

Costs in the counterfeiting business

Counterfeiting business costs depend on a variety of factors, which include *the type of counterfeit products manufactured and their quality*. Generally, the quality of counterfeit products varies. Counterfeit alcohol is a good example. In many cases it is suitable for sale in legal premises (e.g. corner shops and pubs), but in some other cases it has been found to be below the required strength. Most counterfeit alcohol poses no threat to consumers' health, but in 2015 an investigation of a pub landlord in County Durham who was selling fake vodka showed that the alcohol contained dangerous ingredients 'used to make antifreeze, disinfectant and fuel' (cited in Lord et al. 2017). The issue here is that some commodities require significant financial investment in the production phase. For instance, making a quality counterfeit microchip (see Kelley, 2012) or a type of a pharmaceutical product (Hall and Antonopoulos, 2016) is more expensive obtaining something like counterfeit raw tobacco.

The Chinese sources were not short of examples that indicate the higher production costs of counterfeit goods made in the country. The process of manufacturing counterfeit perfume involves electric mixers, ingredients including industrial alcohol, fragrance essences and water, empty bottles and numerous kinds of packaging materials. It cost around 1.3 yuan (£0.15) to make a bottle of fake 'Lancôme' perfume (China Anti-Counterfeiting Report, 2016). Similar information on other high-profile cases (see for example *Nanfang Metropolis Daily*, 2015). In a recent incident detected in Nanjing (*Yangtse Wanbao*, 2017), copies of top-end cosmetics, such as La Mer, Jo Malone and CK (possibly also that handled by Julie, Matt and Christine in the Northeast of England as we saw earlier) were made in plastic buckets stored in a bathroom right next to the toilet, with limited expenses. Thus, the cost of faking a bottle of La Mer Moisturizing Cream could only be several tens of yuan (several pounds in sterling).

By contrast, to make a highly imitated, known as 1:1, Louis Vuitton handbag can be 'costly'. Initial costs include several tens of thousands of yuan (several thousands of pounds) spent on learning techniques and know-hows to counterfeit bags. To imitate a top-brand bag involves purchasing a genuine product for around 15,000-25,000 yuan (approx. £1,700-£2,900), taking it apart completely, making patterns and having different parts made by different specialist workshops, and finally assembling and packaging. For a 'mature' counterfeiting business, to 'delicately' copy, say, a Louis Vuitton Limited Edition Love Birds bag would cost around 1,300 yuan (approx. £150). However, making a 'basic' (quality) copy of Louis Vuitton handbag might cost just over 200 yuan (approx. £23) (*Xinjing Bao*, 2014).

Our research suggests that illicit tobacco factories in Britain, which are specialise primarily in packing tobacco, do not require much investment to yield significant profits.

Some entrepreneurs set up their manufacturing business in disused venues. In a case we came across costs included £200-300 per month for the venue, £5,000 for raw tobacco, £1,000 for counterfeit packs and another £1,000 a month to have a couple of Chinese workers to put the tobacco in the packs. In another similar case, the counterfeiters, who set up a tobacco factory in Grimsby factory, bought the cigarette rolling machine from the internet (www.AliBaba.com) for £7,000 and paid only £25 per week for the venue. Before the HMRC intervened after only 3 weeks the entrepreneurs had made products that guaranteed profits of over £3,000,000 (interview with academic).

Costs also depend on *the scale of the project, its logistical complexity, and the level/position on the entrepreneur in the supply chain*. The need for international transactions also significantly affects the business costs. Many small-scale entrepreneurs reduce costs by trading a small number of items, using internet platforms and/or operating their counterfeiting business from their household using spare rooms, garages and basements. The merchandise is stored in their cars, caravans or family members' and friends' houses. Other small-scale entrepreneurs do not have significant costs simply because their counterfeiting trade practices are unsophisticated and embedded in their normal life and work practices. 'Dave', for instance, often pays less than £1,000 for the watches. There are no accommodation costs because he stays with his wife's family in China, and no transportation costs because the merchandise is small, light, and easy to carry. His flights from Manchester to Shanghai and back are paid for by the summer school in Shanghai (Interview with criminal entrepreneur #4). In some cases small-scale entrepreneurs reduce the costs of their businesses by sharing expenses with other entrepreneurs. For instance, a venue space divided by stud walls can accommodate 6-7 businesses trading, or a small part of warehouse can be used simultaneously by legal and illegal enterprises. In Manchester, some storage units used by counterfeiters are owned by the City Council (interview with National Trading Standards officer #2; interview with HMRC investigative officer).

