

THE RISKS OF THE ONLINE COUNTERFEIT ECONOMY

A NETNAMES REPORT



NOVEMBER 2016

CONTENTS

EXECUTIVE SUMMARY	03
INTRODUCTION DANGERS OF THE DIGITAL AGE	05
PHARMACEUTICAL COUNTERFEITING: A BITTER PILL	09
TOBACCO COUNTERFEITING: A DEADLY HABIT	13
FOOD & DRINK COUNTERFEITING: MILKING A CASH COW	17
CONSUMER ELECTRONICS: A HOTSPOT FOR FAKES	21
APPAREL & ACCESSORIES: LUXURY AT ANY PRICE?	26
CONCLUSION: FIGHTING THE FAKES	30
FOOTNOTES	32

EXECUTIVE SUMMARY

“The digital age has revolutionized how we share information, store data, make purchases and develop products, requiring law enforcement to strengthen our defenses against cybercrime.¹”

Loretta Lynch

US Attorney General

GLOBALIZATION IS GOOD FOR (FAKE) BUSINESS

The collision of globalization and the booming online economy has created an ideal environment for counterfeiters, allowing them to sell goods directly to customers worldwide with virtually no barriers to entry, low overheads, easier distribution and fewer risks of being caught. Meanwhile, the growth of international brands has provided the perfect environment to target and take counterfeit versions to market, with consumers worldwide now using the web to hunt down big names at small prices.

THE WORLD IS A FRAUDSTER'S SHOP WINDOW

The online economy offers many new opportunities for counterfeiters to further their reach, profitability and anonymity. From unpoliced auction sites, online marketplaces and rogue websites, to illicit sales via social media and fraudulent mobile apps, counterfeiters now have more tools at their disposal than ever before. Meanwhile, fraudsters can also target brands and consumers with a new range of digital weapons, such as phishing, cybersquatting, traffic diversion and other forms of online fraud.

FMCGS ARE MOST TARGETED

By value, today's largest counterfeit markets are pharmaceuticals (\$200 billion), electronics (\$169 billion) and food (\$49 billion).² That said, tobacco products are the fake items most frequently seized by the authorities, while apparel and accessories make up the lion's share of the value of all counterfeit shipments globally.



IN HARM'S WAY: CONSUMERS, BRANDS AND ECONOMIES

The global counterfeiting boom poses many risks, from endangering consumer safety and diverting funds to organized crime, to harming industry innovation and eroding customer trust. However, the economic damage reigns supreme: counterfeiting costs G20 governments over \$125 billion³ every year, approximately \$24 billion of which is directly borne by taxpayers.⁴

COUNTERFEITING COSTS JOBS

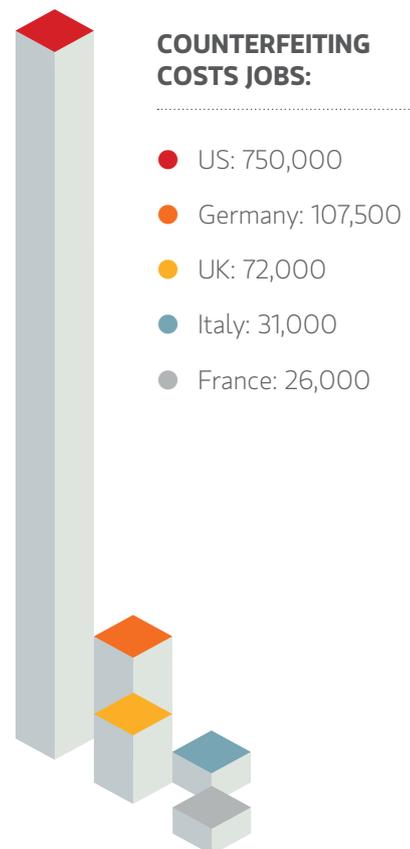
With legitimate sales being squeezed by fake goods, legal businesses are able to support fewer staff. As a result, counterfeiting is estimated to have destroyed around 2.5 million jobs worldwide.⁵ The US is the worst affected nation, seeing 750,000 jobs extinguished by fakes. Meanwhile, Germany (107,500), the UK (72,000), Italy (31,000) and France (26,300) are all estimated to be seeing total job losses that run into five figures or more, based on the size of their counterfeiting markets.⁶

BAD THINGS COME IN SMALL PACKAGES

With direct access to consumers worldwide, counterfeiters have been able to reduce mass shipments of fake goods to local distributors, instead opting for more frequent, but smaller consignments sent by mail. Unfortunately, this makes intercepting deliveries more difficult, as authorities struggle to check skyrocketing numbers of international shipments.

AN ORIENT EXPRESS

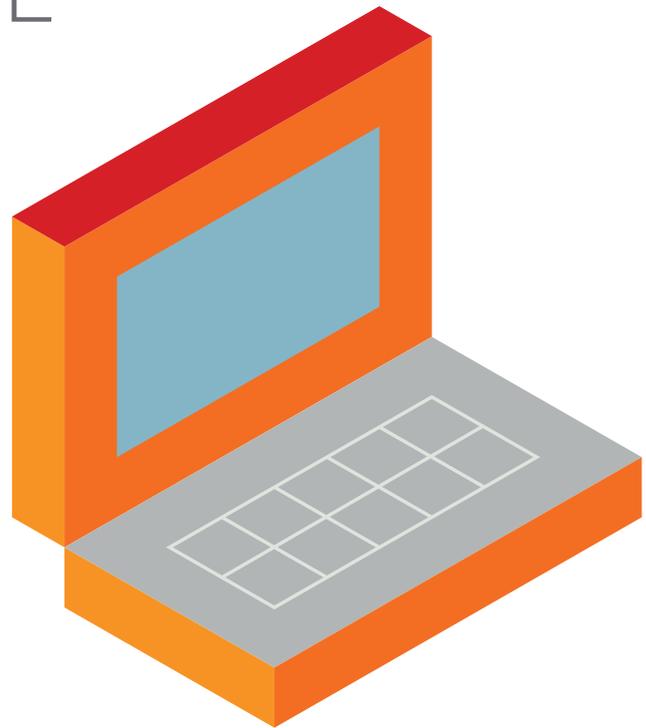
Although establishing the provenance of fakes is often challenging because counterfeit goods take deliberately complex routes to elude the authorities, Asia clearly leads the world in their production. In particular, the tidal wave of counterfeit and grey market goods from China shows little sign of being stemmed, remaining responsible for around 80% of seizures in 2015.⁷ While the FMCG sector depends on Chinese manufacturing, this same ecosystem provides a haven of production facilities, cheap labor and raw materials for counterfeiters.



INTRODUCTION: DANGERS OF THE DIGITAL AGE

Imagine your brand is facing a new competitor. A competitor that doesn't need to abide by industry regulations, that can slash production costs with unethical and illegal practices and that can cash in on your hard-won reputation to sell its own goods. Worse still, unlike you, this competitor is completely unaccountable to customers, shareholders and governments.

Unfortunately, that's the reality for many in the fast-moving consumer goods (FMCG) industry – the sector most impacted by the rise in global counterfeiting. With so many consumers now unwittingly duped into buying fakes online, brand reputations are being badly tarnished by those monetizing their global prestige, or by product recalls and liability claims when counterfeits infiltrate supply chains.



