FICCI CASCADE

ILLICIT MARKETS-
A THREAT TO OUR NATIONAL INTERESTS

EXECUTIVE SUMMARY

About this report

This report has been prepared by Thought Arbitrage Research Institute (TARI) for FICCI Committee Against Smuggling and Counterfeiting Activities Destroying the Economy (CASCADE).

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Due to changes in the data collection and enumeration techniques of the Ministry of Statistics and Planning Implementation (MoSPI) of the Government of India, ASI 2012 data and NSS 68th round data are not entirely comparable with ASI 2010 and 2008 data and NSS 66th and NSS 64th round data respectively, used for ascertaining value and percentage of illicit markets in the previous FICCI-TARI study. To ensure consistency of results across years we have reclassified / re-ascertained certain supply / consumption values for 2010 and 2008.

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- Corporate Governance
- Whistleblowing / Vigil Mechanism
- CSR & Sustainability
- Economics & Public Policy

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Foreword

Product counterfeiting puts consumer health and safety at a great risk. Counterfeit, fake and smuggled goods are no longer just about luxury items. Today, almost all sorts of products are being copied and smuggled having fatal consequences for the consumers.

FICCI has been at the forefront of advocating policy framework on various aspects affecting the industry. In 2012, a FICCI CASCADE study titled "Socio-Economic Impact of Counterfeiting, Smuggling and Tax Evasion in Seven Key Indian Industry Sectors" was released which was the first ever compilation of facts and figures on counterfeiting, smuggling and tax evasion in seven key industry sectors in India. After the earlier comprehensive study, which not only estimated the size of the grey market in the select industry sectors, but also highlighted the losses to the industry in sales and Government in revenue, we have now gone a step further and developed sector specific reports on 'Illicit Markets – A Threat to Our National interests'. The sectors include:

1. FMCG Packaged Goods
2. FMCG Personal Goods
3. Automobiles
4. Computer Hardware
5. Mobile Phones
6. Tobacco
7. Alcohol
8. Broadcasting
9. Motion Pictures

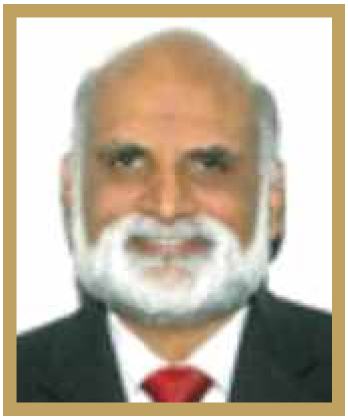
These reports aim to estimate grey markets in each of the above mentioned sector, projects the resultant losses to the industry& Government and assesses its impact on innovation and investment.

I would like to thank and congratulate all the committee members and stakeholders who have contributed towards this project particularly Thought Arbitrage Research Institute (TARI). It is hoped that this study would provoke further debate on the extent of this problem, and ways and means to mitigate the challenge.

I wish FICCI-CASCADE success in its future initiatives.

Dr. A. Didar Singh
Secretary General
FICCI

Chair's Message



I am pleased to present sector specific reports on the problem of counterfeiting, smuggling, piracy and tax evasion in India entitled' Illicit Market: A Threat to Our National Interest'. This is perhaps the first quantitative study in India on the impact of illicit markets on various economic aspects. These sector specific reports have been broadly classified into two sections; firstly the Manufacturing Industry including sectors like FMCG Packaged Foods and Personal Goods, Computer Hardware, Automobiles, Mobile Phones, Tobacco and Alcohol and secondly -the Media and Entertainment Industry including the Broadcasting and Motion Pictures sectors. These sector specific studies project the resultant losses to the industry and government and assesses the impact of illicit markets on innovation, investment, tax arbitrage and financing of organised crime and terrorism.

Illicit markets have broad economy-wide effects on trade, investment, employment, innovation, criminality, environment, and most importantly, on the health and safety of the consumers. Over and above, it also has a negative impact on the brand image and loss of revenue for industry and governments.

