

# **Global market review of counterfeit apparel – forecasts to 2014**

## **2008 edition**

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## Executive summary

Counterfeiting is often viewed as a victimless crime that has little or no impact on the bottom lines of major apparel powerhouses. Indeed, according to some popular misconceptions, counterfeiting actually serves to stimulate trade, boost economies and spread the cachet of an already popular brand. After all, what's the problem if consumers buy a few fake handbags now and then, especially when they couldn't afford to buy the real thing anyway? And besides, isn't it the case that brands simply cost too much and that the luxury houses can easily afford to lose a few dollars here and there?

The truth is, of course, very different. Approximately 7% of global trade is derived from counterfeit products and that figure is growing, according to estimates from the World Customs Organization (WCO). This equates to roughly US\$512bn – a figure higher than the gross domestic product (GDP) of all but 11 countries and the same size as the total GDP of Australia. Other studies, including one from the Organisation for Economic Co-operation and Development (OECD), argue that the figure may be as high as 10% (or more than US\$731bn). And it is definitely getting worse: revenues from counterfeit product sales are growing at an alarming rate – more than 400% since the early 1990s, while sales of legitimate brands grew just 50% over the same timeframe, the WCO reports.

However, the reality is that the legitimate market for apparel and accessories will not significantly change even if counterfeiters were stopped. *“People will still be buying apparel, they just won't be buying cheap knock-offs,”* says Darren Pagoda, a lawyer for the International AntiCounterfeiting Coalition (IACC), an organisation that trains law enforcement, lobbies at state, federal and international levels for stronger laws and testifies before the US Congress to raise awareness of anti-counterfeiting problems and solutions. But all of the related costs and losses – jobs, tax revenues and more – associated with the crime would be eliminated. Even so, there are effects far more insidious than consumers saving a few dollars on a cheap Prada knock-off. While in the consumers' eye, the market for faux versus real may not seem that much different, to the companies and, indeed, the countries that are fighting the illegal activity, the difference is monumental.

The International Chamber of Commerce estimates that counterfeiting and piracy cost the global economy GBP241bn annually (US\$492bn), while it cost the UK industry an estimated GBP15bn in 2007. *“We estimate that the loss of tax revenue in the UK economy through counterfeiting is approximately GBP1.75bn,”* says Ruth Orchard, the director-general of the Anti-Counterfeiting Group (A-CG). *“Counterfeiting robs GBP750m from Irish businesses, places 250 jobs at risk and funds organised crime and terrorism. In addition, the EU GDP is reduced by just over GBP5bn and 17,490 jobs were lost in 2007 due to the manufacture and trading of branded product fakes.”* When you look at all fake products (including videos, music and software), the effect of counterfeiting and piracy in the EU could actually be as high as GBP250bn – of which GBP30bn is lost in taxes and excise. Not only that, but European figures suggest that the global trade in all types of counterfeits robs the global economy of at least US\$1tn per year.

WCO figures suggest approximately 7% of global trade is derived from counterfeit products. Revenues from counterfeit product sales are growing at an alarming rate. Sales of legitimate brands grew just 50% over the same timeframe. Related WCO data also suggest that New York City alone loses US\$750m in state sales taxes due to counterfeit sales. The same data show that Russia loses US\$5bn in tax revenues because of the massive inflow of fake goods into the internal market. It is estimated that clothing and footwear companies lose US\$77.5bn per year to counterfeiting in Western Europe alone (according to the WCO IPR Strategic Group, 2006). A-CG also reports that, of all the organised crime operations identified by UK law enforcement as being involved in counterfeiting activity during 2007, more than 50% were involved in two or more other areas of criminal activity besides counterfeits. Typically the most prevalent of the criminal areas appeared to be drug trafficking, followed by *“organised immigration crime and even football hooliganism being pursued for gain”*.