However, large-scale operations incur diverse, functional expenses that are unnecessary in small-scale operations. For instance, with no guarantee that a deal will be struck some counterfeiting entrepreneurs must pay for initial trips to meet with potential partners abroad. Large-scale means bulk, therefore it can be expensive to transport the merchandise, although these costs will vary according to the distance covered and the risk of seizures or arrests associated with specific UK entry points. However, it is possible for these transportation costs to be significantly different even when the distance covered and the possible risk are identical. For example, according to OLAF (2012), in two separate investigations in the UK, one driver received £1,000 per successful Channel crossing and the other £10,000. Costs associated with 'cover loads' during the transportation of

counterfeit products phase should be added (although it should be mentioned that most cover loads are very inexpensive commodities such as jelly, sand, cattle feed, rotten fruit, etc.).

In large-scale schemes other functional costs include changing the merchandise in containers or moving it from one container to another at ports to confuse the authorities or divert their attention. An average amount paid for this activity is, according to an HMRC source, about £250 although it can vary depending on the value of the merchandise, and whether the criminal entrepreneurs have done business with the 'movers' before (Interview with HMRC investigative officer). In importation/wholesale cases, industrial units (warehouses) are rented to stash the merchandise. In the cases we came across these industrial units were rented for an average cost of about £50 per month (see also Antonopoulos and Hall, 2015). The security guards working in the premises were given small fees every month to watch and protect the particular units rented by the illegal entrepreneurs.

"Wholesale is different. You might have to pay up to £10,000 to a lorry driver to transport the cigarettes from France or Belgium or wherever. You need to put the stuff in a warehouse, if you don't want to keep it in your house. You need minders for the warehouse as you are never sure who knows about it and will try to steal it and so on" (Interview with customs intelligence officer).

Large-scale entrepreneurs can also incur higher costs as they attempt to provide better quality counterfeits in an effort to beat competitors in localities in which counterfeiting thrives. One of the criminal entrepreneurs interviewed ensures high quality merchandise for his illegal business by mixing highly quality merchandise imported from abroad (Eastern Europe; merchandise manufactured in China and Malaysia) with legally produced merchandise. Occasionally, once every 3-4 months, they employ burglars to steal bulk quantities of merchandise from legal stores (e.g. H&M, Debenhams, Topshop etc.) and warehouses where garments are kept. Each entrepreneur employs burglars from their local community to commit burglaries outside the area in which their transportation companies are based. For every burglary the groups of burglars are paid 30% of the price of the stolen merchandise. The smallest amount paid to the burglars per heist is around £200 and the highest around £3,000, so the cost for this part of the business is roughly £600 - £9,000 per year. An additional cost is buying information about warehouses that contain legal merchandise. This information is bought for £200-300 per venue, irrespective of the quantity of merchandise in the premises. The stolen merchandise is sold along with the counterfeit imported items, which facilitates 'counterfeit product laundering' and establishes the entrepreneurs'

reputation as merchants of quality 'fake' clothes. This quality differentiation is essential if the entrepreneur is to ward off competition from other entrepreneurs operating in the area (interview with criminal entrepreneur #5).