Given the emphasis on India's economic development and the much anticipated growth trajectory; technology, invention, and innovation will play a key role in charting out India's growth strategy. However, counterfeits and fakes will prove to hinder this progression. Despite several efforts undertaken to curb smuggling, counterfeiting and piracy, the illicit markets continue to thrive across all industry segments. Hence, a proactive strategy should be in place to fight this serious menace to public health and safety, and to the national exchequer. Cooperation amongst stakeholders (including international and domestic regulatory and investigative agencies), streamlining of complex tax structures, stringent governance practices and enforcement of existing laws are required to curb this tumorous threat.

I am certain that the findings from these reports would increase consumer awareness, drive support from policy makers in tax related reforms and step up the industry for greater investment in R&D and encourage innovation. I hope that this research will put forward the problem that the nation is facing currently and the challenges ahead if concerted efforts are not taken to curb this menace.

Anil Rajput

Anil Rajput
Chairman
FICCI CASCADE

Introduction

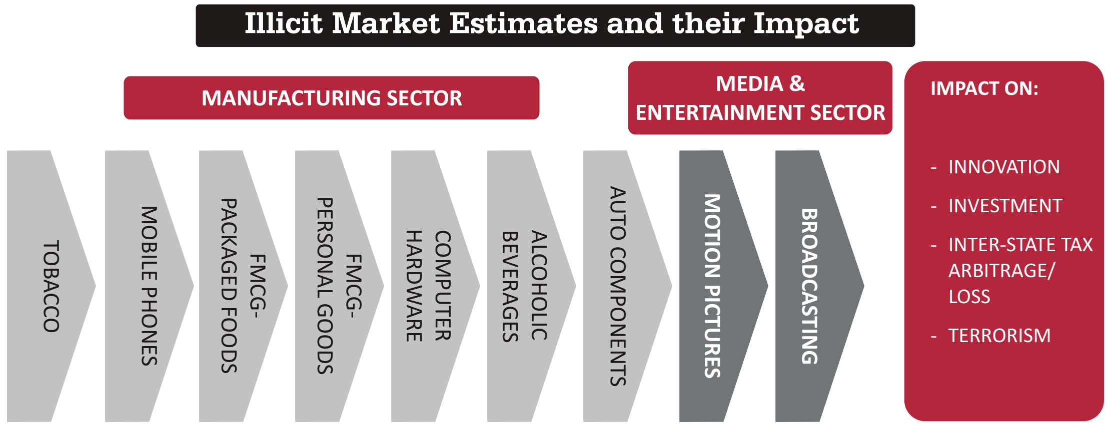
The existence of illicit markets is a matter of serious concern for any economy. More so in India, where rapid technological advancement and economic liberalisation seem to have opened up avenues for the growth of a parallel economy dominated by such goods and services. It has been termed as the crime of the 21st century due to its impact on all world economies. Legitimate businesses suffer on account of loss of profits and brand image. Governments lose tax revenues from black market sales and the common citizen is faced with job losses, sub-standard goods often detrimental to health and safety. IACC reports that "counterfeiting is a $600 billion a year problem. In fact, it's a problem that has grown over 10,000% in the past two decades, in part fuelled by consumer demand."[1] Estimates range from $200-600 billion to as high as $1 trillion - as there is little agreement on definitions and serious problems of measurement, estimates are spread over a wide range.

