Mitigating the Risk of Counterfeit Products
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The manufacture and sale of counterfeit products is a widespread problem that affects manufacturers, distributors and retailers in virtually every industry. According to the International Anti-Counterfeiting Coalition (IACC), the global trade in counterfeit products has increased from $5.5 billion (USD) in 1982 to approximately $600 billion (USD) annually today. In the United States alone, the economic impact of counterfeit goods on businesses is estimated to be between $200 billion to $250 billion annually.

Counterfeit products present a number of potential challenges for legitimate companies all along the distribution channel. Unsafe or unreliable counterfeit products can negatively affect the market perception of the legitimate products that are being copied, thereby reducing potential sales of those products. In some cases, the adverse publicity surrounding unsafe or unreliable counterfeit products can also extend to companies manufacturing or selling legitimate products, damaging an industry’s overall reputation. Finally, unsafe counterfeit products that lead to injuries can ultimately subject legitimate suppliers to increased oversight and inadvertently ensnare them in legal actions targeted against counterfeit producers.

Many companies have already taken steps to prevent others from producing and selling counterfeit copies of their legitimate products, and to minimize their exposure to the risks associated with counterfeit products. Such efforts include the use of holographic labels, the application of overt and covert security coding, and employing special color schemes to identify specific product types. A number of companies have also partnered with customs officials in anti-counterfeiting efforts, resulting in the seizure of millions of counterfeit products.

But reducing the risk of being targeted by counterfeiters ultimately requires each company to develop and implement a formal brand protection program that addresses its unique requirements and vulnerabilities, and which is subject to rigorous periodic auditing to ensure that a program accounts for unanticipated vulnerabilities. This white paper discusses the key elements of such a program and presents a process for mitigating the risk of counterfeit products, from an initial risk analysis to program implementation.
Conducting an Initial Counterfeiting Risk Analysis

Legitimate companies have the most to lose from counterfeit products. Yet, despite widespread counterfeiting activities, many companies are unaware that they have a potential problem. Therefore, it’s important to conduct an initial analysis of potential counterfeiting risks that exist within a given industry, and with certain types of products.

Here are some of the key product factors that often lead to the greatest counterfeiting risks:

High-volume, low-cost products:
Popular, low-cost products that can be easily copied and sold in large numbers are frequently a target for counterfeiters. The high volume of potential sales offsets relatively low profit margins.

Products in high demand:
A product that’s in demand, regardless of its price, will attract the attention of counterfeiters. Counterfeiters can exploit the marketing and branding efforts of legitimate manufacturers by selling look-alike versions of popular products.

Products with large market share:
A product or group of products with a large market share is an ideal target for counterfeiters. If customers are looking for a top brand name, counterfeiters will see an excellent market for counterfeit versions of these products.

Luxury products:
Often, savvy counterfeiters will focus on counterfeiting expensive luxury products. The higher profit margin potential available with luxury products offsets the smaller number of units available for sale.

Products that lack security features:
Security features, such as holographic labels or custom colors, deter counterfeiters since they make counterfeit products difficult to replicate and easier to identify. Legitimate products without such security features are easier to counterfeit.

Complex, loosely controlled supply and distribution chains:
Companies with a long and complex supply or distribution chain present multiple opportunities for counterfeiting, since there are multiple points at which a counterfeiter can enter or manipulate the chain.

Purchasing components and materials based on price alone:
Often, even product components are targets for counterfeit producers. Low-priced components may be attractive to legitimate manufacturers, but counterfeit components present the same risks as counterfeit finished products.

Products sold on the Internet:
Selling products online means a potential loss of control over distribution, making it easier for counterfeiters to sell counterfeit products without a manufacturer’s knowledge.

Essential Elements of a Brand Protection Program

A formal brand protection program is a vital component of a company’s overall effort to protect its products and itself from the efforts of counterfeiters. This is certainly true for companies whose products fall into one of the risk categories identified in the previous action of this white paper. However,
even those companies who products have not been the target of counterfeiters can greatly reduce their potential future risk by establishing such a program.

The following sections of this white paper discuss essential elements of an effective brand protection program.

**Product Security Features**

A critical element of an effective brand protection program is to ensure that anti-counterfeiting security features are integrated into product design from the beginning. Depending on the product, there are a range of product security features that can be reasonably and economically implemented, including holographic labels, overt and covert security coding, and radio frequency identification (RFID) tracking. In addition, authenticating features such as packaging materials, labels and inks can be used in a variety of ways.

