies and formal policies for appropriate channel management
- Train employees to help identify and avoid grey market problems
- Implement a robust process for performing due diligence on new partners and special pricing deals. Ensure new partners are capable of meeting reporting requirements
- Understand and take advantage of positive legal protections such as coding product
- Review incentive programs to identify potential areas of weakness (that could be exploited by channel partners either deliberately or accidentally). If they are uncovered, take steps to strengthen them

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