

# A-CAPP Paper Series



## Brand Protection as a Total Business Solution

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## preface

While there is debate about the definition of a counterfeit product, it generally refers to any good or packaging that bears a trademark that is virtually the same as one registered to an authorized trademark owner. Experts contend that brand owners who don't believe they have a counterfeiting problem either haven't looked or don't have a product worth "knocking off". While such a statement is typically met with a muted laugh, it's meant to underscore the fact that virtually every brand owner is a victim of product counterfeiting or, at least, they are at risk to it. Brand and product protection is a function that means different things to different companies, and its implementation varies considerably from one brand owner to the next. Through the Michigan State University Center for Anti-Counterfeiting and Product Protection (<http://a-capp.msu.edu/>), we work with countless brand owners around the globe on brand protection benchmarking, analysis, training, and outreach. In our experience, they tend to fall on a continuum, both within and across industries, relative to the effort and resources they allocate to this function. Some are very progressive, pushing industry standards for proactive strategy and tactics. Others have their virtual head in the sand, and either do not consider the problem, fail to look for or ignore potential red-flag indicators, or simply devote minimal resources and superficial attention to it when a problem arises. The bulk of companies fall somewhere in between these two extremes. In this paper, we aim to raise awareness about the importance of brand protection, factors that give rise to product counterfeiting, and existing and promising approaches to building effective brand protection programs. Our aim is to encourage corporate leaders to think about brand protection as a total business solution, and to push their brand protection programs toward the more proactive end of the response continuum where effort focuses on prevention over reaction.

## About A-CAPP

The Michigan State University Center for Anti-Counterfeiting and Product Protection (A-CAPP) is the first academic body focusing on the complex global issues of anti-counterfeiting and protection of all products, across all industries, and in all markets, and on strategies to effectively detect, deter, and respond to the crime. Linking industry, government, academic, and other stakeholders through interdisciplinary and translational research, education, and outreach, the A-CAPP serves as an international hub for evidence-based anti-counterfeit strategy. For more information and opportunities to partner, contact Dr. Jeremy Wilson, Director of the A-CAPP, at (517)432-2204 or [jwilson@msu.edu](mailto:jwilson@msu.edu). Additional information can also be found at <http://www.a-capp.msu.edu>.

## Protecting Brands Is Important

Reputation of a brand drives how the products will perform in the marketplace. A strong brand is what many consumers use to make the final purchasing decision. It represents a “contract of expectations” between the company and the consumer. When the reputation of a brand is damaged, the consumer is less likely to trust that the “contract of expectations” will be satisfactorily met. Damage to a brand is usually more expensive to recover from than proactively taking steps to protect it.

In many instances, authenticating the brand has become the topic of standards created through professional certification organizations including SAE and ISO and even legislation. For example, SAE standard AS5553A is intended for use in the aviation, space, defense and other high performance/reliability electronic equipment applications and includes establishing criteria for the control of suspect or confirmed counterfeit/fraudulent electrical parts and reporting to other potential users and authority having jurisdiction. ISO 12931 establishes specific performance criteria for authentication solutions used to establish authenticity throughout the good life cycle of a product. The Drug Quality and Security Act will require serial numbers to be added to all pharmaceutical products. Such regulations are a means of tracing movement of product