According to the UK policing agency, the National Criminal Intelligence Service (NCIS), 26% of all counterfeiters are involved in organised crime and drugs. The group also says that there is a clear link between counterfeiting and terrorist organisations. A 2007 A-CG survey revealed that counterfeiting in the UK alone reduces revenue by GBP955-1,210m annually in clothing and footwear and GBP840-945m annually in related markets of perfumes and cosmetics. The results also showed that profits of legitimate manufacturers in the UK were reduced by significant amounts: GBP19-24m annually in clothing

and footwear and GBP34-38m annually in perfumes and cosmetics. If you consider counterfeit toys, sporting goods and pharmaceuticals – other top items typically ‘knocked off’ – the macroeconomic impact on the UK economy of counterfeiting in these three industries is to:

- reduce GDP by GBP200m (at 2005 prices) per annum;
- reduce UK employment by 4,151 jobs;
- raise unemployment by 2,336 positions;
- raise Government borrowing (PSNCR) by GBP77m at current prices.

In terms of clothing and footwear alone, the A-CG estimates that the proportion of counterfeit goods is 11% in the UK, (perfume and cosmetics 10%, toys and sports goods 12% and pharmaceuticals 6%). An IACC study in 2006 found that in addition to the growing number of items seized, the nature of counterfeiting is changing as well as the modes of transportation used to get the goods to major consumer centres. The group estimates that as much as 22% of all apparel and footwear sold worldwide is fake. *“As for the provenance of these goods, most counterfeit goods (66%) seized in 2007 came from Asia (Thailand and China in particular),”* according to Timothy Trainer, the president of IACC, in testimony before the US Congress. *“This was also the case in 2006. The nature of the products intercepted is now a threat to consumer safety and no longer confined to luxury goods.”* That being said, the IACC still reported that from 2005 to 2007, the number of seizures of clothing has doubled, with accessories (belts, spectacles, bags) accounting for the greatest increase.

Seizures of counterfeit cosmetics and perfumes (often line extensions by apparel brands like Tommy Hilfiger, Calvin Klein and others) rose by over 300% from 2006 to 2007. Recent figures from the European Commission (EC) show that customs seized almost 85m counterfeit or pirated articles – luxury goods plus other consumer items like food and medicine – at the European Union’s external border in 2006 and 50m in the first half of 2007. Also, in 2007, US Customs reported that the value of counterfeit apparel and related articles was approximately US\$42m and the value of seized pirated products was US\$28.3m.

In the UK, 22% of all apparel and footwear that was sold in 2007 are fake. Industry analysts estimate that over 15% of all branded apparel sold worldwide is fake. The value and number of counterfeit apparel products is also on the

rise, with markets such as the US and France detaining 40% more counterfeit goods in 2007 than in 2006.

Despite the fact that the economic loss appears to be clear, many shoppers continue to justify the purchase of fakes. After all, money is still being spent; consumers are still perpetuating the cachet of brands by seeking them out. The fact remains that the buying public is still driving demand.

The perception of a 'typical' fake buyer is usually based around lower-income consumers, perhaps young and single. The presumption is also that these individuals spend little in all categories and, as a result, are of proportionately limited interest to luxury brand owners. However, these preconceptions, like many concerning counterfeiting, are inaccurate: in fact, there is very little to distinguish demographically between those that have bought a fake and those that have not. Fake buyers are not just low-income earners or unemployed; in fact, data from North and South America, as well as Western Europe, prove that both lower- and higher-income strata are the most likely to buy counterfeit apparel.

Not only are fake buyers spending more than non-fake buyers across most categories, they are more likely to have also bought a genuine item from a designer or luxury brand. According to WIPO, just under two-thirds (64%) of fake buyers have bought genuine designer or luxury goods as well (compared to only 42% of non-fake buyers). In terms of the fake brands that today's consumers are buying, Louis Vuitton has overtaken both Burberry and Gucci to move into first place as the counterfeited brand with the most demand from consumers. In 2006, just under 1m consumers bought a fake Louis Vuitton item. In 2007, Burberry dropped from the top spot to the third-most faked brand, with Gucci remaining at number two. Just over one in 25 people bought a fake item of these top three brands in that year, marginally more than in 2006.