A 2012 FICCI CASCADE study titled "Socio-Economic Impact of Counterfeiting, Smuggling and Tax Evasion in Seven Key Indian Industry Sectors" established the existence of such markets by estimating its size in seven key industry sectors, the consequent losses to the industry in sales and the government in revenue for 2008

[1] *"The Global Growth of Counterfeit Trade" - P. Chaudhry and A. Zimmerman, Protecting Your Intellectual Property Rights, Management for Professionals, DOI 10.1007/978-1-4614-5568-4_2, © Springer Science+Business Media New York 2013*

and 2010. This study, commissioned by FICCI's Committee against Smuggling and Counterfeiting Activities Destroying the Economy (CASCADE), updates the estimates of grey markets in these sectors, adding two more industries. The study projects the resultant losses to the industry and government and assesses the impact of illicit markets on innovation, investment, tax arbitrage and financing of organised crime and terrorism.

The sectors covered -in this study as mandated by FICCI-CASCADE are:



This is perhaps the first quantitative study in India on the impact of illicit markets on various economic aspects. Depending on the quality and credibility of data available, the study has quantified different types of impact on various sectors. The study uses reliable Government of India data on consumption and production, namely NSSO and ASI, which is available for 2012 (released in 2014).

ASI and NSSO provide limited data on the motion picture and broadcasting industries. A different approach was therefore adopted for estimating the size of the grey market for the motion picture industry.Impact on aspects like innovation and investment could not be quantified for either industry.

The Manufacturing Sector

Size of the Illicit Market: Grey Market Percentage

The extent of the grey markets in key industries studied in this report has grown, apparent from a comparison with grey market percentages determined for 2008 and 2010 in the 2012 report for these sectors.[2] The table below provides a comparison of 2012 vis-à-vis 2010.

Industry	Grey Market %age	
	2012	2010
Alcoholic Beverages	16.7%	10.2%
Auto Components	33.7%	29.6%
Computer Hardware	27.9%	26.4%
FMCG-Packaged Foods	21.7%	23.4%
FMCG-Personal Goods	31.6%	25.9%
Mobile Phones	25.4%	20.8%
Tobacco	20.2%	15.7%

Barring packaged foods, all industry sectors have shown an increase in grey market percentages, the largest being in the alcoholic beverages sector - an increase of 63.7%. The smallest increase has been seen in the computer hardware market, although this is one of the sectors with the largest grey market percentage in both 2010 (2nd position) and 2012 (3rd position).

In the FMCG - packaged foods industry, the grey market percentage was estimated at 25.4% in 2008, and 23.4% in 2010. The current study estimates it to have further fallen to 21.7% in 2012. This may mainly be attributable to better use of technology and innovations in the packaging of products to prevent counterfeiting, which counterfeiters have not yet been able to crack or replicate. IBEF data shows that the Indian packaging industry, of which the packaged foods sector is a key user, is increasingly become technology oriented with innovations driving the market. Industry needs to be cautious though, as this is likely to be a temporary phase till counterfeiters determine methods and technology to replicate packaging as well.

[2] "Socio-Economic Impact of Counterfeiting, Smuggling and Tax Evasion in Seven Key Indian Industry Sectors" (FICCI CASCADE Study) - 2012

Size of the Illicit Market: Loss to Industry

This report also estimated the current loss to these sectors on account of the illicit markets, by projecting the market size for 2014 and applying the grey market percentages determined for 2012. Factory production taken from the Annual Survey of Industries and household consumption obtained from the National Sample Survey are available as of today only up to the year 2011-12.

The estimated loss to these seven sectors has increased by 44.4% just two years, from ₹ 72,969 crores in 2011-12 to ₹ 105,381 in 2013-14.

Fig: Loss of Sales to Industries 2013-14 (₹crores)

Industry	2013-14	2011-2012
Alcoholic Beverages	14,140	5,626
Auto Components	10,501	9,198
Computer Hardware	7,344	4,725
FMCG-Packaged Foods	21,957	20,378
FMCG-Personal Goods	19,243	15,035
Mobile Phones	19,066	9,042
Tobacco	13,130	8,965
Total Loss	**105,381**	**72,969**

