



Tackling illicit trade in the e-commerce era

KPMG illicit trade viewpoint



Foreword

With illegal online trade on the rise, Sean McGill and David Bird look at how it works, and what legitimate businesses can do about it.

It's an ill wind that blows nobody any good. Businesses and consumers may be struggling to cope with high inflation – but such conditions create the ideal environment for illicit trade to thrive.

As our [recent blog](#) noted, consumers looking for bargains in the current climate are more likely to fall victim to criminals selling counterfeit and contraband products.

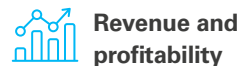
And increasingly, organised crime groups (OCGs) are turning to the digital economy to satisfy this demand. Selling fake or smuggled goods 'direct-to-consumer' online (known as 'D2C') is a trend that exploded during the pandemic, and isn't going away any time soon.

The impact of illegality

Illegal D2C sales particularly affect the fashion, alcohol, perfume, consumer electronics and tobacco sectors.¹

Like all illicit trade, D2C is detrimental to businesses in a myriad of ways. Broadly speaking, it has a damaging impact on three fronts: sales, supply chains and ESG.

Sales



Revenue and profitability

The sale of a counterfeit item is obviously a lost sale to a legitimate firm. But both counterfeit and contraband illicit D2C sales also distort pricing and profitability in the wider market. Companies may be forced to adjust their pricing strategies to compete with black-market operators.



Brand strategy

Fake goods weaken a business's brand strategy, positioning and messaging. That may be through the dilution of exclusivity and prestige; an inconsistent experience between genuine goods and copies; or a lack of control over how and where products are sold.



Channel conflict

Illicit D2C trade also undermines genuine sales channels, by creating friction between brands and their authorised retail and distribution partners. Retailers and distributors may blame brands for not clamping down on illicit trade. Meanwhile, brand owners might suspect distributors of allowing products to leave their warehouses 'via the back door', enabling illicit trade.

No smoke without fire

Counterfeit and contraband tobacco products can increasingly be bought – with little effort or risk – through online marketplaces, purpose-built websites and social media platforms.

With user numbers mushrooming in recent years, social media has increasingly become a go-to channel for illegal tobacco sales. At the same time, however, the use of online marketplaces is also on the rise.

Illicit sellers fall into two categories: opportunist individuals, and international, organised criminal gangs. The latter tend to have access to a steady supply of products and complex distribution networks.

In terms of distribution, both types exploit two key factors: the recent, rapid growth of postal and parcel services; and an explosion in the number small packages passing through customs (which leaves officials unable to inspect them all).

Some of the more sophisticated groups run longstanding operations from multiple addresses, breaking up consignments between many different delivery services. This makes them particularly difficult to track down.²

1. OECD: High Risk Sectors in COVID-19 recovery, Transcrime Research in Brief

2. E-Commerce, Delivery Services and the Illicit Tobacco Trade | Royal United Services Institute (rusi.org)

The impact of illegality

Supply chain

Security of supply

OCGs may infiltrate legitimate supply chains to source materials for illicit products – putting the continuity of supply at risk.

Authentication requirements

The proliferation of fake items imposes costs on legitimate companies by forcing them to invest in product authentication and anti-counterfeiting measures.

Compliance costs

Illicit goods will breach numerous laws and regulations – such as intellectual property, tax evasion, product safety and consumer protection rules. In response, governments and regulators may strengthen these frameworks, increasing the cost of compliance for genuine firms.

Liquid assets

The sale of counterfeit premium Italian wines by a criminal gang provides a glimpse into how illicit traders go about their business.

Working with Europol, NAS Carabinieri of Florence took down a network of counterfeiters who were selling fake wines online.

Their investigation found the gangs were filling empty premium wine bottles with lower-quality produce. They were then selling these as the genuine article on a major online auction platform – for up to €1,000 each – to customers across Europe and in the US. Delivery would almost certainly be made by courier, to maintain a distance between the buyers and the criminal gangs involved.

Once they had buyers' contact details, the counterfeiters would target them directly with offers and promotions on more fake wines – often at prices far below those on the genuine market.³

ESG

Supply chain transparency

An organization's ethical practices, responsible sourcing and labour standards may be undone by counterfeits or smuggled goods. Those making illegal copies of products aren't likely to maintain good practice, such as safeguarding against slave labour in the supply chain.

Quality and safety

Firms put huge effort and resource into making their products safe and compliant. Illegal traders don't. That can damage the reputation of legitimate businesses – and worse, endanger consumers' health.