So, is it possible for the industry to count on consumers to turn their back on a fake Gucci purse if they love the design but cannot afford the original? The answer is "yes". Industry pundits say that if we cannot convince global consumers to make the smarter, more ethical choice on their own, then it should be made a legal issue. *"The best incentive is to make it a criminal offence to buy or be in possession of fake goods, as with stolen goods,"* says

Ruth Orchard of the A-CG. *“France is the only country that has this legal provision and it is seldom invoked.”*

The main problem that confronts both countries and corporations alike is that the public still does not perceive counterfeiting as a real problem – at worst it is seen as a victimless crime. Michael Kessler, founder of Kessler International, a New York-based investigative firm, commented; *“If public perception were to change, it would be expected that the attitude would be reflected in new laws and anti-counterfeiting procedures, but so far, the theft of intellectual property continues to be considered a minimal threat to society. With this attitude prevailing, counterfeiters will have no reason to stop, police will have no reason to apprehend, and legislators will have no reason to change the law.”* On top of that, the lack of laws, law enforcement and brand protection against counterfeiting directly impacts a country’s investment climate.

*“Weak infrastructure (for the collection of taxes) also leads to the establishment of counterfeit goods businesses in the black economy,”* explained Faisal Daudpota, external relations coordinator, anti-counterfeiting for the International Trademark Association (INTA), in his 2006 *Report on Anti-counterfeiting in Selected Countries*. He wrote: *“Counterfeiting, tax evasion and money laundering are also closely related: counterfeiting activities provide illegal profits, tax evasion leads to concealment and non-declaration of such illegal profits, and in money laundering – where the ultimate objective is to disguise illegal profits – the proceeds of counterfeiting activities are laundered through different jurisdictions. This direct overlap expands the scope of counterfeiting, tax evasion and money laundering.”* He added that counterfeiting also negatively impacts international trade because counterfeit goods are trafficked beyond national boundaries, which results in trade disputes and tensions between countries.

Free ports provide the means for criminals to tranship fakes via intercontinental traffickers, which puts customs authorities under great pressure to implement new techniques, technologies and tools designed to identify duplicates. *“They also have to grapple with the complicated legal ideas of trademark rights and international enforcement obligations,”* Daudpota explains. Anti-counterfeiting efforts in most developed countries have some points in common. Most maintain and share information on seized counterfeit goods. Additionally, data are maintained on trends and other historical data such as manufacturers, origin and path of the goods to final destination. This

information is a key aspect of fighting counterfeiting. Additionally, the accumulated data is used to create laws and enforcement procedures against the trafficking of fake goods.

Even though governments are reacting to this issue, the standard method of eradicating counterfeit goods involves the brand owner putting up a security bond. Such bonds limit effective counterfeit enforcement by creating an economic burden on the brand owner, as well as limiting enforcement measures. Another challenge to anti-counterfeiting involves the actual disposal of the seized goods. In many countries, there is no established procedure for their processing, causing further delays – and offering a chance for the goods to finally ingress the local market through charitable or government auction initiatives.

### **Counterfeiting as a global issue**

Points to consider include the following:

- counterfeiting does not merely affect brands, but also designs and models, patents, copyright, geographical indications, vegetable extracts, etc;
- counterfeiting does not only impact upon multinational companies, but also small- and medium-sized companies;
- counterfeiting attacks all sectors of industry, from toys, through textiles and clothing, spare parts for automobiles, washing powders and includes foodstuffs and pharmaceutical products;
- according to the OECD and the WCO, counterfeiting activities account for approximately 7-10% of world trade in general, or about US\$512-731bn. This results in the loss of about 17,000 jobs per year in the EU alone;
- statistics from the European Commission – DG TAXUD (Customs) stated that almost 135m pirate and counterfeit articles were seized at European borders in 2007, an increase of 25% from 2006;
- among the customs seizures, the amount of textile and clothing had doubled since 2005, with accessories (belts, spectacles, bags) accounting for the biggest increase to 9.2m pieces, a rise of 10.9% year-on-year. 10% of customs seizures in 2007 were apparel, 4% comprised handbags, and footwear 3%;
- about 12% of a company's turnover is devoted to research, innovation and promotion, and efforts to protect its innovations. Small and medium-sized enterprises (SMEs) may not be able to afford the

practical implementation of the fight against counterfeiting, be it by recruiting intellectual property specialists, resorting to private agencies of investigators or by starting costly legal proceedings.