“The Internet has just completely changed the face of the problem, made it more complicated and more pervasive... whole industries now have been attacked, not from the street, but from the Internet.⁸”

John Morton

Assistant Secretary in charge of
US Immigration and Customs Enforcement

FORGING AHEAD

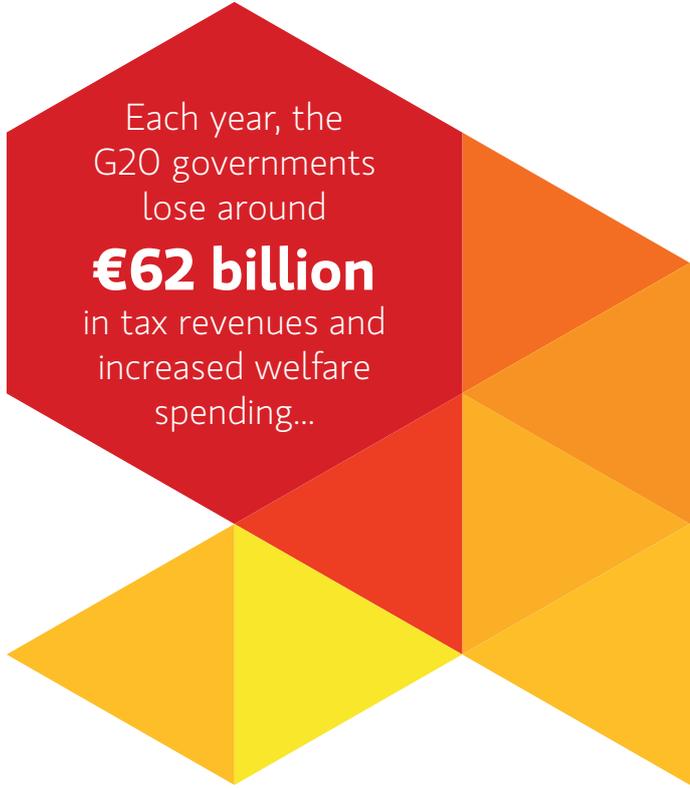
By definition, tracking the size of an illicit industry such as counterfeiting is a challenge. However, there seems little doubt that it is literally and figuratively forging ahead: in 1982, the size of the global counterfeit market was estimated at \$5.5 billion, compared with \$350 billion in 2001⁹ and \$1.7 trillion today.¹⁰

Sales of counterfeit goods dwarf not only everything else on the black market, but even highly developed national economies too. The value of global counterfeiting now towers above the GDP of nations such as Austria, Belgium and Sweden.¹¹ If that doesn't bring home the scale of the problem, consider that, on average, one in six products bought online today is a fake.¹²

The surging tide of global trade has carried fraudsters with it: opening up access to a worldwide market, making it more difficult to check multiplying shipments for fake goods and enabling complex distribution networks that elude the authorities.

Meanwhile, the explosion of online, mobile and social channels offers fraudsters low operating costs, easy and immediate access to a global customer base, and almost unbreakable anonymity. In a very real sense, today's brands are in direct competition with counterfeiters online: both are avidly pursuing greater traffic, sales conversions and profitability in an increasingly digital economy worth £2.7 trillion in the G20 alone,¹³ and where 40% of the Earth's population are potential buyers.¹⁴

Today, the sheer size, diversity and unregulated nature of the Internet exposes brands to a range of serious and evolving threats. It now takes just seconds to register a domain name, with few mechanisms in place to prevent someone immediately infringing on a trademark or intellectual property. A convincing copycat website or swish mobile app can be built in a couple of hours – although marketing and selling products on social media channels, auction sites and online marketplaces are all viable alternatives for fraudsters who are in a hurry to launch their counterfeiting operations or do not have the resources to hand.



Each year, the
G20 governments
lose around
€62 billion
in tax revenues and
increased welfare
spending...

A COMPLEX CHALLENGE

Counterfeiting is all the more difficult to combat because it's such a protean problem; criminals are more concerned with making a profit than how it's achieved. As such, counterfeit goods cover a considerable spectrum – here are just some of the potential avenues open to criminals:

- **Grey market goods:** Also known as 'parallel imports', these goods start life as legitimate products, manufactured by genuine brands. However, they are subsequently imported into another market and sold on without the consent of the brand owner (and usually with a considerable mark-up in price). For instance, Apple's iPhone 6 was smuggled into mainland China before consumers there could purchase it legally.¹⁵
- **Substitute goods:** Once again, these are legal goods produced by genuine brands, but they are then repackaged with counterfeit trademarks. Substitute goods are cheap to manufacture, but can net criminals huge profits by posing as more expensive brands. A good example could be seen in Italy earlier this year when Italian police seized 9,000 bottles of generic sparkling table wine rebranded as Moët & Chandon champagne – something that could have secured the criminals around €1.8m.¹⁶
- **Placebo goods:** While these fakes don't cause direct harm, they lack the crucial element expected by consumers. Perhaps the most insidious example is counterfeit drugs that contain no active ingredient. These fakes can cause treatment failure, or even death, when given to those with life-threatening conditions.¹⁷
- **Dangerous goods:** Sadly, some counterfeiters will stop at nothing to turn a profit, even if it means selling deadly substances or substandard parts. There are stark health and safety concerns in many industries due to counterfeiting, not least FMCG. For instance, in 2012 more than 20 people died after drinking methanol-contaminated alcohol in the Czech Republic.¹⁸ Given the substantial risks created by dangerous goods, it's becoming ever more critical for brands to take action and protect customers from fakes.



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FAKE ITEMS, REAL RISKS

The economic damage from online counterfeiting is both jaw-dropping and eye-watering. By slashing business revenues and harming employment, counterfeiting increases the need for welfare payments, while the funds it generates are diverted to organized crime – in turn necessitating more spending on policing. Of course, a visit from HMRC or the IRS is also low on any counterfeiter's list of concerns, so sales of fakes simultaneously starve governments of much needed taxation – even more so for products such as tobacco and alcohol, where VAT and excise duties are also lost



Each year, the G20 governments lose around €62 billion in tax revenues and increased welfare spending, as well as €20 billion from increased crime and €15.5 billion due to counterfeit-related deaths and healthcare costs.¹⁹ If the secondary impact of counterfeiting on foreign investment is also taken into account, the total costs rise still further.

For consumers, the dangers can be even more terrifying: from financial losses due to malware and fraud, through to physical injury and even death. Anti-freeze, cleaning products and nail polish remover have been found in counterfeit alcohol; sky-high levels of arsenic, lead and mercury in fake make-up. These goods present very real dangers and face none of the rigorous safety checks that legitimate products must undergo. Even cautious consumers can find themselves at risk as fakes increasingly infiltrate supply chains, such as substandard automotive components.

To help you protect your brand's reputation, customers, intellectual property and revenues in the digital age, NetNames has commissioned a detailed investigation of the issues by Cebr, the independent economics and business research consultancy, and has brought together multiple studies from around the world. Read on as we examine how the conjunction of counterfeiting and digital is impacting the most popular consumer goods – and how brands can fight back.

We welcome your views, thoughts and feedback. Please send any comments or questions to marketing@netnames.com.

PHARMACEUTICAL COUNTERFEITING: A BITTER PILL

“Criminals involved in the illegal supply of medical products through the Internet aren’t interested in your health – they’re interested in your money.²⁰”

Alastair Jeffrey

Head of Enforcement at the UK’s Medicines and Healthcare Products Regulatory Authority

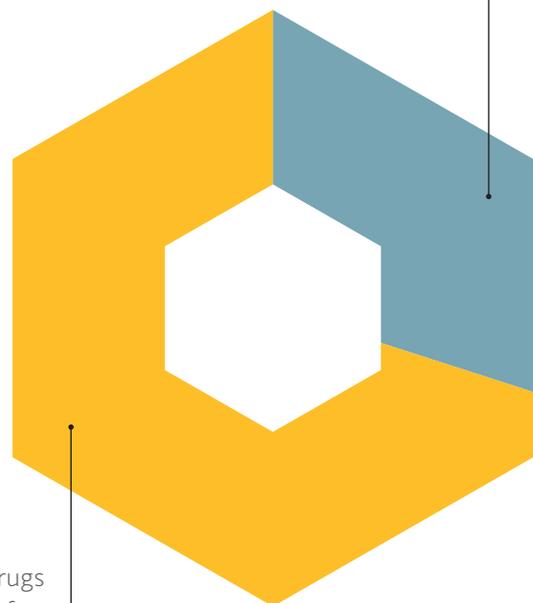
Worth \$200 billion a year,²¹ the market for counterfeit pharmaceuticals now eclipses almost everything else in the underground economy, including prostitution, human trafficking and illegal arms sales.

