

IP Strategies for Consumer Companies

Protecting your assets

CONSUMER MARKETS



Protecting your assets

The management and protection of intellectual property (IP) is rapidly becoming a key challenge for businesses – indeed for an increasing number of companies, it is *the* key challenge.

Increasingly, the assets of businesses are intangible: not only the intangible skills of the individuals who make up a workforce but also the images, the texts and designs, that underlie a company's brands, its services and its physical products.

"If you ask companies today, what is your key resource in your business, they never say, oh, we have a great factory," says David Eastwood, partner in the UK firm, head of KPMG's intellectual property and contract governance practice; "what they point to is their brand or their know-how or perhaps their proprietary technology. In short, they believe they have great intellectual property."

The shift to intangible assets has brought new challenges for companies. In a business world where some of the most important assets are expressions of ideas – expressions that are capable of being transmitted around the globe instantaneously, at marginal cost – the issue of IP protection becomes central. Companies need to know what property they have; they have to manage the use and the protection of IP; they have to form business strategies around IP ownership and development. Intellectual property becomes a strategic issue.

This report aims to address the question of how consumer companies should organize and manage their IP in a world where intangible assets form their competitive resource. It looks at how companies can limit damage from IP theft and piracy, and also make the most of the value of the IP they do own by working collaboratively with partners to improve returns from IP.

"The world is a big place. There is no single global IP protection strategy that works."

Tim Behean
adidas

How serious is serious?

The need for proactive and strategic approaches to IP protection has developed faster than many companies appreciate. The digitalization of the business world and the increased availability of cheap and fast communications technology have created new challenges so fast that many companies may not realize that they are either infringing IP rights, or that their own rights are being infringed. The move to digital data formats and the falling cost of digital copying technologies means that counterfeiting and piracy at a sophisticated level is increasingly affordable for small-scale criminals: even garage-sized operations can produce enough counterfeit material to affect the bottom line of large companies.

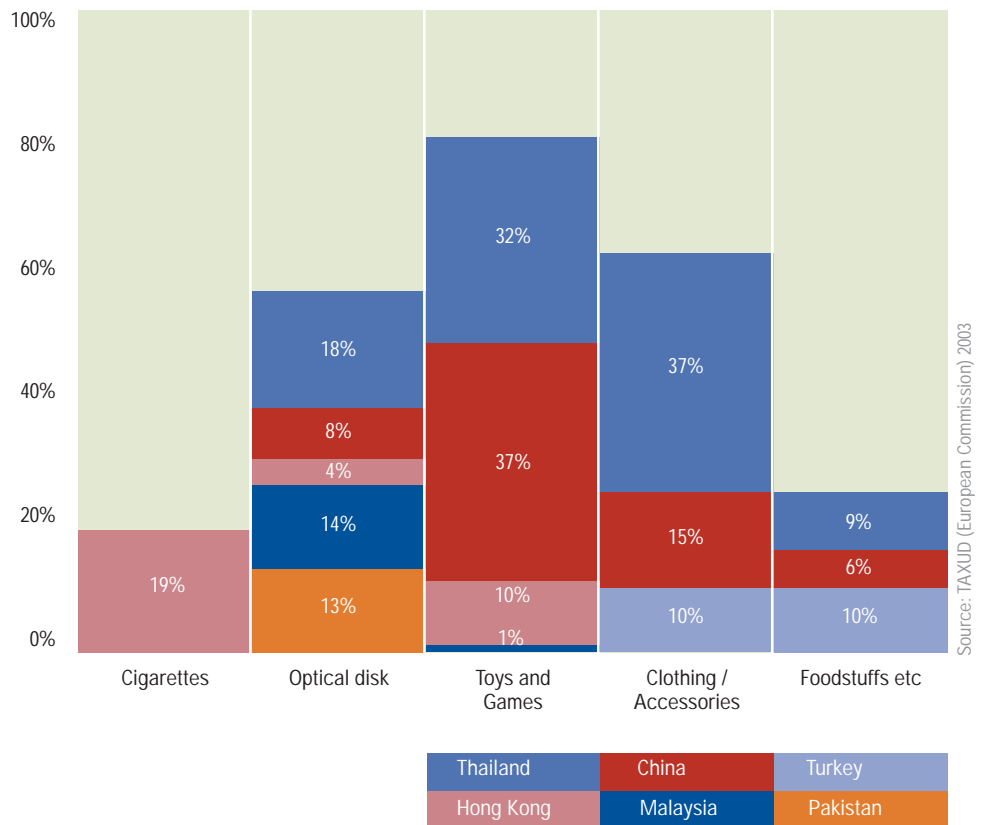
The threat has grown particularly fast in Europe. Open borders and European enlargement represent an opportunity for counterfeiters as much as for legitimate businesses. In particular the increasing ease with which goods can be moved across national borders in Europe has created new opportunities for counterfeiters in products that need large markets to succeed. "Companies should be in no doubt that counterfeiting and IP theft is now a major business issue," says KPMG's David Eastwood. "This should be at the top of everybody's agenda."

Yet just how serious is this problem? Many companies agree that IP theft is serious enough to be a potentially disabling problem for some businesses, yet hard figures on the global impact of counterfeiting and piracy are difficult to find. This is partly a result of the nature of the problem: in many businesses lost revenues can only be estimated broadly by extrapolating from the rate of seizures of counterfeit or other IP-infringing goods. The counterfeit market is by its nature partly undetected, and the ratio of detected to undetected production can only be estimated.

According to the 2005 annual report from the U.K. Patent Office, estimates of lost revenue may also be hampered by the lack of an established methodology for valuing loss. Different companies, industries and industry federations use different sampling techniques, and different bases for establishing the value of counterfeit trade, such as market price for authentic product, counterfeit market price, or legitimate cost of manufacture.

However, while the amount of undetected IP theft and license revenue misreporting may not be known, many useful indicators of the nature, geographical origin and trend of IP losses can be found in declarations of seizures and legal actions by national customs and other enforcement authorities.

Counterfeit interceptions in Europe by country of origin



The European Union publishes figures that now cover customs seizures in all 25 E.U. states, which give an indication of the source of counterfeit goods, of the type of product counterfeited and of the brand names that can generate most cases of anti-counterfeiting action. However, these figures by their nature do not show the value of counterfeited goods that are not intercepted. Although individual companies and trade federations make estimates of this value, these estimates can frequently contain a large element of guesswork.