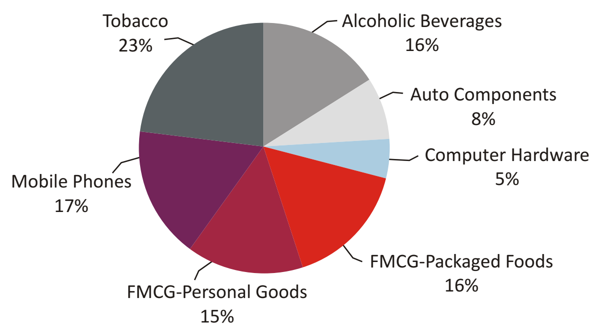
Loss of sales to the industry sectors covered in this study has increased across all industries. The largest increase is seen in the alcoholic beverages and mobile phones industries, where losses have risen by 151% and 111% respectively.

These numbers establish that despite best efforts undertaken to curb smuggling and counterfeiting, the illicit markets continue to thrive across all industry segments, posing a serious challenge to various stakeholders. Industries lose sales revenues,governments lose tax revenuesand customers knowingly or unknowingly lose out due to low quality products which could often lead to hazardous health and safety consequences. Measures to curb this growing threat would include, cooperation amongst stakeholders (including international and domestic regulatory and investigative agencies), streamlining of complex tax structures, introduction and/or enforcement of standard quality parameters for various products of industries, stringent governance practices and enforcement of existing laws.

Size of the illicit market: Loss to Government

Illicit markets cause losses to the original right holders in the form of reduced sales, lower profits, brand value, reputation, consumer distrust, etc. Governments lose tax, incur higher expenditure on public welfare, insurance and health services. Ultimately corporates shy away from making investments due to limited/no protection of rights, resulting in loss of employment opportunities.

Total Loss to Government
(₹39,239 Crores attributed to 7 industries)



The total loss to the government estimated for 2014, on account of the illicit markets in these industries is ₹ 39,239 crores, up from ₹ 26,190 crores in 2012. This study estimates loss only on account of tax revenues - both direct and indirect taxes. If incremental costs incurred by government on account of welfare measures, enforcement and legislation and interest costs are also estimated, the losses government would be significantly higher.

Industry Sector	Loss of Revenue to Government (₹ Crores)						
	2014			2012			Change
	Indirect Taxes*	Direct Taxes**	Total (A)	Indirect Taxes	Direct Taxes	Total (B)	(A-B)
Alcoholic Beverages	5,656	653	6,309	2,251	260	2,511	3,798
Auto Components	2,631	482	3,113	2,305	421	2,726	387
Computer Hardware	1,850	73	1,923	1,187	47	1,234	689
FMCG-Packaged Foods	5,502	594	6,096	5,108	552	5,660	436
FMCG-Personal Goods	4,842	1,111	5,954	3,779	867	4,646	1,308
Mobile Phones	5,660	1,044	6,705	2,678	496	3,174	3,531
Tobacco	7,878	1,261	9,139	5,379	860	6,239	2,900
	34,020	**5,218**	**39,239**	**22,687**	**3,503**	**26,190**	**13,049**

** Indirect taxes represents excise duty and VAT on domestic manufacture and import duty and VAT on imports*
***Direct taxes represent corporate income tax*