**Figure 1: Reasons for consumption of fake apparel, 2005-2007**



**Notes:**

Global survey of selected markets in North America, South America, UK, CONEU and Asia, conducted December 2007. Number of survey respondents = 748

Other reasons include: 'Wanted to sample the product', 'Did not know it was counterfeit', 'Received it as a gift' and 'Just for fun/casual purchase'

**Source: just-style**

# Chapter 1 Brand positioning, counterfeiter use and market response

Brands can take the issue into their own hands as well. By staying innovative and constantly changing offerings, an apparel company can stay a step ahead of counterfeiters, according to John Noble of the British Brands Group. As the apparel market is getting increasingly competitive and companies like Zara have clothes from concept to store shelves in ten days, moving at lightning speed may be one of the only ways to keep counterfeiters at bay.

Operating at this level also keeps consumers loyal; they check store windows once or twice a week because they know new offerings are constantly becoming available, which also makes duplicating the products and getting fakes into the hands of shoppers even more challenging. Beyond that, Noble says having a strong brand is in itself a defence because the more features, functionalities or uniqueness an item has, the more difficult it becomes to replicate. Making these concepts more challenging in practice is the global nature of branding, according to US-based law firm KMZ Rosenman. Retailers and manufacturers need to stay in step with the global market and changing trends in order to continue to grow their business (and their labels), which makes overseas sourcing and production, consolidation and expansion inevitable – but this also makes counterfeiting more likely. The greater you expand your reach worldwide (from sourcing to distribution to manufacture to retail) the less control you have over every stage of the supply chain and ultimately who may be knocking off your brand.

In an interview with *just-style*, Paul Chamandy, vice president, business development of Paxar, explained that as apparel companies move offshore and rely on contract factories to make their products, they are losing a certain degree of control over their intellectual property. *“Depending on the product category, companies are often switching suppliers from season to season. This results in them leaving past suppliers with knowledge about their products and processes that could be used for illegitimate purposes. Even legitimate suppliers are a potential concern as they may be overproducing product (not*

*authorised by the brand owner), which is shipped [on the] grey market. This overproduction, although produced to the same specifications, can be considered counterfeit.”*

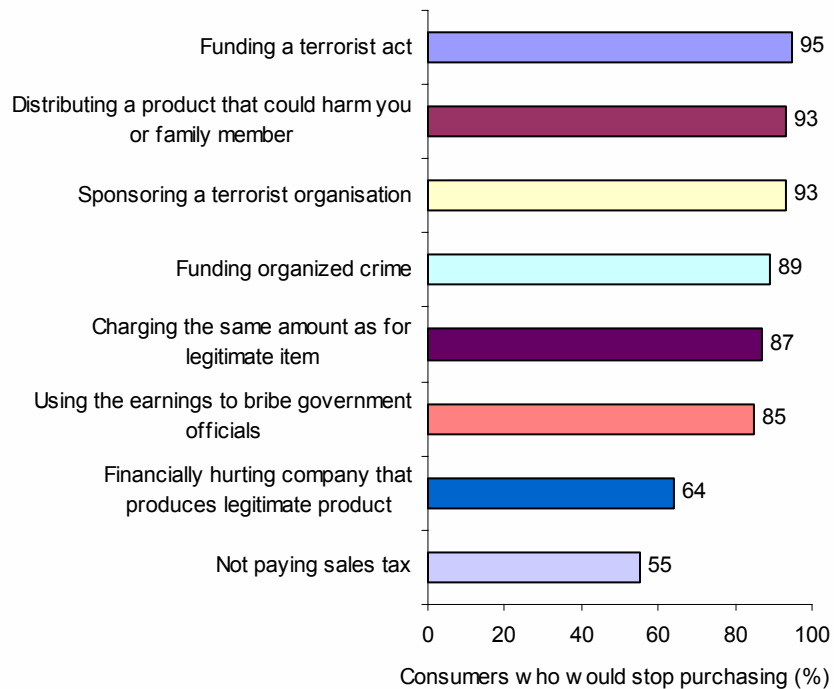
### **Entities at risk**

Of course, certain brands are more at risk than others. Luxury items – Prada, Gucci, Armani, Louis Vuitton – are all prime targets for counterfeiters. The same is true of any brand that is particularly popular at any given time. Jeans of all price points are also a huge item being duplicated and anything ‘Made in America’ seems to be knocked off quickly. But unfortunately the fakes do not stop there. Experts agree that all consumer products are at risk at this point.