Nevertheless some industry federations have succeeded in creating models for quantifying the threat from IP theft. The Business Software Alliance (BSA), for example, produces an annual report that uses an independently verified methodology for estimating the loss from counterfeiting (the manufacture of illicit software that duplicates the physical appearance of the media or packaging of the authentic product) and piracy (the copying of authentic software by unauthorized users).

This method uses more than 7,000 interviews in 23 countries to match the volume of installed PCs against the volume of registered authentic software, and thus derives a figure for counterfeit and pirated software. The BSA found that in 2004 while US\$59 billion worth of authentic software was purchased, software worth US\$90 billion was actually installed on the stock of PCs, meaning that for every US\$2 worth of software sold, at least another US\$1 worth was stolen. This figure represents a small fall in the proportion of software counterfeited and pirated over 2003, but an increase in value.



“Our approach is to centralize enforcement activities. Centralization means that you can take success in one region and extend that worldwide.”

*Tim Behean
adidas*

China gets serious on IP protection

China continues to loom very large on the horizon of any company concerned with IP protection. According to Shanghai-based lawyer, John Leary, of White & Case, “China is only beginning to come to terms with IP protection issues that the industrialized economies have been dealing with for 150 years”. Chinese policy is clear enough, says John Leary: the Chinese government has made it clear that it will respect internationally recognized IP rights; “the problem is with enforcement at the local level”.

A measure of both the problem and the policy response is found in seizure rates of counterfeit products. In Europe and in the U.S. goods of Chinese origin account for around 60 percent of all counterfeits seized by customs authorities. However, Chinese authorities are now seizing more counterfeit products than either E.U. or U.S. authorities are seizing individually.¹

An important factor in shaping Chinese attitudes is the fact that Chinese companies themselves are now beginning to build up brands that need IP protection, and as a result Chinese companies are beginning to demand enforcement of IP rights against domestic infringers. In addition, recent counterfeit cases (such as that which came to light in 2004 in the eastern city of Fuyang, involving the sale of counterfeit milk powder that led to a number of infant deaths), have also helped to raise awareness among Chinese consumers of the importance of brand authenticity.

Nevertheless, some companies still express caution over the speed of change in China: Tim Behean, head of IP for the adidas Group says that China is still producing around 80 percent of the counterfeits known to adidas; “there are parts of China where you can still run an open counterfeiting operation and no one will touch you – that even includes locations in Beijing,” he adds.

¹ KPMG International analysis, 2005

“Counterfeiters tend to be fast and efficient. Law enforcement agencies tend to be slow and cumbersome. That creates a challenge.”

*Tim Behean
adidas*

The statistical work of the BSA has provided a benchmark for assessing the level of IP risk in the business software industry. In addition the International Chamber of Commerce (ICC) which represents the concerns of companies across industrial sectors has pursued an initiative designed both to develop reliable industry-wide data on IP and to seek to ensure that IP protection stays on the top of the political agenda. Guy Sebban is Secretary General of the ICC and sponsor of its anti-counterfeiting initiative, Business Action to Stop Counterfeiting and Piracy (BASCAP). He says the organization recognizes the increasing proportion in all industry sectors of the value of intangible assets over tangible assets, and the fact that there is a continuing need to remind governments that IP is a huge contributor to the economy and that counterfeiting and piracy can hit both tax revenue and employment.

When it comes to raising the issue with the general public the reaction is generally different: many people still see the availability of counterfeits as an advantage. “Companies need to show that IP protection is not only about jobs and prosperity, it is also about health and safety,” says Mr. Sebban. “Counterfeit drugs or car parts for example represent a real and direct risk to personal health.”



Mantero's IP approach: silkworms and lasers

One company that has recently revived its fortunes by focusing on IP protection and brand heritage is textile maker Mantero, based in northern Italy. Mantero produces fabrics for luxury goods makers drawing on customers' designs and on Mantero's own archive of over 12,000 samples and designs dating back to the 19th century.

To protect and develop this IP resource the company has created a dedicated IP management unit called Mantero Lab. The unit is charged with developing technological innovations that make counterfeiting easier to detect: Carlo Mantero who manages new technology at Mantero Lab believes that a combination of technological and management innovation is the key to protecting IP. He says: "we are very interested in developments like RFID as an anti-counterfeiting measure, and laser-based technologies that allow us to identify any fabric made with natural fiber like silk as unique. But we also know you have to go beyond technology to protect IP – a culture of awareness is better than the best technology."

"Mantero has had to learn very fast that it is essentially an intellectual property-based company, and that this property is vulnerable. We understand these issues much better today than we did a few years ago, but from what I have seen most fashion textiles companies have a long way to go before they can say they are really protecting their intellectual property."

Mantero has also moved from working with a very large number of clients to focusing on bigger contracts with fewer clients. "Part of the solution to the IP challenge is to shift to being closely focused on a limited number of customers. At Mantero we now have team of at least three people working for each single customer, where before our designers and managers could be doing work for any one of a much larger number of customers. So now it is easier to answer the question: who is responsible for the way our customers use our designs?"





How to respond to the IP challenge

KPMG International believes that many companies can greatly improve their IP management both internally and externally.

Improve the quality of internal IP management

It is likely that many companies need to **raise consciousness of IP as a business issue** within the company. According to IP specialist Lewis Cohen of U.K. lawyers McGrigors, “the number of companies with an IP strategy is growing but still remains low”. He adds “Most companies do not have an effective strategy for protecting, policing, enforcing and commercializing their IP. This is within the control of individual companies.”

Although many companies say that the last five years has seen IP increasingly recognized as a central business issue rather than an administrative issue, that is far from being the case in all companies. Lack of awareness may be at a basic level: Lavinia Carey of the U.K.'s Alliance Against IP Theft says “I suspect that a great many companies still have no internal guidelines on what is and is not legal in an office – for example in terms of misuse of computers, and illegal file sharing activities.”

At a more sophisticated level, companies should also build awareness that IP is a key asset, if not *the* key asset for many businesses today. For textile maker Mantero, this realization came through the move to digital design in the early 1990s, which showed the company how easy instantaneous copying of IP had become. “It is so easy to share data now,” says Carlo Mantero. “What we learned is that you cannot control everything. You can do water-marking; you can set up walls within your database or internal networks. But in the end it is cheaper to make people more aware of the issue, because there is no software barrier that cannot be breached.”