Finally, functional costs include payment to other actors in the counterfeiting business. In our study, we came across payments to *couriers*, individuals who are trusted with transporting merchandise and/or money. Antonopoulos and Hall (2015) refer to a case of transportation of £1,000,000 illicit tobacco money from the North of England to someone in London. The courier received £5,000 for the service, or 0.5% of the money transported. On some occasions legitimate courier companies are used. In September 2014, for instance, three tobacco counterfeiters from the West Midlands were sentenced for their involvement in a counterfeit tobacco smuggling ring. The counterfeiters were arrested by the HMRC who also seized more than nine tonnes of raw tobacco smuggled in Chinese tea boxes. A search of one of the entrepreneur's home address revealed paperwork showing payments made to legitimate courier firms (HMRC, 2014).

Payments are also made to so-called *minders*, people with physical capital who often accompany the money couriers. Unlike couriers, the minders are subcontracted on an ad hoc basis and paid a standard fee per job. Payments must also be made to *retail sellers* who have not invested in a small-scale counterfeiting scheme but work for someone else. Their daily fee ranges between £20-£100 (Interview with National Trading Standards officer #2; Antonopoulos and Hall, 2015). The payments to actors involved in the counterfeiting business can vary widely, depending on their role and the size and scope of the operation, as well as the personal relationship between the entrepreneur and the actor. For example, in one of the cases we came across, the entrepreneur used his teenage daughter as his inner-town money courier and did not pay a fee.

Other business costs include *contingency* expenses mostly associated with the risks of losing the merchandise or being found out by the authorities. Although these critical moments can also be experienced by small-scale entrepreneurs, it is mostly large-scale entrepreneurs who tend to incur these costs. For instance, when customs officers find that cargo manifest is not in accordance with the recorded load, merchandise is confiscated. The HMRC have also come across cases involving batches of counterfeit products (mostly cigarettes and clothes) stolen from warehouses, although the HMRC suggested that the thefts might have been carried out by competitors. Other contingency costs include those related to seizures of vehicles and legal advice following arrests of criminal entrepreneurs and their associates:

"The police stopped a van 10 miles from Leeds for a broken windscreen. The officer does a check at the back and he thinks there is something dodgy going on. So, he

gives us [HMRC] a call and says 'you might want to take a look at this'. No paperwork.... Turns out it is fake luxury handbags from China" (interview with HMRC investigative officer).

Finally, costs depend on *the embeddedness of the counterfeiting scheme in a legal business*: Generally, large-scale entrepreneurs who operate within the confines of their legal businesses tend to absorb some of the costs relating to their illegal businesses and the risks associated with them. For example, transportations/logistic companies do not pay for transportation expenses since this is embedded in their everyday business. In addition, they do not have to mobilise human resources for their illegal business. For instance, they do not have to pay workers and drivers, who already work in their legal transportation business and are often unaware of the illegal business taking place:

"Nothing, they [drivers] always know fuck all, so they get the load and they deliver it to where they're told and they get about two thousand quid... and then you've got the man let's say the hinge-pin over there and he's the one putting the money in anyway, and he'll have contributions from his other pals who help the hinge-pin accumulate the money so they'll have their costs with running about, distributing, sorting the lorry out and what have you. I don't know how much they've got involved over there but I was always told the driver never knew. So, I never asked questions, I only wanted to know what I want to know that's it..." (Interview with criminal entrepreneur #2).

In addition, some counterfeiting entrepreneurs who own legal businesses, such as interviewee #5, and who get involved in large-scale counterfeiting schemes, have a diverse portfolio (counterfeit tobacco, counterfeit clothes and previously counterfeit alcohol) while operating from a single legal premises. Moreover, international connections and larger investment capability allow them to buy in bulk and get better prices from manufacturers, which creates an economy of scale and a general reduction of overheads. More successful entrepreneurs – and these generally tend to be legal businesspeople – whose initial investments tend to be more substantial, are able to place 'call-off' orders. This basically means that they order a substantial quantity of the merchandise from a producer and take advantage of the usual discount that exists *per single item* ordered and arrange for the merchandise to be sent in installments to cover demand (Interview with forensic accountant).