Fatal fakes

In October 2021, The Automotive Anti-Counterfeiting Council (A2C2) in the USA urged a major e-commerce platform to prohibit the sale of airbags, noting they often comprised completely of counterfeit components.

Other airbags have also been found to be comprised of certain used original equipment manufacturer (OEM) components recombined with counterfeit components to masquerade as legitimate OEM airbags.⁴

The fake airbags are reportedly difficult to spot, appearing nearly identical to genuine, original parts; they can, however, be unsafe and result in catastrophic failures, with fatal consequences.

Data security and privacy

Illicit online sales pose major cybersecurity and data privacy risks. Criminals selling illicit goods are also likely to indulge in hacking, data theft and credit-card fraud.

Loss of government revenue

Illicit trade negatively impacts government revenues by evading taxes like excise duties and VAT, leading to a loss of income to reinvest in public services. It also increases enforcement costs, further increasing the strain on the public sector.

3. <https://www.europol.europa.eu/media-press/newsroom/news/fake-wines-sold-under-expensive-italian-labels-market>

4. OECD/EUIPO (2022), Dangerous Fakes: Trade in Counterfeit Goods that Pose Health, Safety and Environmental Risks, Illicit Trade, OECD Publishing, Paris, <https://doi.org/10.1787/117e352b-en>.

How and why?

To understand how the illicit D2C trade works, let's take a look at some of the typical processes involved:



Inbound

Counterfeit and contraband products are often sourced from clandestine warehouses, or from multiple commercial and residential addresses, to avoid detection and enforcement action.



Marketing

Illegal traders recruit customers on closed-group messaging apps or social media groups via word of mouth, flyers, etc. Or they use highly specific search terms on ecommerce platforms to take users to illegal products. They regularly update these groups and platforms with new products and promotions.



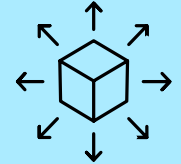
Sales

Once a consumer expresses an interest in the products on offer, the seller gives them a number to call or message – so that the sale takes place away from legitimate platforms.



Payment

Payment may be made on delivery, via an app, or even by debit or credit card.



Delivery

Customer deliveries are made as small parcels, often on a same-day basis. OCGs will use local couriers, which may be legitimate businesses, or criminal enterprises themselves (often using forced labour).

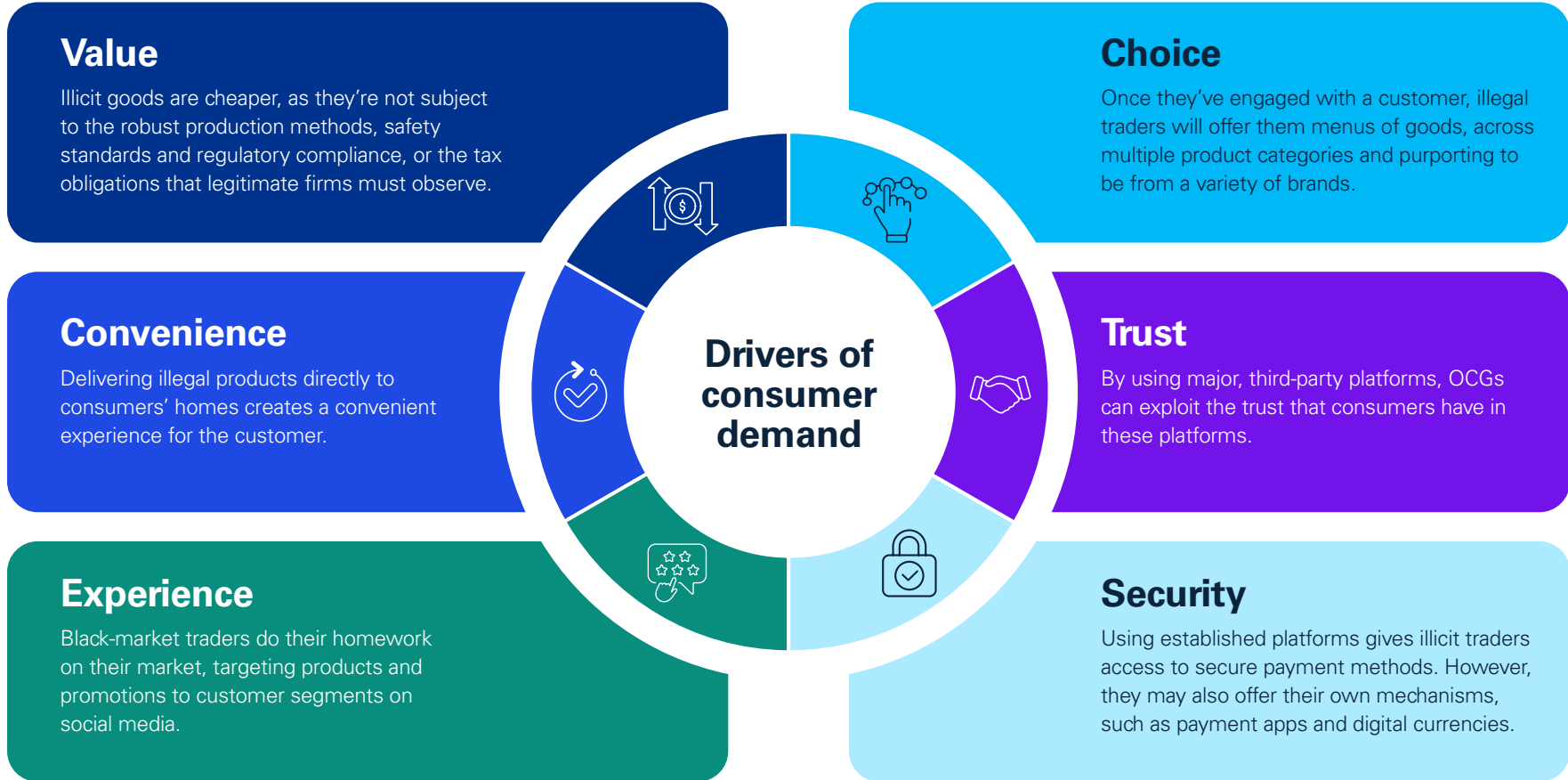
How and why?