In other cases, realization that IP requires more than administrative management may come from outside the company. Says Lavinia Carey of the Alliance Against IP Theft: “the moment a change in perception occurs is often when someone comes to a brand name company like a publisher seeking to license the brand, rather than the content of a product – that is when companies realize that IP is more than just a question of content or design.”



Intellectual Property and legislation

What comprises the intellectual property of a business? Intellectual property can only be protected where it is property that is defined in law. Although the extent of implementation of internationally agreed categories of IP varies greatly between countries, there is now a large measure of international agreement on what constitutes valid IP and therefore what in principle can be protected.

Wherever they operate, companies need to understand what can and cannot be protected under IP law, points out IP specialist Lewis Cohen of lawyers McGrigors. There are seven important categories of IP:

- **Patents** protect new technologies; however, patents are quite costly to obtain and to enforce.
- **Designs** protect the outward appearance of products; designs are broadly-defined, easy to obtain in law, but it remains to be seen how commercially useful they are.
- **Copyrights** protect the expression of ideas, and are useful mainly in the protection of art, literature, music, TV and film.
- **Trademarks** protect any sign that signifies origin: this includes logos, but can extend to sounds or shapes.
- **Trade Secrets** protect ways of doing business, or recipes and other know how.
- **Geographical Origin** protects certain commercially sensitive origin marks or names: examples are 'Champagne', or 'Basmati'.
- **Layout** protects the form of certain products such as semiconductors: this form of IP protection is of fairly limited application.²

However, the enforceability of IP rights varies worldwide. The TRIPs (Trade Related Aspects of Intellectual Property) agreement has provided a base level of protection worldwide, but there remain great regional differences in law and implementation: awareness of the IP issue is variable, and for example in some states in the newly-enlarged E.U. customs officers may still be inadequately trained in IP enforcement.

² KPMG International analysis, 2005

Companies are increasingly aware of the need accurately to audit their manufacturing and distribution partners for IP royalties; they may be less well aware of the need to **audit their own IP legacies** for exploitable assets, and better to understand the competitive IP landscape they operate in.

According to Mark Cohen, senior consultant in the Innovation Technology Management group of Scientific Generics (an international product development, technology licensing and consulting company), many businesses may often hold many patents that are not being exploited to their full potential, despite the high cost of maintenance.

“This is particularly true of consumer electronics companies,” says Mr. Cohen. “We recently worked with a consumer electronics company on a project that involved scrutinizing 100 patents identified as not supporting the core business, and we found 15 patents that could have commercial applications outside of the business.”

Perhaps more important is the need to audit IP in the context of a competitive market. “It is not just a company’s own IP,” says Mark Cohen. “You need to know what IP you have, and what IP other companies hold. Some companies work in an information vacuum, and then it often turns out that they cannot get to market because they are blocked at the last hurdle by the discovery of some externally held IP.”

Many consumer companies may not be aware of the potential of technology IP for their businesses. Tim Behean of adidas points out that a sports company like adidas can be highly reliant on proprietary process technology in manufacturing, and that products themselves may increasingly contain a technological component: he says that adidas recently released a sports shoe incorporating a processor chip, and that more such products are likely to follow.

“There are opportunities to incorporate new technologies in consumer products,” says Mr. Behean, adding “You can also identify old technologies that have renewed potential with new materials. Recently that has happened several times in sportswear products.”

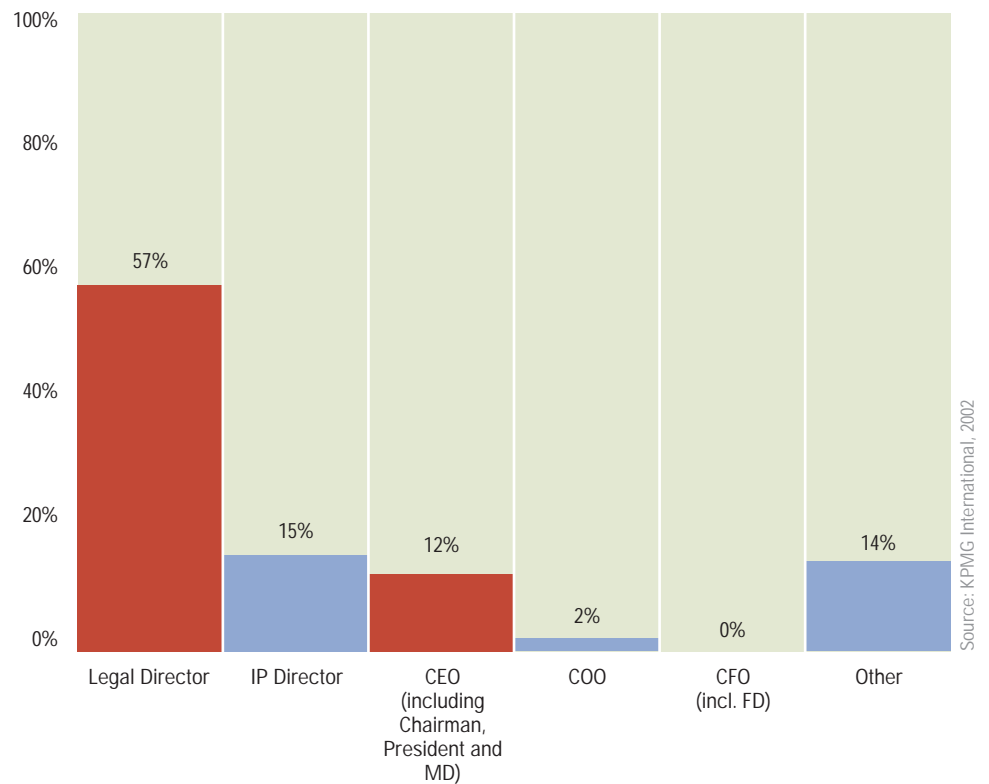


Companies should consider whether they need to **upgrade IP management** to a more central and strategic role. When KPMG International conducted telephone interviews with over 300 large international companies in 2002 on how IP was managed, responses suggested that only a minority of companies had appointed IP directors (only 15 percent of consumer companies had appointed an IP director, while 57 percent of consumer companies said that the legal director had responsibility for IP management).