Profits and investments in the counterfeiting business

The profit margin in the counterfeiting trade in the UK depends on a number of variables. First, *whether the entrepreneurs operate within primary or secondary markets*. According to

OECD/EUIPO (2016), there are two market segments that counterfeiters target: 1) *primary* markets, in which prices are expected to be close to those of the corresponding products sold in the legitimate market and in which customers are deceived about whether the product is genuine; and 2) *secondary* markets, which involve significant price ranges and customers are expected to pay a much lower price than for the genuine products. Entrepreneurs involved in primary markets tend to make the highest profits, although precise product pricing is a dynamic process in which the counterfeiter uses his/her 'entrepreneurial judgement' (Dean et al., 2010). The art of judgment must take into account the level of demand for a product and the market potential; the quality of the counterfeited merchandise; the area of sales; the type of clientele and its buying power; competition by other similar entrepreneurs; and the relationship between lowering/reducing prices and the point of maximum profits (see Hotelling, 1929).

Second, profit margins depend on *the position of the illegal entrepreneurs in the supply chain*. The profits begin to reduce as the merchandise moves down the supply chain. Actors in the retail market will make the smallest profit. This is because retailers rely on wholesalers/importers – either by working for them or by buying products from them – and a significant portion of the overall profit is absorbed by actors in this sector of the business. This was observed at Manchester's Cheetham Hill market where two entrepreneurs spoke of the relatively insignificant role they play as retailers in the supply chain, and of the smaller profits they make as a result:

"I'm a nobody. These markets are linked to larger networks in Turkey and China" (criminal entrepreneur #6).

"The sunglasses are usually £7 but our supplier did us a deal to buy bulk. We still only make £1 per pair if we sell them for £5" (criminal entrepreneur #7).

Sometimes the small profit is the result of the retail part of the chain having been extended by 'consumer-retailers', a process which adds layers in the price of the merchandise:

"When you have a small box, it is most likely going to be resold. Let us say that a box contains 100 lipsticks, sold at a price of £3 each. These will be resold many times and every time, the price will be higher. So the closer you are to the person that receives the package, the lower the price. If you, as the initial customer, buy 10, you pay £30 pounds and then you sell them to your lady friends for £5 each, which is still

a good price and you make £20. Now one of your lady friends might sell a couple for £10 each also making a few pounds..." (interview with HMRC officer).

Manufacturers and original suppliers also tend to make relatively low profits. The Chinese literature suggests that often local manufacturers of counterfeit goods may only achieve a 2% profit margin from selling their products to overseas importers. The only way to make more is to sell bulk whilst the traders abroad make the highest profits on all amounts (Zhao and Xu, 2013). Third, profits depend upon *relationships between associated businesses/entrepreneurs in a locality*. If business is stable and not severely affected by competition, higher prices can be maintained and the entrepreneurs' return guaranteed (interview with Intellectual Property Office official).

Fourth, *accessibility of illegal retailers to customers* is an important variable. The use of legal outlets to sell counterfeit products – such as 'Christine's' salon mentioned earlier, or pubs where locals attend and networks are established – seems to increase sales. As 'Dave' noted with regards to his counterfeit watch scheme, within his stable network, *"30 watches are sold just like that..."* (Flicks fingers) (Interview with criminal entrepreneur #4). In such outlet networks marketing/promotion occurs organically via word of mouth as the actors' status and reputation within specific locales alerts potential customers to the availability of the merchandise. The longer a counterfeiting operation is in existence, the less the need for advertising, as existing customers not only return but inform new customers by word of mouth. Within this context, sometimes merchandise is sold at a 'discount' or even given free to selected individuals from the entrepreneur's social circle. 'Dave' considers the discounted and/or free watches as *"promotional expenses. People might see the watch on one's hand and ask 'where did you get this from? I want one. It's good for business and it costs nothing, really'"* (Interview with criminal Entrepreneur #4). Occasionally, the discount is created by the entrepreneur by suggesting an *initial* high price for the item (relatively close to the price of the item in the legal market) and then lowering the price significantly. This incurs no cost to the entrepreneur since the initial high price is *artificially* inflated and does not correspond to the cost of procurement. It also signals product quality, which attracts more buyers. Marketing research has shown that most consumers think they are buying a better product when they see an initial high price discounted (see Bagwell and Riordan, 1991). Criminal entrepreneurs also sell their merchandise in car boot sales, and increasingly advertise their products on Facebook, Twitter, WhatsApp or Instagram in an effort to expand the circle of potential customers. The internet and social media not only constitute a 'convergence setting' (Soudijn and Zegers, 2012) for criminal entrepreneurs involved in various part of the supply chain products, but also facilitate the exchange of information among potential