According to INTA, of the fakes stopped by customs in France in 2007, Nike came first (12%), followed by Ralph Lauren (10%) and then Adidas and Louis Vuitton (8%). The number of ‘procedures’, i.e. shipments seized for counterfeiting infractions, grew 40% from 2006, with Ralph Lauren (8%), Nike (8%) and Louis Vuitton (6%). Experts suggest that the decrease in these brands may be due to criminals avoiding France as an entry point to the EU due to the increased focus of the Government on stopping counterfeiting for these companies.

One of the biggest problems, according to Noble, is the fact that consumer loyalty is based on a promise from a brand. When brands do not deliver, consumers question their commitment to the label’s message and promise. When someone distributes fakes, the consumer risks buying an inferior product. Over time, the fake ultimately erodes the relationship a consumer has with the brand, which in turn threatens the company’s profitability and ruins its cachet.

*“Branded businesses strive to build and sustain close, meaningful relationships with their individual customers, achieved by delivering against a clear, distinct promise consistently over time,” says Noble. “But in today’s market a brand must deliver more than consistent performance. Consumers demand results at ever better value and from companies that behave ethically, responsibly and sustainably.”*

**Figure 2: Reasons that would stop consumers from purchasing fake apparel, 2007 (%)****Notes:**

Global survey of selected markets in North America, South America, UK, CONEU, and Asia, conducted December 2007. Number of survey respondents = 748

Other reasons include: 'Wanted to sample the product', 'Did not know it was counterfeit', 'Received it as a gift' and 'Just for fun/casual purchase'

**Source: The Anti-Counterfeiting Group, *just-style***

**Brand goodwill**

A brand's goodwill is the reason for the premium price that consumers will pay for their products. This resides purely in the minds of individuals, and successful brands are those that an individual knows, trusts and believes in, to the extent that they will buy that brand over those offered by competitors. To earn such 'share of mind' is neither easy nor cheap. It takes years to build and everything a company says and does plays its part in communicating a certain lifestyle feeling, which consumers not only identify themselves with, but are actually willing to pay more for. *"This value is well recognised by markets, where branded companies command higher share prices, reflecting their more reliable and predictable future earnings potential,"* says Noble. *"It is also increasingly recognised by companies themselves, with around 60% of chief executives at the World Economic Forum in Davis in 2007 attributing 40% or more of the market value of their companies to their brands."*

Michael Kessler, of Kessler International, agrees. Although for many industries, prosecuting distributors of fakes is far more of a life or death issue, the main reason that an apparel company will prosecute is to protect the brand image. *“Counterfeiting, in essence, cheapens the brand when consumers know they can get an authentic-looking ‘luxury item’ for mere dollars,”* he says. *“Of course, phoney goods also serve to directly impact an apparel company’s bottom line, when people elect to simply purchase knock-offs instead of the real thing. Why buy a genuine designer shirt when a fake is only a few bucks?”*

Investigative firms like Kessler International work to locate, investigate and remove counterfeit goods from the marketplace in order to preserve brand cachet as well as stopping more sinister activities like terrorism that wreak havoc on many nations. For example, a well-known Vietnamese gang leader has admitted to the authorities that he made US\$13m selling Rolex and Cartier watches in New York’s Chinatown in the early 2000s, according to the WCO. The first bombing of the World Trade Center in New York in 1993 is also thought to have been funded by the sale of fake garments from a store on Broadway. Other investigations have determined that paramilitary groups in Northern Ireland, as well as extremist Islamic groups, are funding their terrorist activities through the sale of fakes.

### **Counterfeit warning flags**

There are a number of warning signs that one needs to keep an eye on.

#### **Decreased sales**

This is perhaps the most obvious clue, other than actually seeing fake merchandise on the street. If your company is experiencing poor sales, especially in a particular region (such as a large city or previously successful international market), counterfeiting may be the culprit. Fake goods not only give casual consumers an extremely low-cost alternative, but it hurts brand integrity and reduces repeat customers. After all, why would you want to spend money on those new designer jeans when half the teenagers in town are wearing cheap fakes?