“There is a lot less emphasis on cost saving, and more emphasis on getting the right IP for your business strategy.”

Mark Cohen
Scientific Generics

Consumer companies asked: Who runs IP management?



In interviews commissioned by KPMG International in early 2006 many companies expressed support for improved board-level representation of IP management, although in KPMG International's 2002 survey of companies it appeared that on average only 28 percent companies had formal board-level management for IP, while among consumer companies the proportion fell to 26 percent.

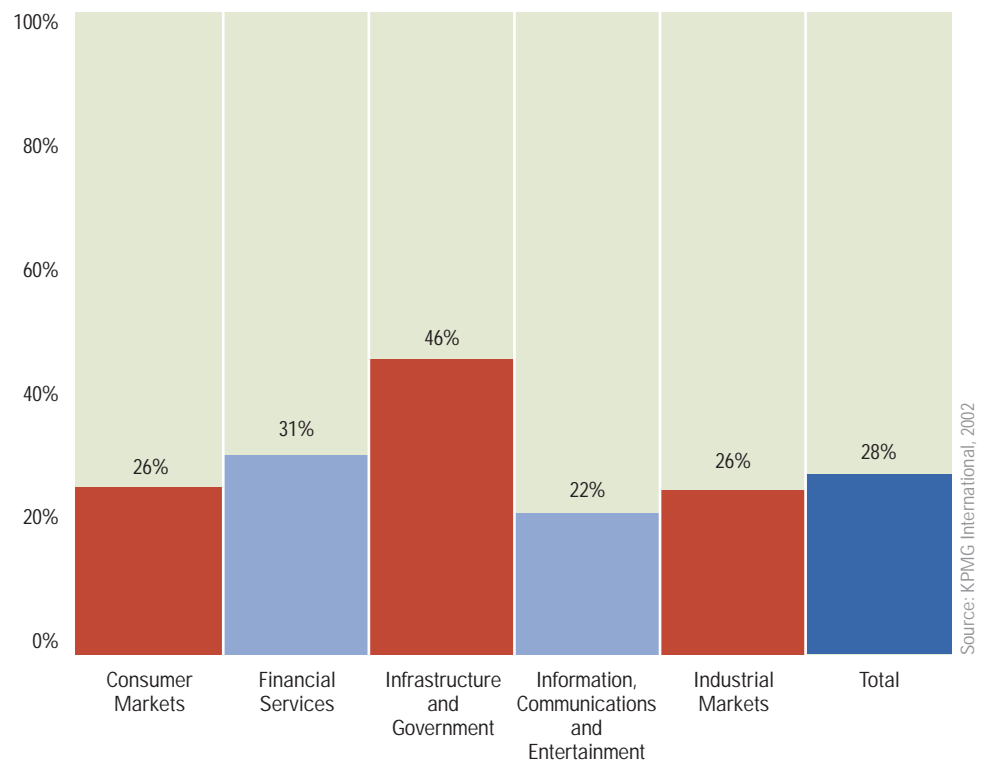
Companies with long experience of IP-related commercial threats tend to see board representation of the IP issue as routine. Says Philippe Lacoste of French clothing maker Lacoste “we know that our biggest asset is our brand. Inevitably that means that IP is at the centre of the business.” And Tim Richman Gadoffre, VP Key Customer Management at Mastercard International says that “IP management has always been fundamental to a business like ours – when you don't manufacture physical goods the business is going have to be based around IP.”

Increasingly, companies are creating dedicated IP management roles, with directors of IP represented at board level. The U.K. clothing group Burberry, for example, says that its management organization now appreciates that “IP does not just sit there and look after itself – it needs to be recognized and nurtured.”

Burberry's head of IP in the U.K. Stuart Lockyear explains that Burberry now maintains an eight-strong IP management and enforcement team in London, with one more staff member in five other cities worldwide (New York, Barcelona, Hong Kong, Seoul, and Tokyo). The director of IP reports to Burberry's General Counsel but also briefs the Burberry board quarterly. Says Stuart Lockyear, "the board understands the IP issue – it is most important that a board always understands what can and cannot be done in IP protection."

However, larger staff numbers are not necessarily the answer to IP protection challenges, cautions Alistair Campbell, brand protection manager of Glasgow Rangers Football Club. "What is key is not the number of people you have in your brand protection unit," he says. "It is more a matter of the effect you can generate through a combination of investigations, prosecutions, and collaborations with other companies who are facing the same problems."

All companies asked: Is IP management represented at board level?



Lastly, companies may need to reorganize to **fill in knowledge gaps** in IP-related work. These may be knowledge gaps regarding new technology, or in understanding markets where IP threats are developing.

Companies frequently find that effective IP protection may require specialist knowledge of the kind that is often only found in large research laboratories. For example, a textiles company may need to acquire skills in highly sophisticated technologies for the examination and identification of textile fibers – the kind of knowledge that is unlikely to be found in a fashion house focused on design. Italian fashion textiles company Mantero faced just this problem when exploring the potential of laser-based fabric reading and marking technologies capable



of distinguishing authentic products from sophisticated counterfeits. Carlo Mantero explains that one approach is to know what a company needs to know, and what skills it needs to rent: “you don’t need to be a dedicated expert in the subject, but you do need to know exactly what it is that you want,” he says. “At the least I need to know the minimum to understand what the researchers are talking about. Then I can decide whether I can rely on the skills of our contacts at the university research labs where we sponsor projects, or whether in, say, our laser-based research, I may need to rent some laser expertise.”

Carlo Mantero adds that for companies with little technical knowledge in areas where they wish to experiment with new IP protection techniques it may seem attractive to use market-ready, fully developed technologies, as these require less management learning time, and less development cost through sponsoring academic or specialist research. But he believes that could be a mistake: “if you have a finished technology, then the problem is that everyone can get hold of it – there is no competitive advantage there, and also that technology may not fit with your structure of operating,” he says, adding “On the other hand if you have a technology that is too new, it may be too expensive to develop it. You need to look for something that is already developed without being finished.”