customers (Interview with economist at the OECD), and the sales of various commodities to a much broader pool of customers locally, nationally and internationally.

“The internet is a formidable market opportunity also for counterfeiters. They use it – there is no doubt about that – but there you have different levels. Some of these internet sites, as some of the investigators say, sometimes they’re even more beautiful than the true ones. They sell the products, and sometimes at quite high prices. They then say, ‘We will give you a 10% discount,’ something like that, and their products are sometimes really of high quality” (Interview with member of EUIPO).

Finally, profits depend on the *time of the year of the sales*. Business and corresponding profits increase significantly at specific times of the year such as summer and Christmas: *“Gets busier at Christmas because there’s a lot more than of the general public that tend to go down there...”* (Interview with National Trading Standards officer #2).

Spending and investing profits from counterfeiting

How counterfeiting money is spent and/or invested naturally depends on the profits but also the social microcosm of the entrepreneurs and the opportunities it offers (von Lampe, 2007), as well as the entrepreneur’s values and priorities. To return to the kind of money involved we can see in how the profits of counterfeiting are spent the hallmarks of ‘special monies’. That is despite how ‘modern money seems starkly homogenous ... Yet camouflaged by the physical anonymity of our dollar bills, modern money is also routinely differentiated, and not just by varying quantities but also by its special diverse qualities. We assign different meanings and designate separate uses for different kinds of monies’ (Zelizer 1989: 342-343). In many households money from different sources is designated for different purposes – be that reserving gifted money for special purchases, or creating separate funds for particular kinds of discretionary spending, such as an allowance for a hobby. In the same manner money derived from counterfeiting is often not simply treated the same as all other monies available. Counterfeit trading is often linked to providing the funds for different forms of expenditure, and thus to satisfying specific wants and desires than simply making money for money’s sake. It is money with a purpose. We have identified four types of counterfeiting money spending/investing, although in many instances there are overlaps between and among different types:

Survivalist spending: This is spending the proceeds of small-scale entrepreneurship on essential commodities and services. The entrepreneurs who engage in this type of

spending are far away from the 'organised criminal' stereotype. Many engage in the counterfeiting business to supplement benefits and/or low wages.

Impulsive/chaotic spending: Profits from the counterfeiting business are often spent on lifestyle consumption, including luxuries (such as jewellery, antiques, cocaine, expensive cars with high running costs) that allow the conspicuous display of the counterfeiters' success and personal wealth (see Hall et al., 2008): *"quite funnily, they [counterfeiters] stick to the areas they come from, disadvantaged areas, and drive expensive cars... and they wonder why people snitch"* (Interview with HMRC investigative officer). Ironically, the first thing 'Dave' bought with the money from his first importation of fake watches was a real TAG Heuer Carrera from a major jeweller's chain in the UK: *"I could not live with myself knowing that I wear a fake watch"*. Other purchases include expensive furniture: *"We can now say, 'let's go and buy this handmade coffee table or a dining table with 10 chairs, not six! We even got a king size bed without looking at the price'"* (Interview with criminal entrepreneur #4). Money is also spent on expensive holidays abroad: *"Some people [counterfeiters] on Facebook it's like they're celebrities. Oh God, you're in the Maldives again?"* (Interview with investigator in private company) (see also Junninen, 2006). In one case which involved the importation of six metric tonnes of raw tobacco in hundreds of parcels from Belgium and the Netherlands to the UK, a criminal entrepreneur spent £1.1 million at betting shops in a single year (The Gazette, 2016). The couple travelling to South East Asia spend their profits on the next trip; a rolling investment and return process that pays for their holidays.