WHICH ITEMS ARE COUNTERFEITED?

Pharmaceutical counterfeiters rely on cost and convenience to drive sales: deliberately targeting the drugs that patients are unable to afford or find easily. Although fraudsters initially focused on the lifestyle drugs still sought in developed markets, such as those to control obesity and baldness, they now primarily target expensive, high-demand medicines.

Today, it’s estimated that up to a third of the world’s prescription drugs are counterfeit, although this figure is closer to two-thirds in some developing countries.^{22,23} Of these, more than half would be classified as ‘life-saving’, such as treatments for malaria, tuberculosis and HIV/AIDS.²⁴

Up to **30%** of all pharmaceutical drugs in circulation worldwide are counterfeit



Up to **70%** of all pharmaceutical drugs in developing countries are counterfeit

THE IMPACT ON CONSUMERS

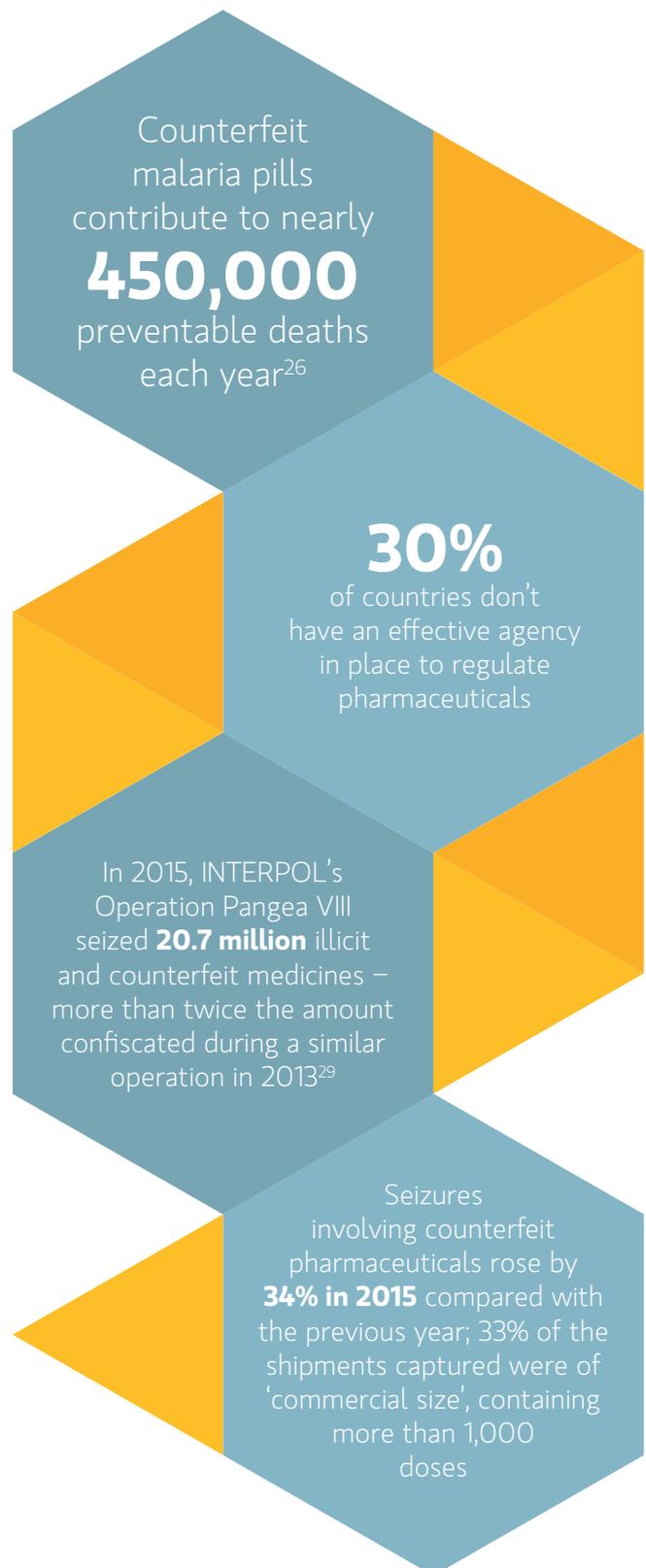
Counterfeit medicines pose an extreme risk. More than 20% either have incorrect quantities of active ingredients, or contain the wrong ingredients; around 30% contain no active ingredient at all.²⁵ As a result, counterfeit drugs can easily cause treatment failure or even death when given to those with life-threatening conditions.

Since in many cases the patients receiving counterfeit medicines are already seriously ill, it's difficult to quantify the number of deaths being caused, but it's estimated at up to a million people per year.²⁷ This illicit trade also has indirect effects on all consumers: for instance, the ineffective treatment of infectious diseases means they will continue to spread, while readier access to prescription drugs can increase antibiotic resistance.

COUNTERFEIT SEIZURES

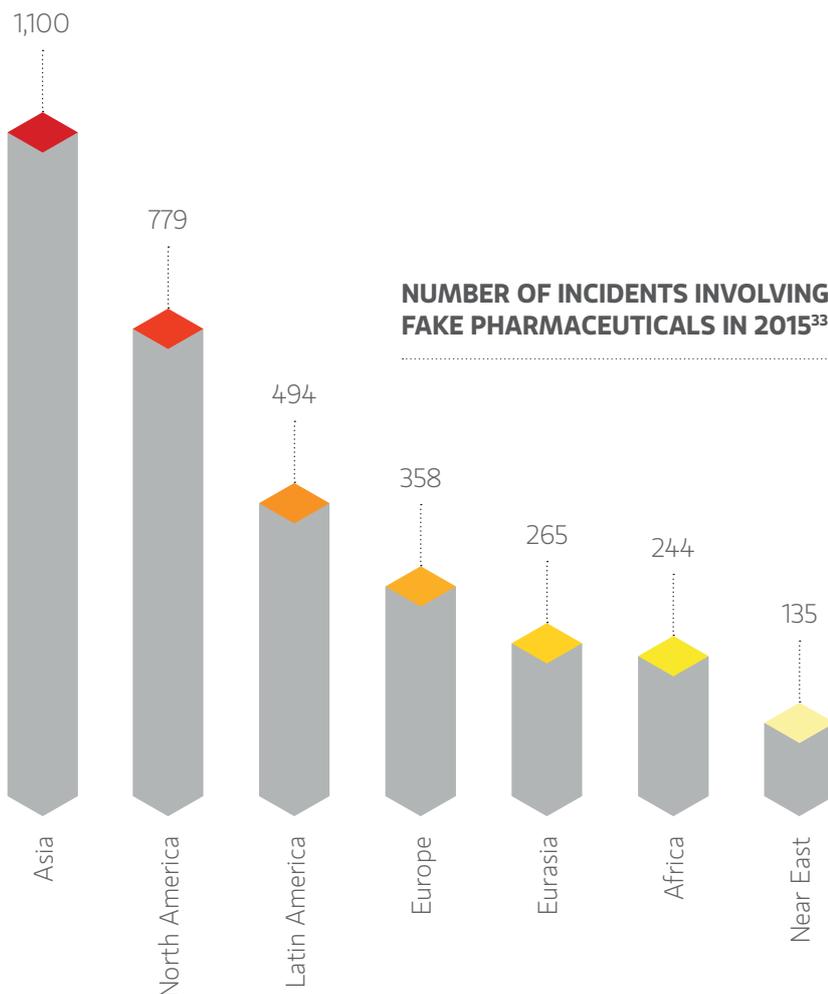
While medical products accounted for 7.9% of the counterfeit articles detained at EU borders in 2014, each of the products seized had an average original retail value of just €1.²⁸ This suggests that consumers in developed economies are buying counterfeits not to save on costs, but because the original drug is either unavailable or legitimate channels are too indiscreet to use. Worse still, they may be completely unaware that the drug they are buying is counterfeit. A report from PwC revealed that 31% of consumers who purchased counterfeit goods had no idea that they were fake.³⁰

However, the World Health Organization (WHO) estimates that a third of countries don't have an effective agency in place to regulate pharmaceuticals.³¹ This makes drug counterfeiting difficult to detect, investigate and quantify in the developing world, although recent seizures suggest the market is expanding rapidly. As a whole, seizures involving counterfeit pharmaceuticals rose by more than a third in 2015.³²



WHERE DO COUNTERFEIT ITEMS COME FROM?