According to Christian London, legal counsel for French fashion company Lacoste, it is likely that technological innovation will become increasingly important for IP-based companies. “In the past it has never been necessary to use specific technologies to recognize fakes, because they were so obviously fakes,” he believes. “But now counterfeiters are getting more sophisticated, and they are working with much greater resources. The fakes are getting a lot better, so your technology must get better.”

Tim Behean of adidas agrees: “some counterfeits are now of very high quality – so high that they are actually hard for the manufacturer to identify.” This may be because IP information is being leaked to counterfeiters; KPMG firms’ experience in partner auditing suggests that it may often be the result of manufacturing over-runs of authentic products. Tim Behean adds that companies should be aware that there is a danger that some arguments against counterfeiting – such as the consumer risks they may pose – lose some validity when counterfeit products are indistinguishable from genuine products. “The answer to this problem is that it is part of the brand owner’s job to make sure there is always a difference, by using methods like sophisticated labeling and numbering systems.”

Knowledge of the market is another area where companies may have to fill gaps. As digital markets continue to grow very rapidly, companies are often pressed to keep pace with the extent of counterfeit and gray markets. Fashion company Burberry says “at the moment there are around 13,000 transactions involving Burberry at any one time on eBay, and around half of those are fakes. Of those fakes we close down around 25,000 a year. It is a major undertaking.”

“You must make sure that copyrights are fully assigned to you, you must have your logos trademarked – but that alone won’t protect you. It is equally important to conduct investigations and if necessary prosecute infringers.”

Alistair Campbell
Glasgow Rangers Football Club

Dealing with this level of IP threat may mean investing both in more in-house capability and using external contractors. Lacoste, for example, uses specialist agencies to track IP infringements on Internet sale sites worldwide, 24-hours a day. “We are not just concerned about eBay, we are concerned about the Internet in general because the Internet is becoming one of the main channels of counterfeit trade,” says Lacoste’s legal counsel Christian London. “Ebay is not the worst. We have problems with all the auction sites, including many B2B sites.”

Alistair Campbell of Glasgow Rangers Football Club sees the growth of Internet sales of counterfeits as a particular threat to brands. “In the last year we have begun to notice the emergence of a lot of high-priced counterfeit items – in some cases they are actually more costly than the genuine product,” he says. “It is not a matter of genuine product shortage, it is more a function of the fact that the Internet can very readily be used to manipulate expectations. A lot of people see something on a screen, and that is enough to make them think it is genuine.”

Improve the quality of IP management in external relationships

Companies that derive revenue from IP licensed to partners such as manufacturers and distributors may need to **review partner auditing procedures**: KPMG International’s experience shows that in many cases revenues can be increased and partner relationships consolidated at the same time. This can also help keep licensees on their toes and redefine the risk of genuine products leaking out of the back door.

Perhaps some of the most important IP protection work companies can do on their own initiative is to continually and pro-actively audit agreements with distributors and suppliers for compliance, according to David Eastwood of KPMG’s intellectual property services practice. “There is almost no other way of ensuring that royalty or other IP-related statements from business partners are accurate,” he says.

Some companies believe that one of the best ways to ensure accurate royalty revenues is to have strong and long-term relationships with partner companies. “Our relationships with licensees are not just subcontracting relationships,” explains Christian London, legal counsel for Lacoste. “We have long-term partnerships: we rely on them, and they rely on us. In a relationship like that they know they will always lose more from counterfeiting than they will gain.”

However, KPMG International finds that 75 percent of business partners may make errors on royalty statements. Typically they will be unintentional but costly errors: a company may be erroneously deducting shipping costs from royalty declarations; a company may fail to control label printing, with large numbers of brand labels unaccounted for; pricing agreements may not be respected; design alterations may be made outside the scope of agreed licenses. “These are just some of the examples from recent audits conducted by KPMG firms,” says David Eastwood. “And in many cases the value of fees recovered exceeded the cost of auditing.”



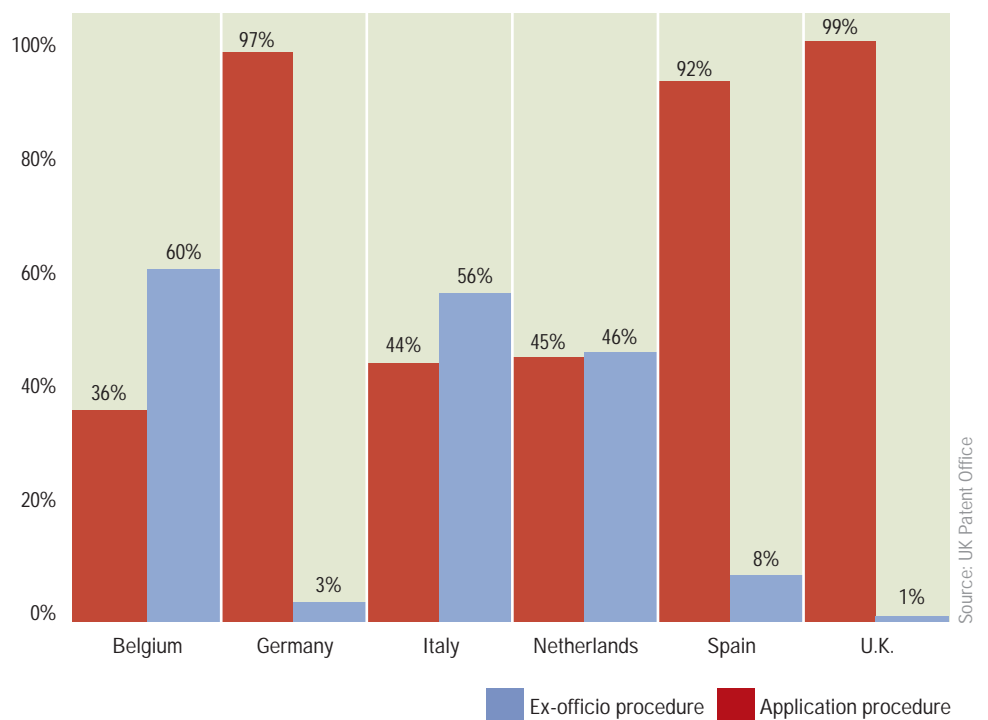
How should companies present the need to audit to partners? Partner companies may assume that the IP owner does not trust them. One answer is to make clear that auditing is a routine part of the business, and that no individual company is being victimized. Says Philippe Lacoste of French clothing company Lacoste: “auditing partners should be an ongoing process – a process where no one sees it as anything out of the ordinary.” Audits can in fact improve business relationships – KPMG firms have conducted over 1,000 such audits for one particular client without a single instance of dissatisfaction.