Family-oriented spending/investment: Unlike those entrepreneurs who are mostly young with limited social responsibilities and prefer to spend their profits on hedonistic pursuits (see Hall et al., 2008), some entrepreneurs pay off their own and their (extended) family members' debts and mortgages. Others in this category buy or renovate houses and other properties in the UK and abroad (Ireland, Spain or the entrepreneur's country of origin for minority ethnic entrepreneurs) and/or invest in their children's' education. Family-oriented spending/investment is usually modest, and in these cases entrepreneurs are careful to make sure that it does not extend too far beyond their legal income, thus avoiding too much attention (see also van Duyne and Levi, 2005; Skinnari, 2010).

Business-oriented investment: Types of business investment are linked to the individual actors' own contacts and networks and areas of previous experience and knowledge (see also L'Hoiry, 2013). For example, we came across an entrepreneur with an existing job in the food supply chain who sought to expand his business using profits from his illicit tobacco business. Actors are typically restricted to investing in areas in which they have some prior experience and expertise.

However, the counterfeiting business itself is also a common target for reinvestment. From the initial moment a scheme becomes successful, part of the profit is invested in

subsequent schemes and occasionally – especially in the case of owners of legal businesses – towards expanding and/or diversifying (see also previous section). Some criminal entrepreneurs, especially those who are sole entrepreneurs or do not own a legal business that acts as a platform for their counterfeiting business, carefully consider the ‘profit-risk’ ratio of their business (see Dean et al., 2010). They *deliberately* re-invest relatively small amounts of money (£1000) and do not wish to expand but simply maintain a low volume-high value scheme because of the logistical complexities and risks involved in expansion or diversification; mostly financial risks that they do not have the capacity to absorb should something go wrong:

“Imagine if I brought over 100 watches... I would need a suitcase at least, and what would happen, if they are seized at the border? Exactly... my money is gone...”
(Interview with criminal entrepreneur #4).

Similarly, those entrepreneurs with an online component to their business re-invest small amounts from their initial profits in order to maintain a low profile on specific online platforms:

“You just start off with one batch and then you build it up and build it up, but the problem you’ve got then is if you’re on eBay, eBay will make you become a trader so you will have to put information about yourself on there so you’d have to hide there, so there are obstacles that you’ve got to overcome and you’ve just got to hope that... we’re not watching. So that’s another way of doing it, it’s the investment is quite small” (Interview with National Trading Standards officer #3).

Business-oriented investors involve *criminal business-oriented* investors. Although the usual route is for criminals to invest profits from other criminal business into counterfeiting because of the relatively lower risks involved, in one interesting case provided by the HMRC investigative officer we interviewed a couple invested their profits from counterfeiting and other business activities in the construction of a hotel in Pakistan. It was used as a recruitment and transit point for individuals who were to be trafficked into the UK for labour exploitation:

“We had information about a British Pakistani couple in Bradford. They were owners of a relatively big clothes company in Bradford and our intelligence suggested they were involved in counterfeiting. Clothes, bags, belts, you name it. We raided the premises in this area full of warehouses, and we started searching for money, products, documents. People were also working illegally in the business. One of my

colleagues noticed a poster of a big building on the wall. Looked like a big house abroad but the thing is that this house was in bigger and smaller frames in their house too... In the living room, in the office, in the kitchen. Our investigation revealed that this building was in fact a hotel that was built with money from the counterfeiting business and it was used as a recruiting and harbouring venue for trafficked persons from Asia, mostly Pakistan. After they came to the UK, they would work in the clothes company, in restaurants..." (Interview with HMRC investigative officer).