Illicit Markets & the Impact of Inter-state Tax Arbitrage within India

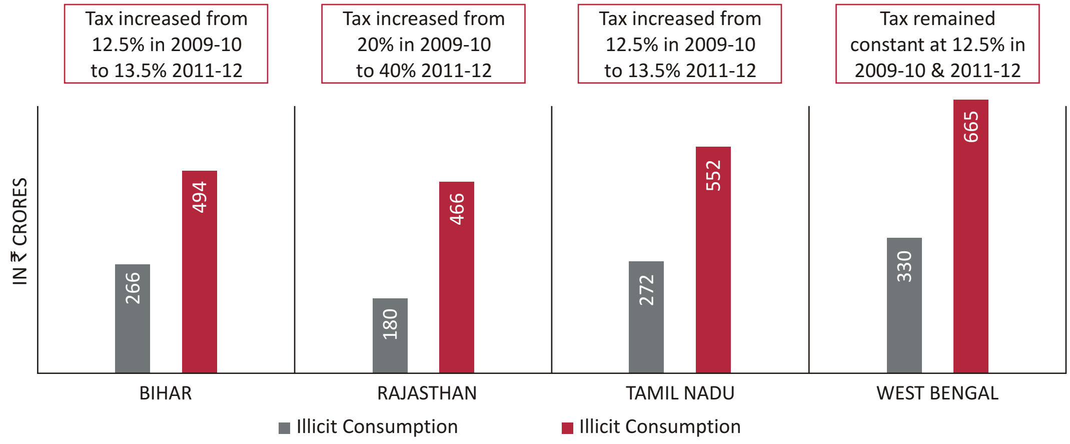
This section of the study sought to establish a relationship between high taxes and availability of illicit products. Only sectors with higher incidence of tax which is set at 20%-25% were covered in this section, since a lower tax rate among states does not provide enough arbitrage forillicit markets. An analysis of tax rates for each of the sectors under evaluation across all states in the country showed that taxes were higher than 20-25% only in the alcoholic beverages and tobacco industries. Tax rates for these products also varied significantly from one state to another.

Tobacco Industry:

Successive studies have postulated that high tax rates tend to exacerbate illicit markets by creating greater demand for cheap and counterfeit substitutes. A significant reason being, that high tariffs and taxes create opportunities for those involved in illicit markets to step in and supply 'reduced' versions of the original product at lower prices.

Tobacco and tobacco products are not only highly taxed, the tax structure is highly intense and dual in nature with both the central and state governments levying separate taxes - excise duty, value added tax and many others. These taxes add up to more than 50% of the selling price of the product in some states. Besides, there are considerable differences in tax rates between states which open up opportunities for illegal cross-border trade.

CHANGING ILLICIT CONSUMPTION & TAX RATES
(EXCLUDING BIDIS)



The graph shows that illicit consumption increases with increase in tax rates in most states. The rise in taxes show a positive co-relation to the rise of illicit markets in the states that have higher taxes and lower tax collections after factoring the normative growth in consumption in these states. In such cases the legitimate industry gets significantly disadvantaged.

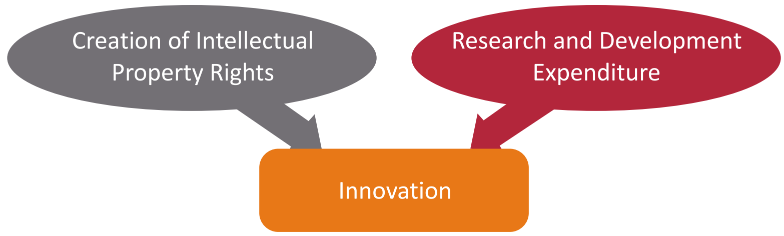
This increase in prices has fuelled illegal markets at the cost of legal business and lower government collections. The ability of legitimate businesses to meet this growing demand is hampered due to stricter regulations and increased taxation, thereby resulting in growth of the illicit markets and given the demographics and growing income levels this will continue to be a heightened risk.

Alcoholic Beverages Industry:

Our analysis of the alcoholic beverages industry shows tax structures are quite complex, varies from state to state and by product. It is the only industry in which there are state excise levies and also VAT. Each state is left to structure their taxes in the manner they so wish, with tax rates as high as 190%. We compared alcohol consumption with production to understand the reasons for a gap if any. It was observed that even after factoring in the possibility of legitimate inter-state sales (which is otherwise subject to a number of barriers) and closing stock, there is a net excess of 31% of alcohol consumption in 2012 vis-à-vis production in the entire country (using production as a base). The corresponding number for 2008 and 2010 are 27% and 17% respectively. Excess consumption raises questions on the source of this consumption and possible losses to the exchequer as well as the harmful effects on consumers. Consumption data also showed an increasing trend, among states with prohibition where there is limited or no production.