#### **Customer complaints**

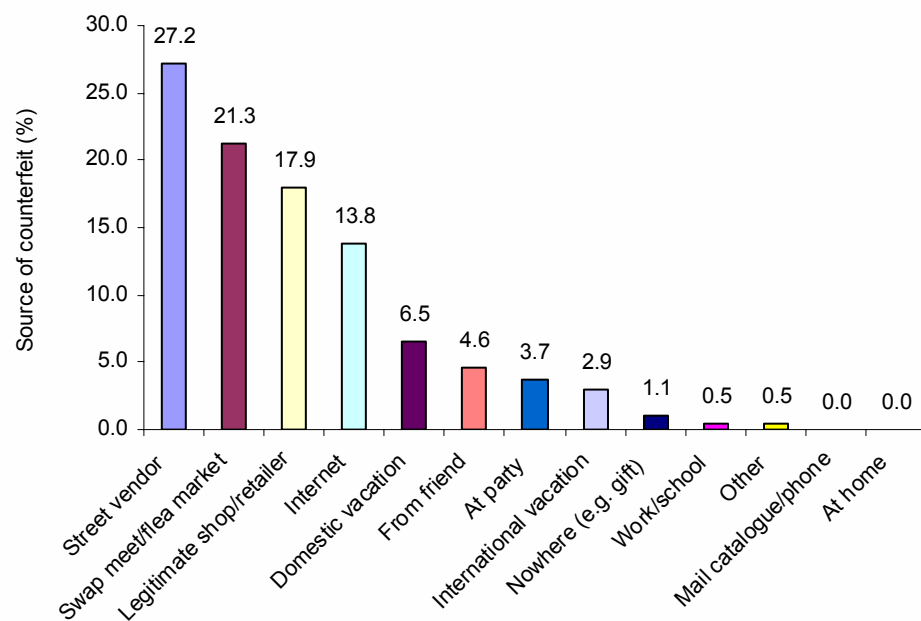
Keep an eye on the type of customer issues coming into your service department. If you are receiving an inordinate amount of calls or letters complaining about items falling apart, colours running excessively or generally

poor craftsmanship, you may want to focus on where those calls are originating and look for counterfeit goods on the street. It is quite possible that counterfeit products (sold to people who did not know they were fake) are the reason so many customers are having problems.

### New, unexpected markets

Are you receiving customer service calls from places where you have never sold your products? Have you witnessed people wearing your merchandise, even though you have never come close to entering that market? This is another sign that you may be suffering from counterfeiting. Even if you do not sell your product in a particular region, your brand may be in demand, and the counterfeiting industry is always willing to fill that void.

**Figure 3: Sources of counterfeit apparel, 2007 (%)**



**Notes:**

Global survey of selected markets in North America, South America, UK, CONEU and Asia.

Performed December 2007. Number of survey respondents = 748

Other reasons include: 'Wanted to sample the product', 'Did not know it was counterfeit', 'Received it as a gift' and 'Just for fun/casual purchase'

**Source: World Intellectual Property Organization (WIPO)**

## Chapter 2 Global landscape of counterfeiting

If as much as 7% of global trade, or US\$750bn, is derived from counterfeit products and that figure is growing, it is clear that the practice is not only pervasive but also highly networked. WCO predicts that this figure is growing at an alarming rate – more than 400% since the early 2000s, while sales of legitimate brands grew just 50% over the same timeframe.

Tempering the activity of counterfeiters is a huge step on its own: it is akin to asking whether any crime could be stopped completely. But the degree of counterfeiting could certainly be lessened. This would require governments to take the crime more seriously, and become more aggressive with enforcement as well as a complete shift in attitude among consumers who do not see (or at least turn a blind eye towards) the negative effects from widespread or large-scale counterfeiting practices. The bigger question is whether this is possible.

There are signs that the initial steps are actually happening now. Within the past couple of years, media interest in this issue has increased dramatically. With increasing evidence of ties to terrorist groups which view this type of crime as a much safer and effective way to raise funds and make a living, consumers are starting to see genuine negative effects, not just a few lost sales.