“Audits make money for IP owners,” says Mr. Eastwood, “but in the long run they are more important as consolidators of trust in the licensor-licensee relationship.” And Alistair Campbell of Glasgow Rangers Football Club points out that IP protection actions can be shown to benefit of licensees as well as IP owners. He argues “brand protection actions are not just there to manage licensees. We also have to show licensees that their investment is being protected.”

Companies may also have to devote more time to learning how to **work with national authorities** on IP protection issues: the rapid growth of IP theft through counterfeiting, piracy and gray markets means that it is no longer feasible for companies to simply assume that national police, customs and trading standards authorities will carry all the burden of dealing with these issues.

Increasingly, customs seizures of counterfeit goods follow requests from companies, rather than occurring at the instigation of national authorities (‘ex officio’ procedures). As the chart below shows, in the E.U. the proportion of corporate application procedures versus ex officio procedures can be as high as 99 percent.

Official customs procedures versus corporate applications 2004



“In a period of rapid but incremental technological change it is absolutely vital to protect more and more finely defined differentiation points between products.”

Mark Cohen
Scientific Generics

Antonio Deidda of KPMG’s Tax investigations practice says that experience shows that official investigations and penalties for counterfeiting are only a partial remedy for IP infringements. “In many parts of the world there is a reluctance to commit state funds to enforcing the IP rights of companies that are seen as beneficiaries of high profits from luxury products,” he warns, adding “and from the corporate point of view official investigations cannot be fully controlled by companies in the way that private civil actions can be controlled.”

In the E.U. customs and revenue officials can intercept counterfeit and gray market goods at borders, usually after an IP holder has filed a request for interception. But the procedure for such applications varies – in some states the authorities require an impracticable amount of information before they can act. In some jurisdictions customs officers may be ill-paid and ill-trained: in such cases companies should establish contacts at the highest level with country customs authorities. However, companies should be aware that customs authorities can also attack counterfeiting operations on tax grounds: in a recent operation in Manchester in the U.K. the authorities established that a counterfeiting operation represented 10 million euro (UK£7 million) in VAT evasion, resulting in a four year prison sentence for the perpetrator.

Companies should consider developing collaborations with national enforcement agencies. For example, Alistair Campbell of Glasgow Rangers Football Club says that the Club is currently running investigations in Europe, in the U.S., in Turkey, Thailand and China: “Customs officers, like all enforcement agencies, have many duties to perform and we travel to various countries to assist them with training in identifying counterfeit goods – often this is done in conjunction with other brands who are experiencing similar problems. However, with new products coming on to the market and the fact that customs officers are often transferred to different areas every year or so, it is important that this training is an ongoing process.”

Successful enforcement actions remain difficult to achieve even in some of the best-policed markets, say many companies. “Companies should note that the quality of evidence is crucial in criminal proceedings,” says KPMG’s Stuart Smith. “Evidence gathered through unauthorized entry or telephone intercepts is unlikely to win cases – and whether in civil or criminal proceedings, companies should never underestimate the difficulty of securing positive results, especially where they are acting alone.”



Gray markets are an IP issue

Gray markets arise when genuine products turn up in markets for which they were not intended. These markets are large: it is estimated that around US\$5 billion is lost a year through gray market trading in consumer electronics alone³. Many consumers think of gray market traders as consumer champions, as they pay less for goods than they would otherwise. Yet recent studies suggest that in many gray markets, almost all of the price differential ends up in the hands of intermediaries, not consumers.

Within the E.U. the harmonized European trademark law gives trademark owners an exclusive right to sell their products in Europe. This means that companies can use trademark rights to block gray imports of their own products from outside the E.U. area (within the E.U. goods can circulate freely). Outside the E.U. protection is often more difficult, and in some countries such as New Zealand there is no legal remedy to control gray markets.

Yet it may not always be necessary to resort to court action. Companies should also develop coherent pricing structures that can help to eliminate profit incentives to gray traders. Gray markets can be detected by monitoring sales: unusual sales growth is often an indicator of the source if not the destination of gray market products. Companies should also monitor distribution partners, although it is important to convey to partners that such monitoring is routine, to avoid disrupting what may be essential business relationships.

Gray markets may often be associated with counterfeited products, and in the E.U. courts treat gray products as if they were counterfeit. According to Ian Jackson of KPMG's intellectual property services practice: "one of the keys to a successful anti-gray market legal action is cast-iron traceability of product origin, and deciding which part of the gray market distribution chain to target."

³ KPMG International analysis, 2005

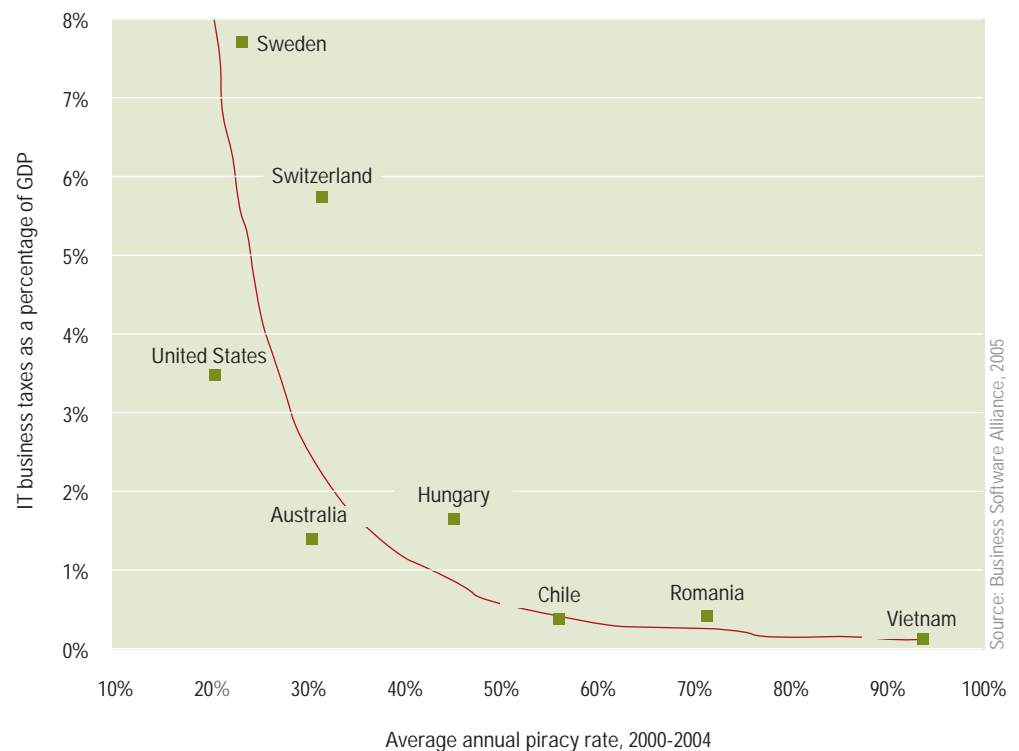
Build lobbying and public relations positions