Counterfeit drugs primarily originate in South East Asia, where regulatory systems are lax and low-cost labor is readily available. As thriving hubs for generic drug manufacturing, China and India are particular hotspots for counterfeit production – the very same factories can make legitimate pills during the day and counterfeits by night. In 2015, Asian countries reported 1,100 incidents involving counterfeit drugs – the largest number anywhere in the world and more than three times the levels seen in Europe.



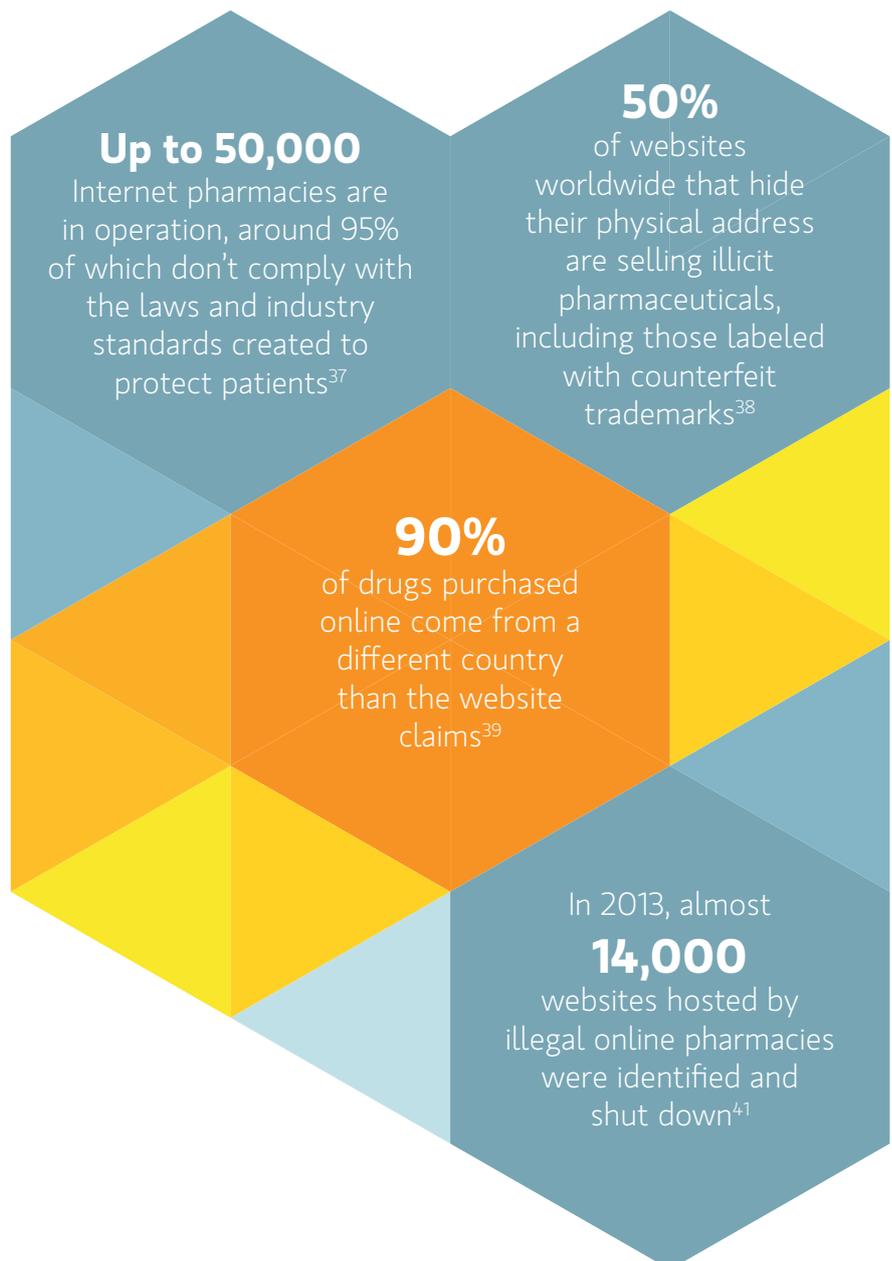
Three factories were dismantled and **150 tons of illicit drugs** seized during a recent INTERPOL operation in Southern Africa, including **424,000** fake antiretroviral tablets with an estimated value of **\$3.5m³⁴**

THE ROLE OF THE INTERNET

Today, the web is rife with so-called 'Internet pharmacies', as fraudsters exploit skyrocketing demand for prescription drugs. For counterfeiters, e-commerce offers low overheads, high profits and few risks of being caught. Any intervention by law enforcement and pharmaceutical brands has been likened to a game of 'whack-a-mole'; websites can simply be launched more quickly than the authorities can shut them down. Additionally, the arrival of the new gTLDs, including some health-related domain names, may create even more fragmentation, confusion and opportunities for fraud in the pharmaceutical market.

One online pharmaceutical network dismantled by US authorities earned \$55m in just two years⁴⁰

It's estimated there are up to 50,000 Internet pharmacies luring in global consumers at any one time,³⁵ with drugs usually arriving from a different country than the website claims – if they arrive at all.³⁶ For some fraudsters, simply gathering financial information from customers is more lucrative than selling drugs, while others thank their shoppers for stopping by with malware or phishing attacks as a precursor to financial fraud.



TOBACCO COUNTERFEITING: A DEADLY HABIT

The low cost of production, coupled with the high duty charges imposed on them around the world, makes counterfeit cigarettes the perfect target for profit-hungry criminal gangs. The lost taxes from this illicit trade amount each year to as much as \$7 billion in the US⁴³ and more than €10 billion in the EU.⁴⁴

“Consumers, retail outlets, manufacturers and governments all are harmed by the illicit trade in tobacco products. When consumers purchase illicit tobacco they undermine their own security.”

US State Department report, 2015.⁴²

WHICH ITEMS ARE COUNTERFEITED?