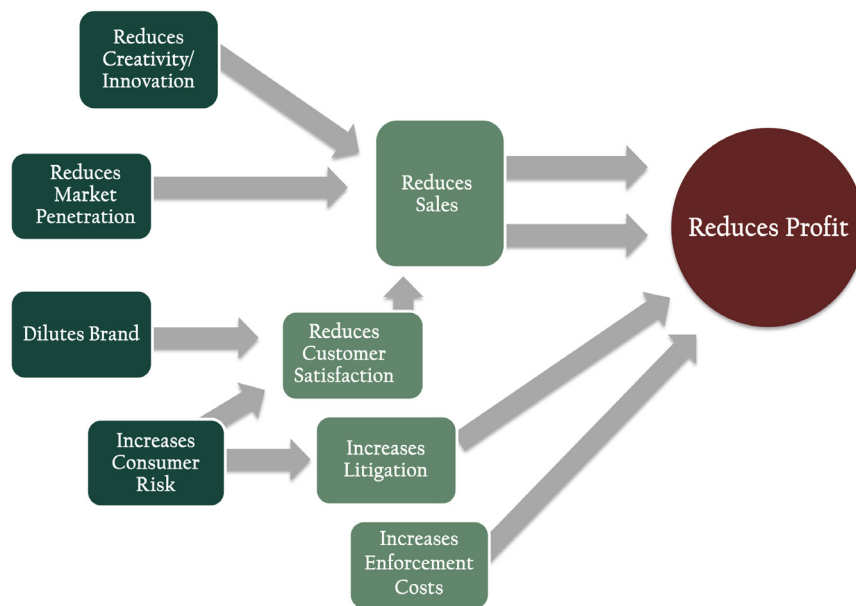


Figure 1. Effects of Product Counterfeiting on Corporate Profitability

through the supply chain and to assist in protecting the integrity of product from company of origin to the retailer. Finally, long-term financial success depends on protecting the brand. Consider specifically the risk of product counterfeits, which are a trademark violation and a fundamental threat to the brand. Through the production and sale of counterfeit product, the counterfeiter can be thought of as an “unseen competitor that undermines corporate profit. As depicted in Figure 1., this occurs both directly and indirectly. Through inferior and unreliable products (though some counterfeits are higher quality than others), counterfeits dilute the value of the brand,



which reduces customer satisfaction with the branded product. These same products increase veer from using quality, safe materials and manufacturing products to specified standards. This, of course, is reason enough to combat product counterfeiters. Yet it also reduces customer satisfaction while simultaneously increasing the risk of litigation as a result of customers and others filing suit against the brand owner.



Product sales are reduced as a result of declining customer satisfaction with the brand, but this is not the only factor that begins to drive down sales due to counterfeits in the marketplace. The mere presence of counterfeits can serve to stifle creativity and innovation as there is less incentive to invest in research and development and to create new products when criminals are poised to immediately steal and profit from the hard-earned intellectual property of the company. Similarly, by flooding the market with counterfeits, the unseen competitor reduces the penetration of the authentic, branded product in the marketplace. Particularly when the counterfeits sold are deceptive and consumers are duped into buying a counterfeit instead of an authentic product (as opposed to nondeceptive when they understand they are purchasing counterfeit products), this reduces the probability that any given product purchased will actually be that of the brand owner. Of course, there is not a legal distinction between deceptive and nondeceptive counterfeits—both are illegal and damage the trademark owner and result in other detrimental economic and social consequences.



By simple math, these detrimental consequences combine to reduce profits. As shown in Figure 1, profits are a function of (among other things) sales and litigation. The presence of counterfeits in the marketplace reduces sales and increases litigation, which inhibits profits. At the same time, it is necessary for brand owners to combat product counterfeiting through prevention, detection, investigation and enforcement. These costs, like the others, affect the bottom line. However, it is important to acknowledge that, like other risks, investment in preventing product counterfeiting can ultimately save the company far more than its cost while also protect the safety and well-being of its customers.



Of course, many brand owners don't believe this applies to them because they don't believe their products are being counterfeited, or they have taken the position that since they didn't create the counterfeits they are not responsible for correcting the problem. This is short-sighted. If a brand owner isn't aware of its products being counterfeited it's probably not looking. And even if they aren't being counterfeited currently they are likely at risk of it, and once counterfeits are in the market place the damage begins. While it is common to think that luxury or designer items are the most susceptible, the fact is virtually ANY PRODUCT CAN BE COUNTERFEITED. Automotive and electronic parts, pharmaceuticals and medical products, food and beverages—everything from Christmas tree lights, toys, and toothpaste to aviation parts, nuclear power plant components, and pesticides, and everything in between. The more successful the brand is and the greater the demand for the product the more likely it is to be counterfeited, especially when there are few legitimate alternatives in the market place.

## Business Conditions Create Product Counterfeit Opportunity

Many factors serve to increase the opportunity for counterfeit products to be produced (see Figure 2). Chief among them are globalization and technology, which make the world a smaller place. Through advancements in communication, transportation, manufacturing, distribution, etc., demand created in one region can easily be detected and fulfilled by another on the other side of the world. The internet alone has created vast opportunities to market and sell deceptive and nondeceptive counterfeits of all forms (not to mention bolster gray markets and diversion), and with relative anonymity. Consider also the opportunities for counterfeiters made available by advances in 3-D printing.