Using D2C channels in this way has several advantages for OCGs. Firstly, it's a highly effective way for them sell counterfeit and contraband goods – as it makes it easier to satisfy the six main drivers of consumer demand opposite.

What's more, the D2C route means black-market players can adopt highly flexible business and operating models, which are asset-light, lower-cost and lower-risk.

Plus, using legitimate online platforms reduces their exposure to points of illegality.

Finally the smaller shipments that D2C trading involves de-risks last-mile delivery, as they are harder to detect, and have a smaller financial impact if seized.



A collaborative exercise

Illicit D2C trade is anonymous, agile and therefore difficult to tackle. There's no 'silver bullet' with which to eliminate it. What's required is a comprehensive approach to disrupting it as much as possible.

A successful strategy must involve the entire stakeholder eco-system. This comprises consumers, platforms, payment companies, logistics providers, governments, regulators and law enforcement.

Effective action will depend on extensive collaboration between these stakeholders. In our view, they should work closely together on the following steps to make life difficult for counterfeiters and smugglers and to reduce the profits made in the channel.

1 Map the problem

The first task is to gain a thorough understanding of the issue – including:

- the scale of the trade
- its drivers and trends
- who the buyers are
- which platforms are used
- how payments are made
- how goods are delivered

2 Set your objectives

With that data to hand, you can put metrics in place to measure the effect your actions are having on illicit D2C trade – for example:

- reducing the total addressable market (TAM)
- cutting the lifetime value (LTV) of customers
- increasing customer acquisition costs (CAC)
- impairing customer retention

3 Restrict reach and profitability

Working with the online platforms, reach out to consumers to inform them about:

- the safety risks presented by illicit goods (substandard products, data theft, fraud)
- the exploitative practices used by OCGs (forced labour, funding of other criminal activities)

That should help disrupt gangs' efforts to tap into the drivers of consumer demand – which will in turn diminish their TAM.

In addition, develop your firm's capabilities for combatting counterfeiting and smuggling, so as to inflate illicit operators' CAC, and damage their customer retention. Make use of advanced technologies, tools and techniques, such as heuristics, algorithms, artificial intelligence and machine learning.



A collaborative exercise

4 Strengthen screening and authentication

Another reason to work with online sales platforms is to develop reliable, technology-led authenticity checks.

These build trust, and benefit consumers and rights holders, by certifying the authenticity of branded bought products online. This makes it harder for OCGs to connect with customers, further reducing their TAM and pushing up the CAC.

Collaboration with delivery providers and app-based delivery services will be equally important.

The aims here are to improve screening of parcels for illicit products; and tighten drivers' employment terms to discourage them from taking packages from illicit operators. The more packets seized, the greater the inconvenience to customers and the CAC for illegal operators. That lowers the customer LTV, along with the ability to retain customers.