Companies should aim to do more than just improve their business management of IP issues: they also need to develop **policy lobbying positions** designed to keep IP on the policy agenda at national and international governmental levels.

According to Guy Sebban of BASCAP, companies need to remind governments that a well thought-out IP protection strategy leads to more tax revenue and less unemployment. However, many companies and industries may still lack convincing data on economic losses from IP theft, say many IP specialists. "The poor quality of available data is a very big problem, particularly in the trademark world," says Stuart Lockyear of Burberry.

One sector in which there has been considerable progress in quantifying the broad economic implications of IP theft is the software industry. An economic impact study published in 2003 by the Business Software Alliance and conducted by the independent International Data Corporation (IDC) concluded that a cut in the software piracy rate of 10 percentage points over four years would add more than a million jobs and US\$400 billion of economic growth in the official economy.

High piracy rates mean low IT tax take



“There are practical ways of protecting IP – things like sequentially numbered labels for example – but they have to be cost effective. It’s no good coming up with a great way to protect your football jersey design if it’s going to add 15 pounds to the cost.”

Alistair Campbell
Glasgow Rangers Football Club

However, the BSAs economic impact study relates only to the software industry, and there is little comparable data for other industries. Companies need to do more to sponsor credible data – and that means spending more money on research at the sectoral level. Says Lavinia Carey of the Alliance Against IP Theft, “you can’t expect politicians to support you unless you are prepared to do something to show that you are committed to fighting the issue.”

According to some companies, that may require a change of culture in businesses that are unaccustomed to sharing data on commercially sensitive areas like counterfeiting and piracy. “One part of the answer has to be for us to share more data,” says Stuart Lockyear of Burberry. “Luxury brands are not very good at sharing data, and that is creating a problem for the companies.” Tim Behean of adidas agrees: “the copyright-based industries have been very successful in collaborating against IP theft,” he says. “Brands are much more diverse, in a way that makes it harder to collaborate. And some are reluctant to share data for competitive reasons. Yet adidas has worked very effectively with Nike in the recent past, and we maintain good contacts with other sports footwear manufacturers.”

Companies should also **reach out to customers**, as well as to governments. One clear reason that counterfeit, pirated and gray market trade is increasing is because there is demand for the trade: in a great majority of cases it appears that customers do not understand the costs associated with illicit products.

Addressing consumers and the wider public raises complex issues for companies, as consumer motivations for buying counterfeited goods rather than authentic products are many and varied. Recent research conducted in the U.K. into consumer preferences for counterfeited versus authentic products – the Intellectual Property Theft and Organized Crime (IPTOC) project, funded by six industry federations and the U.K. Patent Office – suggested that buying preferences varied considerably according to age, sex, and economic status as well as type of product. But the research also showed that consumers expressed strong preferences for authentic products where they were aware of arguments against counterfeiting.

Motivations For purchasing counterfeit goods

	They are cheaper	They are off acceptable quality	Could not afford otherwise	Lets me buy more for my money	My children want them
DVD's	97%	43%	30%	27%	16%
Music	91%	57%	23%	41%	7%
Computer Games	94%	24%	6%	24%	12%
Business Software	100%	29%	29%	29%	0%
Fashion	72%	70%	38%	45%	5%
Alcohol and Cigarettes	100%	29%	12%	53%	0%
Toys	33%	33%	0%	33%	0%

Source: IPTOC, 2005

Motivations Against purchasing counterfeit goods

	Waste of money	Poor quality	Prefer the real thing	Children prefer the real thing	No product guarantee	Links with organised crime	Products might be harmful
DVD's	19%	44%	45%	3%	34%	56%	7%
Music	17%	44%	45%	3%	36%	55%	8%
Computer Games	16%	33%	35%	3%	30%	47%	8%
Business Software	15%	24%	35%	1%	35%	39%	11%
Fashion	19%	40%	49%	3%	35%	39%	6%
Alcohol and Cigarettes	21%	23%	41%	1%	12%	51%	41%
Toys	15%	35%	34%	8%	28%	33%	44%

Source: IPTOC, 2005

The IPTOC research suggested that consumption of counterfeit and pirated products is both widespread and routine in the U.K., although the frequency of purchasing varied markedly between product categories, with music CDs (12 percent of survey participants had purchased counterfeits within the previous 12 months) and fashion items (11 percent of survey participants had purchased counterfeits within the previous 12 months) being the most affected. The research also showed that purchases occur over a much wider demographic range than previously research had suggested.

Lavinia Carey of the Alliance Against IP Theft argues that despite the considerable challenge of altering public perceptions, a little information can go a long way in changing attitudes: "most people don't actually want to break the law, and when they are persuaded that IP theft is against the law they will stop, voluntarily," she says, adding "the biggest challenge is often to show people that there is something called intellectual property, and that it belongs to somebody."

“Like most criminals, counterfeiters want an easy life. We have found that by vigorously pursuing and prosecuting them, they will turn to other targets.”

Alistair Campbell
Glasgow Rangers Football Club

Why brands are vulnerable

Companies with valuable brands are among the most vulnerable to IP theft. Although estimates produced by the U.K. Patent Office of the value of counterfeiting and piracy in the U.K. suggest that IP loss in the luxury sector is much smaller than in the entertainment and software sectors, the cost of counterfeiting remains high as a proportion of total revenue for luxury branded goods; in addition there is a cost in terms of damage to the brand that is difficult to quantify but may well be the highest cost of all.