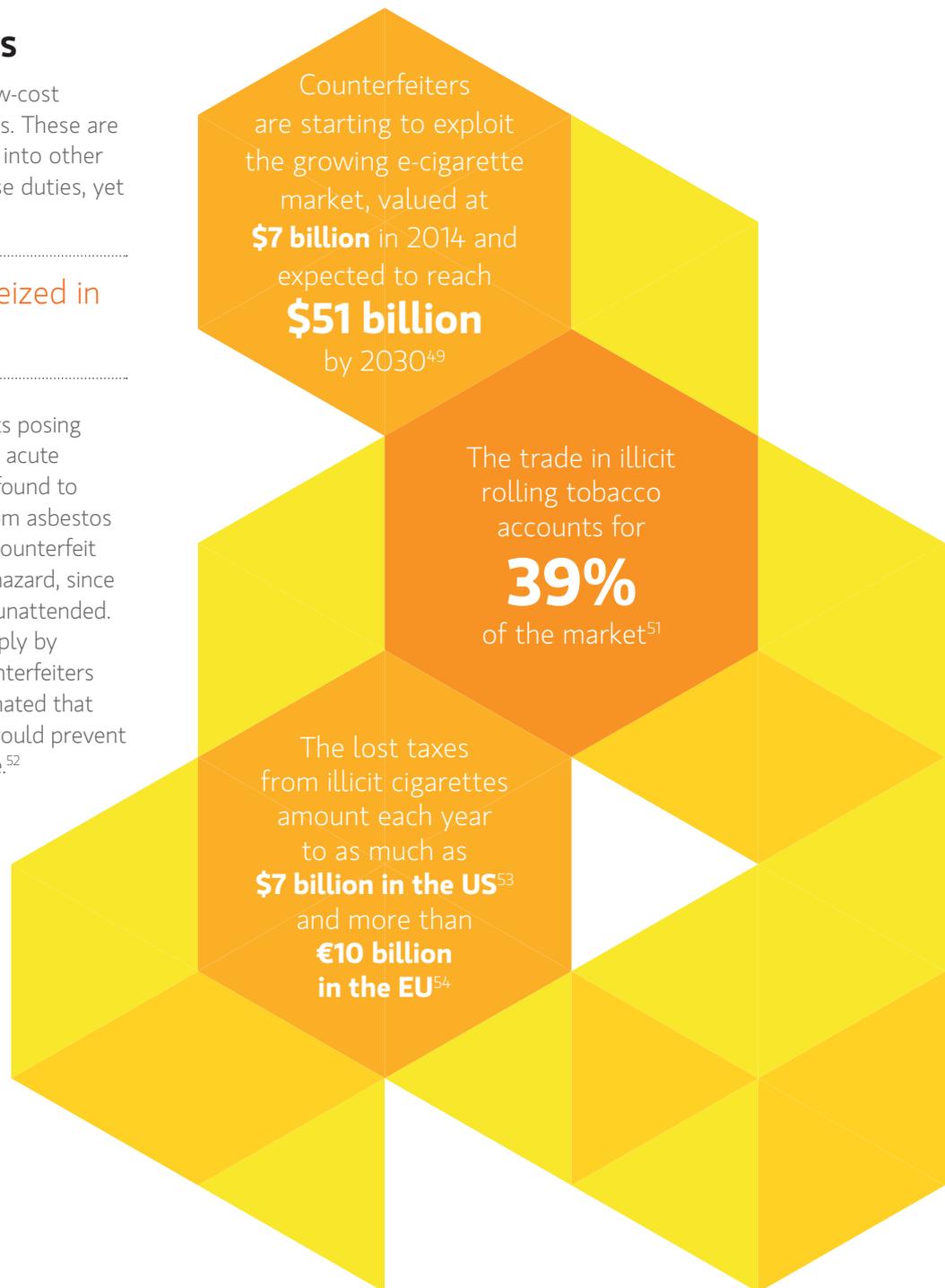
While cigars, rolling tobacco and e-cigarettes are all exposed to counterfeiting, illicit cigarettes are by far the most popular choice for fraudsters today. Up to 600 billion cigarettes smoked each year, or around 12% of worldwide consumption, are illegal.⁴⁵ Indeed, counterfeiters are now outcompeting major tobacco firms: while duty-paid sales continue to fall, the illicit cigarette trade grew by 5% in 2014,⁴⁶ with Marlboro topping the list as the most counterfeited brand, accounting for 56% of fakes.⁴⁷ However, counterfeiters are always quick to adapt; as the e-cigarette market sees mounting success worldwide, fraudsters are increasingly offering cheap e-cigarette ‘clones’ or fake liquid refills.

THE IMPACT ON CONSUMERS

Many consumers willingly opt for low-cost contraband or 'cheap white' cigarettes. These are produced legally, but then smuggled into other markets – avoiding taxation and excise duties, yet raising healthcare costs.

About 65% of cigarettes seized in the EU are counterfeit⁴⁸

However, counterfeit tobacco products posing as well-known brands create far more acute risks to consumers. These have been found to contain toxins and poisons ranging from asbestos to heavy metals such as cadmium.⁵⁰ Counterfeit cigarettes also pose a significant fire hazard, since they will not go out safely when left unattended. Some have even pointed out that simply by making tobacco more affordable, counterfeiters are putting lives at risk. It's been estimated that eliminating the illicit cigarette trade would prevent 38,000 deaths a year in Europe alone.⁵²



COUNTERFEIT SEIZURES

Tobacco counterfeiting is an acute problem for Europe, which accounts for almost two-thirds of seizures worldwide.⁵⁵ In 2014, more than a third of articles detained at EU borders were tobacco-related.⁵⁶ The motivation isn't difficult to fathom: fraudsters can make a potential profit of £1.5m if a single shipping container – each capable of holding more than eight million cigarettes⁵⁷ – successfully enters the target market.⁵⁸

Unsurprisingly, this makes counterfeit cigarettes a priority for organized crime, including the Mafia, Camorra and Yakuza. The United Nations Security Council has also traced illegal tobacco revenues worth millions of pounds flowing to al-Qaeda, the Taliban and other terrorist organizations.⁵⁹

In the UK, around one million packs of counterfeit cigarettes are seized by police every day⁶⁰

Chinese factories create 400 billion counterfeit cigarettes in a year - enough to give US smokers 460 packs each⁶¹

WHERE DO COUNTERFEIT ITEMS COME FROM?

The majority of counterfeit cigarettes are manufactured in China, although some fraudsters are moving production to Eastern Europe – especially Poland and the Baltic States – in order to benefit from reduced border security inside the EU's free trade zone. However, while the number of known illegal cigarette factories in the EU has almost doubled this decade,⁶² China still supplies almost all the counterfeit cigarettes in the US, and up to four-fifths of those in Europe.⁶³

Counterfeit cigarettes in the UK were found to have **500 times** as much cadmium as the genuine product

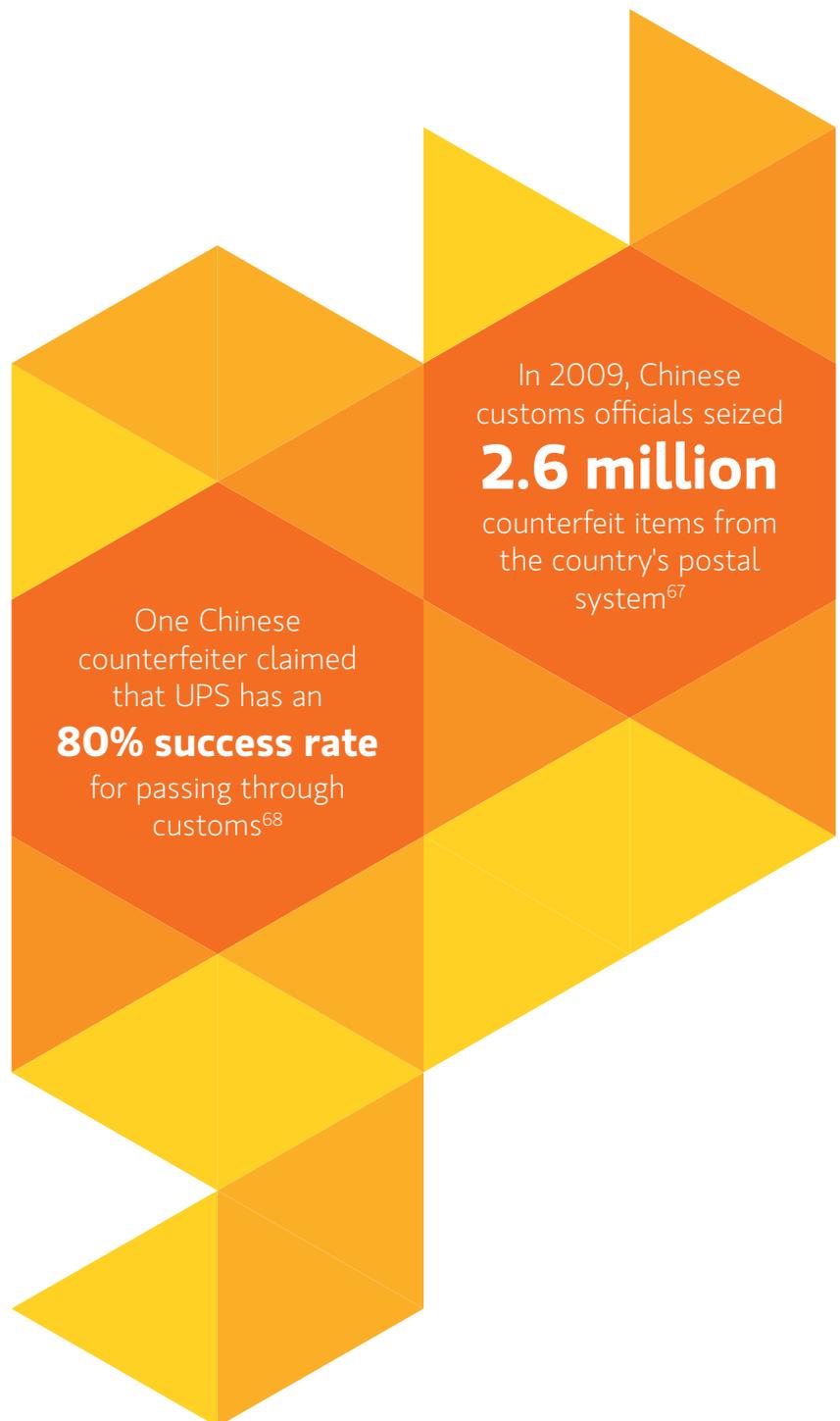
Eliminating the illicit cigarette trade would prevent **38,000 deaths** a year in Europe