5 Heighten the risks for illicit operators

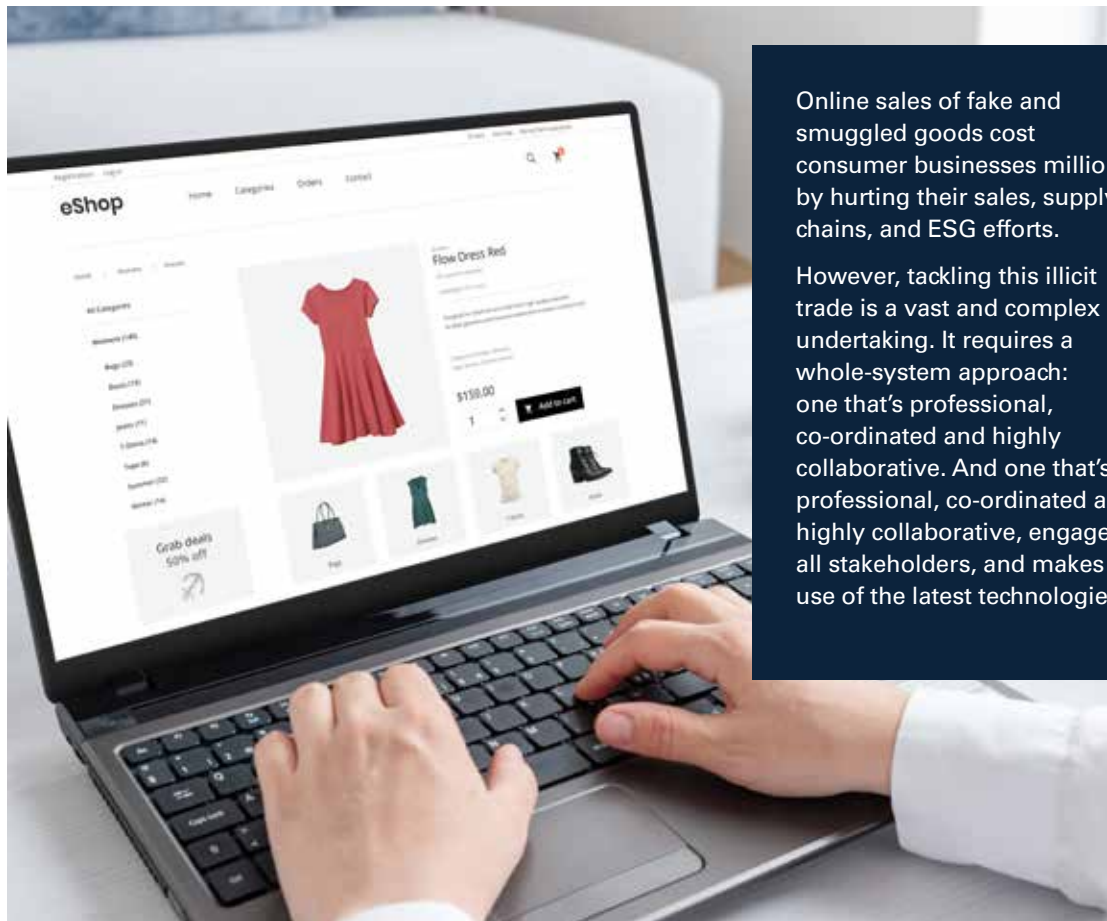
Intelligence-sharing will be necessary between the public and private sectors: on known perpetrators, their networks, and the latest trends and developments in the illicit D2C trade. That will enhance law enforcement's ability to take black-market players and sites offline altogether.

Also, work with regulators to strengthen legislative controls. For example, greater penalties for businesses and individuals involved in counterfeit trade, and for the platforms that persistently enable it.

The effect will be to increase the risks and CAC facing OCGs, while shrinking the TAM available to them.



In summary



Online sales of fake and smuggled goods cost consumer businesses millions, by hurting their sales, supply chains, and ESG efforts.

However, tackling this illicit trade is a vast and complex undertaking. It requires a whole-system approach: one that's professional, co-ordinated and highly collaborative. And one that's professional, co-ordinated and highly collaborative, engages all stakeholders, and makes use of the latest technologies.

KPMG's anti-illicit trade team can help you put such an approach in place. We'll work with you to:

- understand the dynamics and drivers of illicit trade in your sector
- measure the scale of the problem
- define a strategy to combat it

Please get in touch to see how we can support your business.



Sean McGill
Director
Strategy & Performance Transformation
sean.mcgill2@kpmg.co.uk



David Bird
Associate Director
Strategy & Performance Transformation
david.bird2@kpmg.co.uk



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