“Calculating the loss caused by IP theft is very difficult – partly because the serious damage is intangible,” says Stuart Lockyear of Burberry, who adds “usually we are not talking about lost sales with luxury items – more important is loss of brand value, a loss of luxury. And loss of luxury is a hard thing to quantify.”

Lavinia Carey of the Alliance Against IP Theft agrees: “companies don’t know how to calculate the consequential loss,” she says. And she believes that brand owners often fight shy of confronting the amount of damage counterfeiting does to the brand. “A lot of brand companies have never researched this. The copyright industries are working hard to establish the real losses due to IP theft, not just the value of the black market, but brand manufacturers are struggling to find a methodology that works for them.”

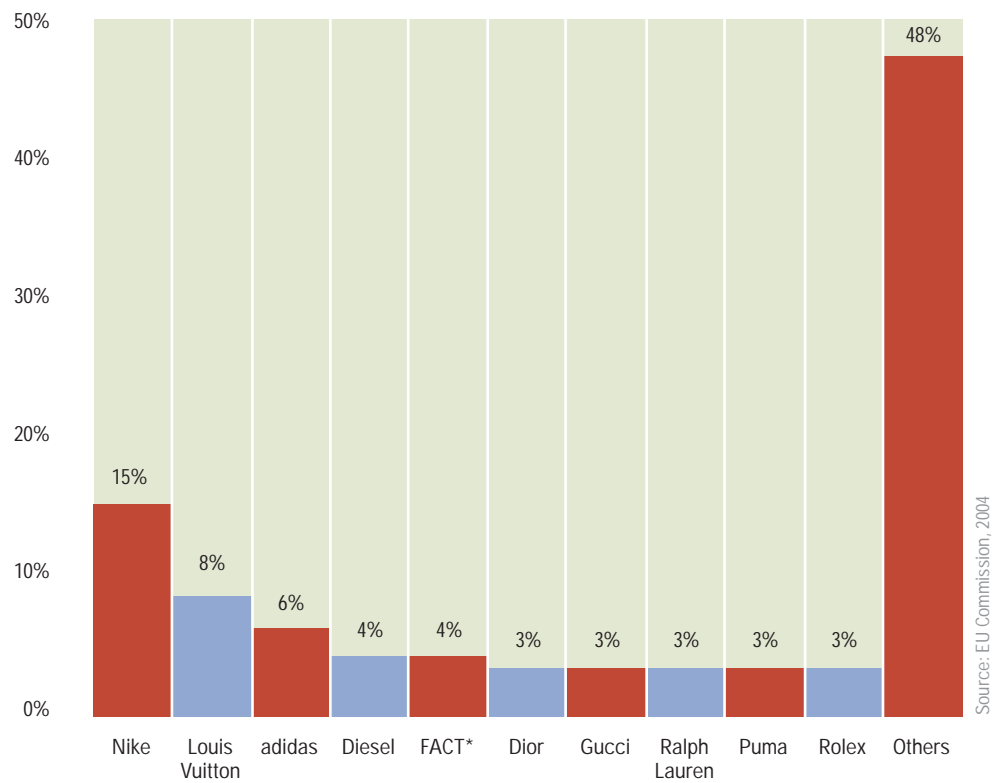
Philippe Lacoste of clothing maker Lacoste says that even where companies find it difficult to assess the commercial cost of brand damage through counterfeiting, there will still be some counterfeiting costs that can easily be measured: “it is not possible to quantify the loss of brand identity,” he says, “but what you can quantify is the cost of acting against counterfeits – the cost in terms of management time and legal actions.”

Developing a credible assessment of the hidden damage to brand businesses is likely to take much more collaboration between companies than at present, believe many. One disincentive for information sharing and publication is that some companies see admitting to a counterfeiting problem as bad for share values: says one industry federation head, “companies don’t want to admit to an IP theft problem, because they feel they will be hit twice – once when they are counterfeited, and again when the financial analysts mark their shares down because they are seen as vulnerable to IP-related losses.”

Stuart Lockyear of Burberry agrees that luxury brand companies are reluctant to be seen as victims of counterfeiting – but he believes that keeping quiet about IP loss only compounds the problem in the long term. “We have to learn to share more data,” he says.

Tim Behean of adidas adds that it is important not to let an attitude of ‘resigned acceptance’ take hold in companies: “nine or ten years ago a rather jaded attitude had developed – the attitude that there will always be counterfeiting, its something we just have to live with. And that attitude is something you also have to fight against.”

E.U. IP infringement cases by trademark



* FACT (Federation Against Copywrite Theft) acts on behalf of brand owners in counterfeiting and piracy cases

Conclusion

Global companies increasingly compete on their ability to manage intangible assets, and the quality of intellectual property management is emerging as a key to the competitiveness of 21st century businesses. Consumer companies in particular face the challenge of protecting IP resources in consumer markets where large or mass markets and increasing freedom of cross-border trade combine to make IP protection a 24/7 business concern. Companies most likely to succeed in this environment are those that can identify and implement preferred practices in managing their IP as a central and strategic business issue.

“To manage IP effectively you need to look at two dimensions. Internally you need to be sure your processes and resources are sufficient, to identify and capture the right IP. Externally, you have to know what IP other companies hold, how it impacts your business and make sure the appropriate staff are aware.”

Mark Cohen
Scientific Generics

Internal management issues include auditing the company's use of IP and own holdings of IP. It may mean working to increase understanding of IP protection as a business issue within the company; it may also mean organizational change that gives IP management a more central and 'strategic' role within the company, and allocating management resources to fill in knowledge gaps.

External issues are likely to include a review of how accurately IP revenues from manufacturing and distribution partners are reported, and this may require the creation of a new and formal professional auditing process. Companies will also need to learn how best to collaborate with external enforcement agencies such as national customs authorities, police forces and trading standards bodies, as well as formulating their own strategies for best results from private enforcement efforts.

Lastly, companies should think carefully about their **public profile** on IP protection: they should plan lobbying of governments whether on an individual basis or through industry associations. They may need to review how they address customers on intellectual property, and how they argue the IP case in society at large.



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