THE ROLE OF THE INTERNET

Counterfeiters are rapidly developing the potential of online channels to drive sales; promoting 'Internet tobacconists' directly to consumers via forums, blogs and social media. Thanks to e-commerce, criminals can reduce more conspicuous bulk shipments, which are usually passed to illicit distributors inside the target country, in favor of smaller packages sent directly to consumers via mail and courier services. This not only makes shipments harder to intercept, it also reduces the ability of the authorities to seriously hamper counterfeiters when they are found.

Every year, US Customs processes around 250 million international and express mail parcels⁶⁴

Today, there are twice as many seizures of counterfeit cigarettes in mail centers than in airports and seaports combined.⁶⁵ Additionally, the European Commission found that the average counterfeit consignment has shrunk substantially in the past decade.⁶⁶ For example, shrinking from 3,623 articles per shipment in 2008 to 374 in 2014.



FOOD & DRINK COUNTERFEITING: MILKING A CASH COW

We may rarely think of food as a prime candidate for counterfeiting, but with the worldwide grocery market on course to reach \$12 trillion in the coming years,⁶⁹ it's a \$49 billion opportunity for fraudsters.⁷⁰

WHICH ITEMS ARE COUNTERFEITED?

With many retailers relying on convoluted international supply chains for their inventories or ingredients, and using highly convincing labeling that can be replicated with ease, criminals have ample opportunity to exploit this industry.

Olive oil, alcohol, honey and seafood are the most targeted foodstuffs; recent estimates suggest that up to 80% of olive oil in the US is fake,⁷³ along with 33% of its fish,⁷⁴ while a \$100m of counterfeit wine is circulating worldwide⁷⁵

Today, it's estimated that a tenth of all food purchases in the developed world are in some way contaminated by counterfeit ingredients.⁷⁶ Unsurprisingly, high-value, under-regulated products tend to be most targeted – such as olive oil, honey and seafood. Due to the high duty charges imposed, alcohol is also a heavily faked commodity since counterfeiters can undercut the market and attract buyers easily.

“Fake and dangerous food and drink threaten the health and safety of people around the world.”⁷¹

Michael Ellis

Assistant Director, Trafficking in Illicit Goods and Counterfeiting Unit, INTERPOL.



THE IMPACT ON CONSUMERS

Clearly, when counterfeiters target goods designed for human consumption, the health risks are considerable. While some counterfeiting poses little danger, such as relabeling legitimate sparkling wine as Champagne, other fake foods can contain deadly ingredients – such as anti-freeze, cleaning products and nail polish remover in counterfeit alcohol. Additionally, unregulated counterfeit producers also increase the risk of food-borne illnesses reaching consumers.

Counterfeit food can contain toxic substances, such as sugar mixed with fertilizer and olives soaked in copper sulphate to change their color⁷⁹

Alongside the health risks, there are considerable financial implications: sales of counterfeit food not only defraud consumers of money, they also undermine trust in the grocery sector – potentially driving down sales and increasing prices as supermarkets and restaurants are forced to invest in greater supply chain security.

More than 300 food recalls are reported every year, resulting in more than 75 million food-borne illnesses, 325,000 hospitalizations and 5,000 deaths⁸¹



In 2012, more than **20 people died** after drinking methanol-contaminated vodka and rum in the Czech Republic⁷⁸

Counterfeits can be sold by trusted retailers unknowingly: several US retailers were recently duped into selling Parmesan cheese mixed with wood pulp by a fraudulent supplier⁸⁰

More than 40% of Amazon's sales come through its third-party marketplace⁸²

COUNTERFEIT SEIZURES

Food fraud is on the rise globally, with the UK Food Standards Agency seeing more than a 30-fold increase in reports of counterfeiting within the past decade.⁸³ In the EU, food and beverages made up 6.2% of all counterfeit items seized, but accounted for less than 1% of their total value.⁸⁵ Unfortunately, this suggests that criminal gangs intend to generate revenues not through fake quality, but quantity: flooding markets with large numbers of everyday foodstuffs and putting consumers at increased risk. However, in many cases, the presence of counterfeit ingredients cannot be confirmed without lab tests, making the scale of this challenge even more nebulous.

In 2016, INTERPOL's Opson V operation led to its largest ever seizure of counterfeit food and drink. More than 10,000 tons and one million liters of hazardous fake food and drink were captured in coordinated raids across 57 countries⁸⁷



In the US, products regulated by the Food and Drug Administration already come from more than 300,000 facilities in 150 countries, with food imports projected to grow by up to 15% every year⁸⁹

WHERE DO COUNTERFEIT ITEMS COME FROM?

With the globalization of food manufacturing and more complex supply chains that depend on millions of producers,⁹⁰ food and drink fraud has evolved into a universal challenge involving almost every region of the world from Albania to Zimbabwe. While food and drink counterfeiting often has more to do with substituting cheaper ingredients or faking brand labels, origin fraud is also used. This includes activities such as renaming South American beef as European, Chinese wine as French, and American olive oil as Italian – all of which can hugely increase the prices commanded.

Comparing food traceability regulations in 20 nations, all 13 European countries assessed were judged to have superior visibility into their supply chains, China's was poor and the six deemed average included the US⁹¹

THE ROLE OF THE INTERNET

With much food and drink fraud concerned with infiltrating legitimate business-to-business supply chains, the Internet has played a less direct role in facilitating counterfeit sales here than in some other FMCG categories. However, with major grocers from Walmart to Tesco now heavily promoting online shopping, consumers are becoming increasingly used to making purchases via the Internet - around 11% of UK shoppers now do their weekly shop online.⁹²

Sales from Chinese sellers more than doubled on Amazon's marketplaces during 2015.⁹³ Amazon's marketplace sellers recently demanded that the retailer acts to stop Chinese counterfeiters using the platform⁹⁴

Unfortunately, counterfeiters have been quick to take advantage of this trend, as well as the rise of online marketplaces selling groceries, such as Amazon and Taobao. While most consumers are cautious about the provenance of food, these well-known retailers command a higher degree of trust and may even 'fulfil' orders. However, marketplace systems, in fact, offer little oversight of their third-party sellers and are a much-used channel by counterfeiters as a result.

CONSUMER ELECTRONICS: A HOTSPOT FOR FAKES

“With the average knock-off phone selling for around \$45, our conservative estimate of \$6 billion in illegal sales represents a massive financial loss for governments and the mobile phone industry.”⁹⁵

Michael Milligan

Secretary General, Mobile Manufacturers Forum.

Today, it's estimated that one in ten IT products sold worldwide may be counterfeit,⁹⁶ and in many cases these fakes, or fake components, infiltrate supply chains and are sold by legitimate retailers. In all, electronics counterfeiting is now a \$169 billion business worldwide.⁹⁷

WHICH ITEMS ARE COUNTERFEITED?