This is especially true with regard to health and safety issues that are regularly posed by substandard counterfeit products in the toy, electrical, pharmaceutical and food industries. *“Governments now have incentives to take counterfeiting more seriously – the ultimate job of a government is the protection of citizens,”* said the IACC’s Darren Pagoda in an interview with *just-style*. *“There are legitimate corporate citizens and employers that keep the economy going, provide jobs and play by the rules. These are the people who need to be rewarded with economic incentives created by the legal system.”*

In many cases, however, you are not dealing with a small racket pumping out a few extra Prada purses and selling them on the streets of New York. These tend to be major operations run by major criminals who use the enormous

profits to fund other large crime rings. This means those trying to prosecute are tracking counterfeits through a web of intricate illegal activity.

Brands are a popular target, with their value, reputation and consumer franchise delivering a large market and assured sales. Easy profit, overstretched enforcement authorities and relatively light penalties if caught, combined with the convenient use of existing criminal networks, make this a very 'soft' crime, which costs the UK economy an estimated GBP10bn a year. Adding to the challenge of stopping the crime is the fact that counterfeiters are able to so closely duplicate a brand down to name, logos, tags, etc, that they become difficult to distinguish from originals.

### **Counterfeit apparel seen as low priority**

A US Immigrations and Customs Enforcement (ICE) official remarked bitterly in a recent article on the ICE site: *"You know, this is a crime that costs the US about US\$500m a year. Bank robberies cost us about US\$100m, and yet, they have by far the most visibility."* Despite the pervasiveness of counterfeiting and its detriment to a brand, most apparel companies do not make prosecution a great priority. In fact, most companies often view it as a project limited to its legal staff, rather than something that is discussed as a major issue throughout the company. Maxima International Consultants found that less than 1% of sales turnover is spent protecting the brand, 10% of companies allocated no resources whatsoever to anti-counterfeiting measures and nearly a third have kept the same budget for years. And due to the high cost of tracking and prosecuting criminals, many brands just consider counterfeiting an unfortunate cost of doing business.

Companies that fail to look to available intellectual property rights and the protection of their brands lay themselves open to attack. *"They risk lost revenue and increased costs,"* added John Noble of the British Brands Group. *"More seriously, they put their brand equity and their very competitiveness in jeopardy. A copycat attack can hit sales by over 25%. Nestlé was forced to spend GBP30m re-packaging its coffee range after its previous packaging had been rendered generic through copying. Consumers worry about brand authenticity if they know a particular brand is subject to counterfeiting. More to the point, each pound of revenue lost and additional cost incurred from inadequate brand protection is a pound lost to innovation and brand-building. That is a loss to the very heart of brand competitiveness."*

When it comes to apparel, as opposed to food or pharmaceuticals, consumers often know they are purchasing counterfeits and have few qualms about doing so because it allows them access to over-priced designer product they would not normally be able to afford. This helps most people justify their purchase. They figure that a Hermès handbag should not cost US\$12,000, so it serves the company right that it is knocked off, or they do not realise that buying a fake is harmful to both the company and the economy, while at the same time fuelling more insidious crimes.

Harm to enterprises is considered by those respondents surveyed in December 2007 to be the most direct and severe harm caused by counterfeits. Such harm creates problems in national and international markets for companies and causes losses in revenues. Counterfeiting of international brands not only infringes the rights and interests of foreign enterprises by selling the products at lower prices, but also takes away the markets of domestically well-known brands.

For example, A-CG reports that of all the organised crime operations identified by UK law enforcement agencies as of 2007, more than 50% were involved in two or more other areas of criminal activity. Typically the most prevalent of the criminal areas appeared to be drug trafficking, followed by *“organised immigration crime and even football hooliganism being pursued for gain”*.

The group also says that there is a clear link between counterfeiting and terrorist organisations. This is why many experts believe that if you cannot force consumers to make the correct moral and ethical choice on their own, it should be enforced.

Make the penalty for being caught purchasing fakes very high and you will curb the shoppers driving the demand and hopefully stop fuelling the networks supporting the activity.

### **Consumer attitudes towards counterfeiting**

- An October 2007 survey by the EUROPA – Taxation and Customs Union/Customs shows that around 15% of clothing and footwear purchased in Europe is counterfeit.
- According to the EU TFEU, brand owners lost 3.2% of annual revenue to fakes in 2007 (GBP107.528m).





























































































