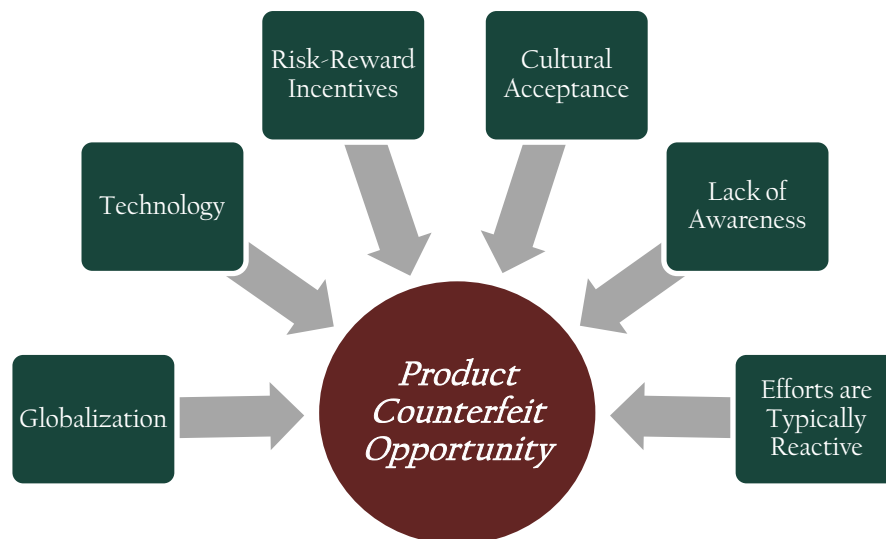


Figure 2. Product Counterfeit Risk-Reward Opportunity Structure



The risk-reward structure of product counterfeiting serves to incentivize the crime. According to experts, at least three conditions make counterfeiting attractive. First, although this may vary from one product or industry to the next, entrance into market can be easy. For example, equipment such as a pill press required to manufacture counterfeit pharmaceuticals can be purchased directly from online auction websites, 3-D printers can facilitate the production of components if not entire products and packages, and digital print technology, which includes small desktop models, has made high quality printing of packaging components much faster and easier for counterfeiters. Counterfeiters only need to find affordable products on the open market from stock lifts, excess and obsolete inventories or scrap to present a product in the market that by all appearances is the genuine, new product.

Second, the profits earned from counterfeiting products can be enormous, rivaling that of the illicit narcotics trade. Given counterfeiters can produce products with inferior or even missing parts, using illicit or otherwise inexpensive labor, without costs for research and development, and without concern or costs for safety and durability or regulatory standards yet still charge a competitive or near competitive price, while drawing on recognition of the brand, the potential profit margin they stand to gain can be quite large.



Finally, compared to other crimes, the risk of penalties for counterfeiting a product can be low. Many counterfeiters go undetected, or, at least, they do not rise to the level at which a brand owner or law enforcement agency would pursue them. If detected and pursued, investigations are time consuming and expensive, and not all are eventually caught and then charged criminally or sued civilly. Given the complexity of cases, particularly as they involve multiple, often international, jurisdictions and that the judicial system in many instances does not prioritize product counterfeiting cases, pursued counterfeiters may not be convicted or obtain a ruling against them or, if they do, the penalty may not be as great as the damage caused. This isn't to say that there aren't many examples of counterfeiters receiving long prison terms and large fines and damages, but, on average, the risk of apprehension and then ultimately receiving a stiff penalty are low, resulting in low deterrence. For instance, as explained in

a June 2014 FBI press release, serving as a money launderer, a member of the largest product counterfeit goods conspiracy ever charged (estimated at over \$300M) received a 46-month prison sentence. While certainly a win for law enforcement and brand owners, it will be up to potential counterfeiters to determine if this sentence deters their actions.