The consumer tech industry's complex supply chains and reliance on manufacturing in the Far East make it extremely vulnerable to fraudsters and grey market profiteers. However, counterfeiting is a particular challenge for the telecoms industry, given surging global demand. With one billion more global subscribers predicted by 2020 – largely driven by consumers in emerging markets – mobile handsets from aspirational brands such as Apple have become one of the most popular targets for criminals. Fake phones are now a \$6 billion industry, with counterfeits accounting for more than a fifth of the market in some countries.⁹⁸

One billion more mobile subscribers are predicted by 2020.⁹⁹ Counterfeiting is a \$6 billion+ problem for the telecoms industry, and 8% (148 million) of all mobile devices sold worldwide in 2013 were substandard or counterfeits¹⁰⁰

THE IMPACT ON CONSUMERS

Counterfeit consumer technology doesn't just endanger brand revenues and drive up prices, it also puts lives at risk – with instances of exploding smartphone batteries, substandard blenders and more hitting the headlines. Worryingly, almost a tenth of consumers would consider buying fake electrical goods to save money, but many more are at risk from substandard components managing to breach otherwise legitimate supply chains. According to the Electrical Safety Foundation International, one million counterfeit electrical products have been recalled by authorities in recent years, including extension cords, power strips and batteries.¹⁰²

After a Chinese air stewardess was killed by an electric shock when charging her iPhone 5, Apple started a global program to replace third-party and counterfeit USB chargers at a reduced price¹⁰⁴

8%

of UK consumers would consider buying fake electrical goods to save money, but 56% of those who did so experienced a problem¹⁰¹

In the US, **64% of counterfeit electronics sales** take place through legitimate retailers¹⁰³

Counterfeits account for **more than 20%** of the mobile phone market in India¹⁰⁵

2.5 million

UK consumers have either knowingly or accidentally bought a fake electrical product in the past 12 months¹⁰⁶



COUNTERFEIT SEIZURES

Global efforts to intercept and remove counterfeit electronics heavily focus on emerging markets, where they are most commonly produced and have the greatest saturation. Recent seizures in Asia have captured over 200,000 fake products, including imitations of well-known brands such as Apple, Samsung and BlackBerry.¹⁰⁸ However, mobile handsets also offer authorities more options when it comes to removing fakes from the market. In June, more than 600,000 counterfeit mobile phones were simply disconnected in Tanzania.¹⁰⁹ While effective at removing fakes from circulation, some criticized this approach as doing more harm to the consumers relying on these devices than the counterfeiters selling them.

Of \$104.4m in counterfeit consumer electronics and parts seized in the US, around \$71.5 million worth originated in China¹¹³

WHERE DO COUNTERFEIT ITEMS COME FROM?

Given that the Far East is the world's electronics workshop, it's not surprising that countries such as China also lead the charge in producing counterfeit products. In 2015, Chinese factories created more than 1.6 billion mobile phones for a market that sees annual global sales of just 1.8 billion. Unfortunately, the very same factories, staff and components can easily be used to make counterfeit goods. These products are often exported to Africa, leading to a flood of counterfeit technology across the continent – for example, four-fifths of electronics sold in Kenya are counterfeit, despite being bought from legitimate retailers.¹¹⁵

The Asia-Pacific region, including China, is the largest grey-handset market in the world, trading 103 million units in 2013¹¹⁶



Hewlett Packard ran 4,600 anti-counterfeiting investigations across 88 countries from 2008 to 2012, capturing over 36 million counterfeit cartridges and components. 25 million of those were seized in the Asia-Pacific region¹¹⁸

THE ROLE OF THE INTERNET

With consumers worldwide increasingly searching for big-name tech brands at low prices online, many are unwittingly buying fakes. Thanks to the rise of peer-to-peer auction sites such as eBay and Alibaba, counterfeiters can now advertise thousands of products with relative ease and anonymity. Current regulations do not require these retailers to pre-emptively remove counterfeit listings; they only need to do so when notified by the rights holder. With counterfeit goods leading to customer complaints and reputation damage for leading electronics brands, it's unsurprising that more than half of business managers in the telecoms industry are extremely or very concerned about brand protection in this evolving web landscape.¹²¹



APPAREL & ACCESSORIES: LUXURY AT ANY PRICE?

“Although luxury brands often restrict direct selling on sites like Amazon, unauthorized third-party listings are nearly impossible to prevent. [They] need to do a better job on consumer education... what are the tell-tale signs that a listing is fake?”¹²²

Brian Igel

Founding Partner at Bellizio + Igel.

Today’s consumers are demanding high-fashion goods at the lowest possible cost – and fraudsters are ready to exploit them. The European Commission estimates that sales of fakes now drain 10% of the fashion industry’s revenue in Europe,¹²³ worth around €26 billion every year.¹²⁴

WHICH ITEMS ARE COUNTERFEITED?

Thanks to globalization, the rise of social media and e-commerce, consumers everywhere know and aspire to own world-famous fashion brands. The word ‘counterfeit’ traditionally summons up images of fake handbags, so it’s no surprise that high-value, designer accessories are the most targeted items. It’s an extremely lucrative category: by value, personal accessories – including watches, jewelry, handbags and wallets – account for highest share of all counterfeit goods seized at both EU (32%) and US (59%) borders.^{125, 126} American fashion labels are the most faked (20%), followed by Italian (14%) and French brands (12%).¹²⁷

Based on the number of accessories detained and their total value, the average retail price of each accessory is €105. The category with the second-highest per item retail value is clothing (€42), followed by shoes (€38)¹²⁸

THE IMPACT ON CONSUMERS

While counterfeit clothing and accessories are of lower quality and can pose physical risks due to toxic dyes or flammability, it's the indirect impact from this form of counterfeiting that has the greatest effect on consumers.

Apparel and accessory counterfeiting costs the EU more than €8 billion in lost taxes¹³⁰

Since fewer sales directly translate into fewer staff, apparel and accessory counterfeiting is estimated to cost hundreds of thousands of jobs across the EU. Additionally, reduced tax revenues – adding up to billions in the EU alone – also limit the ability of governments to fund everything from welfare to healthcare, while the proceeds of counterfeiting often directly fund organized crime.

The knock-on effects of apparel and accessory counterfeiting are estimated to cost as many as 518,000 jobs across the EU¹³²

For high-fashion brands, this is not simply a financial problem; counterfeiting can also damage brand reputations to such an extent that they lose their status entirely. Customers who unknowingly buy fake products may associate their lack of quality with the genuine brand, and even more severe reputational damage can occur if counterfeit products are found to have been manufactured unethically – for example, in sweatshops.



COUNTERFEIT SEIZURES

Counterfeit designer clothing and accessories are the most common articles detained at EU borders for infringing intellectual property rights, making up more than a tenth of all seizures and more than half the total value of goods captured. It's a similar story in the US, with all fashion merchandise combined accounting for nearly three-quarters of the value of counterfeit seizures.¹³⁴

WHERE DO COUNTERFEIT ITEMS COME FROM?