Companies must also ensure that all parties involved in the supply chain are actively involved in efforts to maintain the integrity of such product security features. A manufacturer of a finished product can implement anti-counterfeiting measures at the product level, but any benefit can be reversed through the use of counterfeit components and materials from suppliers. Manufacturers should maintain security throughout the supply chain by using appropriate features and methods to authenticate products.

**Security of Product Components**

In addition to implementing product security features, it is equally important to ensure the security of product components sourced through third-party suppliers. This involves identifying and working with reputable suppliers, proactively cultivating strong working relationships with them, and implementing reporting systems that allow suppliers to provide information through the supply chain whenever they detect suspicious activity.

Although switching to suppliers who offer lower prices can result in short-term cost savings, this activity introduces unknown vendors into the supply chain, exposing a company to increased security risks. Further, the continued practice of procuring parts on the basis of price alone can be an unnecessarily risky strategy, and an unusually low price for a component may also be an indication that it is not legitimate. Counterfeit components in an otherwise legitimate finished product can expose a company to the same level of risk as a completely counterfeit product.

A company’s purchasing department should implement policies and procedures to ensure that the components it procures are not counterfeit. One approach to avoiding counterfeit components is to purchase components through franchised distributors or the franchised aftermarket. Third-party suppliers should be able to provide the documentation necessary to substantiate the origins of the parts they sell. If such documentation is not available, buyers should demand other evidence that can identify the manufacturing source.

A supplier’s inability to provide proof of legitimate component production is a potential indication that the components involved are counterfeit.

An effective anti-counterfeiting effort also includes due diligence checks at every stage of the product manufacturing process, including assembly, packaging and distribution. These checks should also ensure the proper management of excess material and waste produced during the manufacturing process, since counterfeiters often re-create products from scrap materials.

**Intellectual Property Rights**

There are several logical steps that companies can take to protect their intellectual assets from counterfeiters and to preserve their intellectual property rights. First and foremost, a company’s legal department should take the necessary steps to ensure the prompt registration of its patents and trademarks in those countries where it intends to sell its products. A company that fails to diligently protect its intellectual property may be at a significant disadvantage in subsequent efforts to defend its rights to that property in its pursuit and prosecution of counterfeiters.

In addition to registering intellectual property within the United States, an attorney or appointed legal counsel should also register the company’s intellectual property according to the patent and trademark laws in every jurisdiction in which a company anticipates conducting business, including product manufacturing, production, and distribution. Many countries follow the “first to file” rule, granting intellectual property rights to the first person or organization registering a corporate name, patent or trademark. In some cases, companies have attempted to register
their proprietary intellectual property in a new market, only to discover that a counterfeiter has filed a registration first.

Companies should also consider recording their registered marks with the U.S. Customs and Border Protection (part of the U.S. Department of Homeland Security). This step can help enforcement officials block the importation of counterfeit products at the borders, before illegal products gain entry to the U.S. marketplace.

Employee-Related Risks

Because intellectual property theft and abuse are often due to internal causes, a company’s anti-counterfeiting efforts should also cover potential actions by its own employees. A company’s human resources department should establish clear policies regarding employee disclosure of proprietary or confidential information, and any limits to the use of such knowledge and information during and following the term of their employment. In addition, a company should evaluate the potential benefit of conducting background checks on potential hires for key departments, including engineering, production and purchasing.

Many companies require employees to sign non-disclosure and non-compete agreements as a condition of employment. Some companies also require vendors, independent contractors and other third-parties to execute non-disclosure agreements. However, all such policies and agreements should receive proper legal review to ensure that their terms are enforceable under all applicable laws in the areas where a company operates.

Communications

Continuous communication is essential to any effective brand protection program, and another key element in determining whether a company has a counterfeiting problem. Companies concerned about counterfeit products must be continuously aware of potentially threatening activities in their marketplace and ask questions of key people throughout the entire distribution chain.

A company’s own sales force can be a valuable resource in detecting suspicious activity. For example, sales people can pay close attention to marketplace anomalies, such as selling prices that are excessively low, a potential indicator of the presence of counterfeit products. If a company’s returns department is consistently receiving defective products, it may want to evaluate those returns as possible counterfeit products. If a product proves to be counterfeit, there may be an opportunity to gather valuable information from the party that returned it.

Similarly, a company’s engineering department should regularly communicate with sales, marketing and other company departments regarding changes in a product’s design or configuration. Providing the entire internal distribution network with timely access to this information provides all key departments with the tools necessary to distinguish between legitimate and counterfeit products.