In some emerging markets, cultural acceptance can create a supportive environment for counterfeiters to apply their trade and even thrive. Countries vary in the way they think about intellectual property and proscribe its violation. What one considers an infringement another may not. Additionally, in some regions authorities may tacitly support counterfeiters by turning a blind eye to their operation due to positive social conditions they help to promote, such as employment for local residents and various forms of taxes. The argument is often made that it is the demand for “stuff” that drives the market and emerging markets are filling that demand with manufacturing operations that provide economic growth to their local economies.

Moreover, consumers and law enforcement, and even in some instances brand owners, often have little awareness of product counterfeiting. Think about the last product you or a family member purchased, was any consideration given as to whether it might have been counterfeit prior to buying it? What about the last product you had that failed to work properly? Many consumers simply do not think to question the authenticity of the products they purchase, and, when they do, they may not know where to report it. Similarly, local police, who are often in a good position to spot counterfeits and assist consumers and brand owners, often know little about product counterfeiting, consider it something best left to other law enforcement organizations, and find it difficult to allocate resources to the problem given other crime they must prioritize. Furthermore, brand owner responses are typically reactive, which allows counterfeiters to get the upper hand, but we discuss this below. All these conditions create an environment conducive to product counterfeiting.

## **Product Counterfeiting is Important to Address**

Above we discussed how product counterfeits affect profitability. Estimates put this annual loss to U.S. businesses at nearly \$250B. For the brand owner, this is a primary reason to take this risk seriously. However, there are many other reasons that brand owners, and indeed governments, consumers, and other stakeholders, need to work toward combating counterfeits. Experts and data suggest the counterfeit problem is large and growing. Measuring the prevalence of product counterfeits as well as the scope and scale of its detrimental consequences is very complicated and existing estimates, which are widely cited, are fraught with methodological problems and generally considered unreliable. A full discussion of these issues is far beyond the scope of the present article, but it is worthwhile to review some of the common estimates and features to place the

crime in context. Commonly cited estimates suggest counterfeits account for 2-7% of higher than in the early 1980s, when it was estimated to be just over \$5B.



Consumer health and safety are additional reasons to prevent product counterfeiting. Consider just counterfeit generic and branded pharmaceuticals, which could contain incorrect and unsafe ingredients, or no or insufficient active ingredients. These are thought to represent upwards of 15% of the world's drug supply, and are responsible for many injuries and deaths. The consequences can be catastrophic, especially where demand for life-saving drugs are high and resources to combat counterfeits are minimal. For example, anti-malaria drugs consumed with low potency make the person more subject to infection and death by lowering resistance to the actual disease. Low potency is becoming a critical issue in the anti-biotic arena as it allows old strains of bacteria to once again become more harmful to humans and animals. Related, a counterfeit pesticide could wipe out a sorely needed crop in a developing nation, thereby leading to malnutrition and further disease susceptibility for an entire village. Of course, counterfeits in virtually every industry can be dangerous. Consider the potential implications of counterfeits in military, nuclear power, agriculture, water, communication, and aviation applications, for example.



Governments and the economy suffer from counterfeits too. Taxes aren't paid on counterfeit purchases, which often supplant legitimate sales, thereby preventing taxes from being collected on those purchases as well. In addition, governments must spend considerable scarce resources to investigate violations and enforce intellectual property rights, not to mention the considerable resources just to destroy counterfeits. Due to loss in revenue and incentives to innovate, the economy suffers from a significant loss of jobs and diminished economic growth.



Finally, society in general suffers from product counterfeits. Counterfeits represent a risk to national security by infiltrating the defense supply chain, and many other crimes are associated with product counterfeiting. Both international crime syndicates and terrorist groups have engaged in counterfeiting to fuel their enterprises.



Much more systematic research needs to be done to understand the nature of product counterfeiting, and its scale and consequences. We know existing estimates are unreliable, and, in some ways, we don't know what we don't know. Yet, despite the thought by some, we know product counterfeiting is not a victimless crime. As described above it has multidimensional consequences and victims. We also know that virtually all brand owners are at risk—small and large. Small companies may have only a single or few products so the existence of counterfeits can be devastating to their survival. By contrast, large companies may have many brands, a diverse portfolio of products and suppliers, etc., so the opportunity to penetrate the market with counterfeits is greater. All these reasons make product counterfeiting worth a concerted effort to address.