China remains the largest source of counterfeits, with nearly two-thirds of global seizures originating either on the mainland or in Hong Kong.¹³⁵ Although other countries such as Turkey, Singapore, Thailand and India all contribute noticeably to the flow of fake apparel and accessories, they do so in much smaller quantities (each are responsible for 1-3% of the influx of counterfeit goods).¹³⁷ There is also evidence to suggest that counterfeit clothing and accessories are being produced in the Western world too, with manufacturing equipment found in countries including the US and Canada. A 2016 raid in New York discovered \$200,000 worth of industrial machinery able to produce hundreds of thousands of garments, along with more than \$1 million in counterfeit designer clothing.¹³⁸

In 2016, police in Thailand seized 895,897 fake sunglasses sporting the names of famous brands such as Ray-Ban, Oakley, Louis Vuitton and Christian Dior.¹⁴⁰

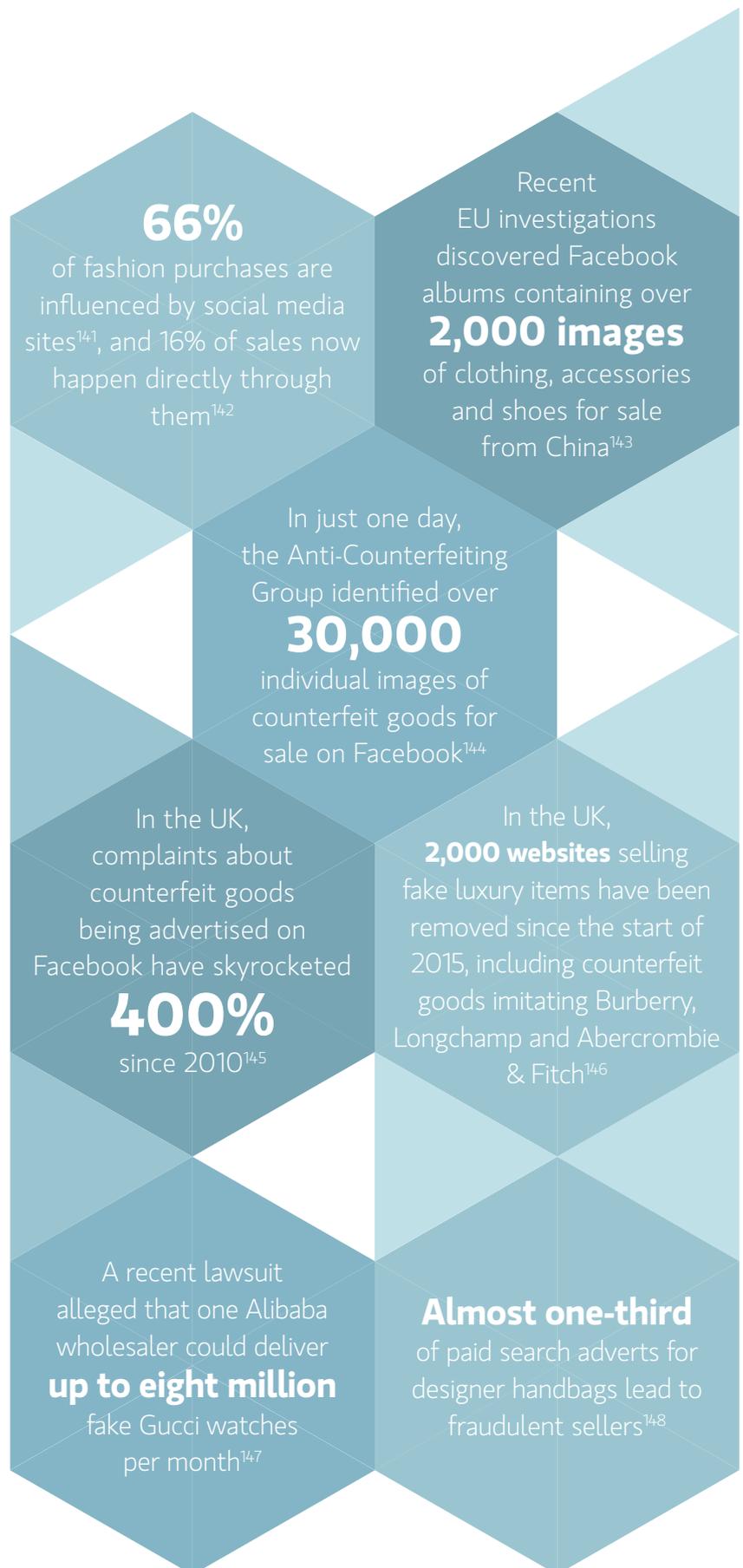


THE ROLE OF THE INTERNET

Counterfeiting in the fashion world highlights the rising challenge of social media. Although brands have been quick to harness the power of social interactions to drive sales and customer loyalty, counterfeiters have spotted the same opportunity. With little or no regulation to govern them, these platforms have now become a haven for those selling fake designer clothing and accessories.

Social media channels enable fraudsters to launch virtually zero-cost, global marketing campaigns. A few thousand followers can be purchased with ease, creating an authentic-looking digital footprint that can be used to exploit unwitting consumers for just a few dollars. However, while social profiles impersonating official brands are comparatively easy to find and remove, it's far harder to stop those selling counterfeit products through their own accounts. For instance, on platforms such as Facebook, counterfeiters can advertise fake products with near impunity in photo albums and groups, as well as buying targeted advertising that appears on users' timelines.

However, while social media may be the hot new channel for fashion fraudsters, online counterfeiters continue to use the tried and true methods as well: rogue e-commerce sites, paid search, peer-to-peer auctions, marketplace listings and more.



CONCLUSION:

FIGHTING THE FAKES

“In the digital world, the most valuable asset a brand has is its intellectual property, and we have made it our business to stay one step ahead of infringing forces.”¹⁴⁹

Andrew Brodsky

Commercial Director
at NetNames.

In 2016, Jack Ma, founder of Alibaba, has claimed that today’s “fake products... are of better quality and better price than the real names... it’s not the fake products that destroy them, it’s the new business models.”¹⁵⁰ Our glimpse into the collision of the FMCG sector and online counterfeiting paints a different picture.

Today’s pandemic of fakes is far from a new era for business; it’s an erosion of business. Counterfeiting drains sales from legitimate firms while requiring them to spend more defending their intellectual property – lowering wages and destroying jobs. Meanwhile, companies are less able to invest in future innovation and must elevate their prices – crushing creativity as much as profitability.

Of course, it’s not just brands being harmed by poor-quality, mass-produced fakes, but consumers and whole economies too. This is a trade that endangers lives, funds crime and impoverishes societies the world over. The online counterfeit economy creates a vicious circle, forcing governments to spend more on healthcare, welfare and policing

while simultaneously starving them of tax revenues. Where legitimate businesses can and should form a symbiotic relationship with governments, counterfeiting is purely parasitic.

However, the state of play in online counterfeiting makes it readily apparent that no brand can afford to underestimate the sophistication of the fraudsters now exploiting the digital world for their own ends. They have already proven exceptionally resourceful at adapting their tactics to exploit the ever-changing online environment, even migrating to cybercrime and information theft when it proves more lucrative.

In the European Union, a third of all counterfeit seizures are already linked to Internet distribution channels,¹⁵¹ with fraudsters cashing-in on rogue e-commerce sites, peer-to-peer auctions and online marketplaces. We can only expect this trend to accelerate in the next decade as counterfeiters increasingly exploit the illicit potential of social media and mobile apps, where there are fewer safeguards to protect brands and consumers.

Mobile, in particular, will be a channel to watch. More than half of all web browsing now happens via phones¹⁵², and we're using them to make ever more purchases – but smaller screens and on-the-go engagement may leave consumers more prone to being duped.

In this fast-changing environment, it's more crucial than ever for brand owners to manage their online presence carefully. Domain names are a brand's visibility on the Internet, making them one of the most vital and valuable assets a business can own. By proactively defending their digital assets, brand owners can safeguard not only their IP, but also legitimate traffic, their reputation and online revenues. Marketers, meanwhile, should be at the forefront of encouraging customer engagement and promoting

education in order to mitigate the risk from online counterfeits.

While the digital revolution has armed modern counterfeiters, it can also dramatically assist brands in finding and removing fraudulent sites, listings and apps. By using cutting-edge methods to detect, analyze and enforce against key infringers, brands can deploy a veritable arsenal of techniques against counterfeiters. The breadth of this type of response is only possible through digital technology.

Now is the time to develop a proactive and effective anti-counterfeiting strategy to safeguard customer confidence, brand equity, sales and revenues.

To learn more about how NetNames can help, please contact: **+44 (0)20 7015 1777** or email **marketing@netnames.com**.



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Country	Annual job loss
Denmark	700
Singapore	900
Norway	1,000
Sweden	2,000
Australia	9,700
France	26,300
Italy	31,000
UK	72,000
Germany	107,500
(US	750,000)
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