Companies should also consider conducting market surveillance in geographic areas where there are anomalies in market share. Low market share could be a signal that counterfeit products are penetrating a particular market. Alternatively, some companies have found that their products hold leadership positions in markets in which they have no presence, due to the sale of counterfeit versions of those products.

Law Enforcement Engagement

Regardless of the degree of vigilance by a company, a successful brand protection program cannot function in a vacuum. Therefore, an essential part of an effective anti-counterfeiting effort involves working with U.S. Customs and Border Protection, and with global law enforcement agencies. Providing information and training to enforcement agencies, including product identification manuals and information on security features, can make it easier for enforcement officials to distinguish between genuine and counterfeit products.

Working with customs and law enforcement also means committing the necessary resources to support these officials at all times. Doing so may involve establishing a dedicated hot line or secure website for exclusive access by law enforcement officials so that they can quickly and efficiently access critical product information when necessary.

It’s also important to forge strong partnerships with other anti-counterfeiting resources, especially in those instances where products are manufactured outside of the United States. Increasing awareness efforts and legislative activities can help place the counterfeiting issue in front of those agencies that can take concrete action.
Other measures companies can take include:

- Educating distributors and other stakeholders
- Moving intellectual property protection onto the agenda of trade associations
- Joining intellectual property protection coalitions and associations
- Sharing best practices with other manufacturers to help protect the industry

When collaborating with other manufacturers, it’s important to work with companies from different industries. Typically, counterfeiters don’t observe industry boundaries, and today’s purveyor of counterfeit pharmaceuticals could be tomorrow’s dealer of counterfeit printed circuit boards. Successful efforts to stem counterfeiting in one industry ultimately work to the benefit of companies in every industry.

**Commitment from the Top**

The most successful anti-counterfeiting efforts are those that embody a company-wide commitment to combat product counterfeiting starting at the top. Leadership by the company’s senior management on the issue of preventing counterfeit products is essential to its success, since employees will ultimately take their cues from those in charge. Without the active engagement and support of a company’s senior executives, individual departments may find it difficult to get their anti-counterfeiting efforts off the ground.

**Implementing the Plan**

The implementation of a company-wide brand protection program must be tailored to an organization’s unique needs. For example, the number of company employees will often dictate the approach that should be taken regarding implementation. An organization with 100 employees will have a different set of requirements than a company with 20,000 employees. Likewise, a company that produces one or two high-demand products will have different needs than a manufacturer producing popular items in several different product categories. Companies must also consider the various geographic locations in which they do business. The location of suppliers and distributors is an important consideration in determining an approach to anti-counterfeiting. If the supply chain extends across multiple countries, companies must also consider applicable laws and regulations in those regions.

A manufacturer may choose to implement a brand protection program on its own, but there is no “off-the-shelf” solution that can address each organization’s unique requirements. Because the implementation of such a program is a complex undertaking that involves a significant commitment of resources, manufacturers often have difficulty knowing where to begin. Guidance from an independent third-party with expertise in developing brand protection programs, and with strong relationships with global law enforcement authorities, can help put manufacturers on the right track.

UL works with local, national and international law enforcement agencies to identify and seize counterfeit products. UL has trained thousands of law enforcement authorities to identify and recognize legitimate UL certification Marks, and works with national and international governments, and with international enforcement agencies, including INTERPOL, EUROPOL, the FBI, Immigrant and Customs Enforcement, Hong Kong Customs, the Royal Canadian Mounted Police and the World Customs Organization, to thwart counterfeiting and to help stop the flow of counterfeit goods. Finally, UL’s active participation in U.S. legislative efforts helped to obtain passage of the “Stop Counterfeiting in Manufactured Goods Act,” signed into law in 2006.

Although no single source can provide all the answers, a knowledgeable third-party resource can help bring clarity to each specific situation and circumstance.
Conclusion

Counterfeiting is a serious crime that affects all industries, reduces profitability, and exposes the public to potential safety hazards and concerns about product reliability. Companies should actively and aggressively work to combat counterfeiting, but the benefit that individual companies derive from any brand protection program depends on how much they are willing to invest in its success. A comprehensive approach and a zero-tolerance attitude toward counterfeit products can help protect a company from the risks of counterfeit products, and help to stop their spread.

For more information about the “Mitigating the Risk of Counterfeit Products” white paper, please contact Brian Monks, vice president of Anti-Counterfeiting Operations, at Brian.H.Monks@us.ul.com.

References

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