## Typical Brand Protection Programs Are Weak

Historically, brand owners that could afford their own brand protection programs have made them enforcement-driven if not exclusively enforcement-based. This tends to coincide with a tactical emphasis, where, also, incidents are tackled individually after they occur. While effective to some degree, these reactive approaches limit opportunities for ongoing proactive practices that could mitigate a brand owner's risk of having a product counterfeited. Other brand owners that are unable to dedicate resources to an enforcement based program have virtually no brand protection program or take a minimalist approach to the problem. Unprepared, this places them in a reactionary stance when one of their products is counterfeited. They are left trying to make sense of the incident and responding as best they can without planning to control the damage. This results in an inefficient, piecemeal approach. To be sure, enforcement and tactics are critical components of an effective brand protection program, and they will help catch, prosecute and penalize offenders. However, they alone are not enough to minimize the risk of product counterfeits.

## Improving the Effectiveness of Brand Protection Programs

Research and field experience contends that the most effective brand protection programs are strategic, proactive, and holistic. Studies suggest the most effective crime interventions are data-driven and comprehensive. The idea is to systematically assess the problem to illuminate the criminal opportunity, which can be used to inform the strategic response to it. Using evidence and analysis, the aim is to shrink the opportunity for the crime to occur, such as by increasing effort to carry out the crime and the risk of being apprehended. This approach has been shown to reduce many forms of crime. Moreover, leading law enforcement and brand protection experts routinely contend they cannot arrest and litigate their way out of the counterfeiting problem. As opposed to a purely enforcement



approach, they call for partnerships, information sharing, research, awareness, education and training, and a total business solution. In other words, effective brand protection programs are evidence-based and strategic—they work to understand the risk of product counterfeiting and institute a plan to mitigate it. They are reactive as necessary, but as proactive as possible, with emphasis on prevention, awareness, education and partnerships. Importantly, they recognize the brand protection function must be integrated throughout the organization to be efficient and effective.

## Many Parts of the Organization Relate to Brand Protection



As explained above, effective brand protection is achieved from an interdisciplinary understanding of the problem and the development of an informed response. This requires a total business solution that incorporates virtually all functions of the organization. With its emphasis on the protection of people, products, and facilities, security obviously plays a prominent role in brand protection. Likewise, through its enforcement capabilities and ability to promote the integrity of partners through contracts the legal function is critical to the brand protection mission. Unfortunately, many companies relegate their entire brand protection operation within one of these functions. This is like trying to build a puzzle with only half of the pieces.



To be successful, all of the pieces are necessary so it is important to incorporate the other functions that can bolster brand protection. Consider just a few other functions and their contribution to brand protection and the prevention and response to counterfeits:



- Market monitoring (which includes but is not limited to internet monitoring) by sales and marketing employees looks for counterfeit or diverted product in the marketplace, compares sales levels and product life cycles with prediction models, audits distributor purchasing/return practices, and actively tracks company business

practices related to excess and obsolete material, scrap, multiple sales/price practices and back order cause and effects. Marketing and sales strategies related to advertising and geographic distribution influence if and when they are targeted by the counterfeiter.

- Packaging incorporates features that allow positive product authentication, indicate tampering, increase difficulty of replication, and permit product track and trace.
- Quality assurance identifies instances of product problems/returns.
- Procurement works to vet reliable and legitimate suppliers, and to ensure authentic product is sourced.
- Warehousing facilities must properly secure product.
- Human resources screens employees by conducting background checks, and facilitates training and awareness of staff.

To be sure, virtually every part of the organization plays some role in brand protection. Organizations on the more progressive end of the continuum work to learn and integrate their functions as part of a total business solution to brand protection.

## Conclusion

A function of numerous business conditions, product counterfeiting is a fundamental risk to the brand for most brand owners. It reduces corporate profitability, but also causes many public health and safety, economic, and social problems. Many brand owners take a minimalist response, either doing little to protect themselves or by taking a solely reactive, enforcement-based approach that simply addresses problems as they occur. Those on the cutting edge of brand protection understand that a more strategic, proactive, holistic, and evidence-based approach is required to minimize the risk to product counterfeits. This involves the integration of all functions in the corporate brand protection strategy. Brand owners seeking to improve the protection of their brand from product counterfeits should consider what more they can do to create a total business solution.

## PAPER SERIES

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