Impact of Illicit Markets on Innovation

In this section, with the help of quantitative and qualitative tools we assessed the effect of illicit markets including counterfeiting, smuggling and piracy on innovation. Our analysis reveals that industries characterised by higher levels of illicit markets spend lesser money on innovation. In order to assess the impact of illicit markets on innovation, we analysed two proxies/indicators.



Creation of Intellectual Property Rights

Innovation results in the creation of intellectual property rights (IPR) in the form of patents, trademarks, copyrights, etc. The number of patents owned by a company has often been used as one of the main indicators for determining its innovation intensity.

A Thomson Reuters report, 'Research and Innovation Performance of the G20'[3] examines research and patent information to study the scale and impact of innovation in the G20 countries. The report states that an average of 5,900 applications **are filed in India per annum,** which equals that of Australia and UK. However, around two-thirds of the patent applications filed in India are those of foreign concerns seeking protection in the Indian market. Domestic innovation has remained stable at 29% since 2005. India's contribution to innovation when compared to the rest of the G20 is highly concentrated in agro-chemical and pharma-related technology sectors.

Our analysis reveals that most patentable innovation in India takes place in government laboratories (CSIR) with little participation by industry. Although such patents may be subsequently commercially exploited, the process must be reversed with industry leading innovation in order to be at the forefront of new breakthroughs. Patent application statistics reveal that these applications are mostly concentrated in certain areas, such as computers / electronics and pharma-related technology sectors. The top ten industries in which patents of Council of Scientific and Industrial Research of The Government of India(CSIR) are in force, constitute almost 81% of their patents. Of the industries included in this study, CSIR's patents covered only the food and beverages segment - or 17% of their patents.

Micro, small and medium enterprises usually refrain from filing for patents due to high costs, complexity and delays in grant of patents, which acts as a disincentive for undertaking innovation activities.

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[3] *http://sciencewatch.com/sites/sw/files/images/basic/research-innovation-g20.pdf last accessed on May 5, 2014*

Hence, the process needs to be accelerated and other incentives need to be provided by the government to encourage more companies to innovate and file for patents. This will also allay the fears of businesses, domestic and international, and encourage innovation, which will work in India's favour of transitioning into a knowledge economy.

Research & Development (R&D) Expenditure

Companies invest in R&D to develop new and innovative products and enhance their profitability. However, upfront R&D investment also entails the risk of returns not getting realised due to risks associated with product failure. **Illicit markets allow illegitimate organisations to avoid the investment along with business risk, allowing them to reap immediate profits.** This situation discourages legitimate businesses from making investments in R&D and in turn may negatively impact business efficiency and enhancement through innovations. Since research is a risky activity, returns on successful R&D must be large enough to compensate for the high proportion of R&D that is unsuccessful, generating in this way a normal return on R&D as a whole. However, **for an industry sector faced by the challenges of a grey market, the returns would be much lower on account of the greater risk of operation of illicit markets.**

For this study, for the purpose of measuring innovation, a comparison was made of the percentage of R&D expenditure over operating expenditure, across the industry sectors under consideration, over a period of six years from 2007-08 to 2012-13.

On an overall basis the ratio is remarkably low across all the industries. It ranged from 0.04% for the FMCG-packaged foods industry in 2012-13 to 1.99% for the computer hardware industry in 2008-09. The FMCG - packaged foods and alcoholic beverages sectors in fact show a low ratio of R&D and operating expenditure through the period under review.

The computer hardware industry, showed a high ratio relative to the other industries, almost consistently over the years, averaging 0.95% during the six year period the analysis covered.

The FMCG - packaged foods industry is the only industry with a falling grey market and a significantly low level of R&D expenditure. Innovation in the packaging of its products, which counterfeiters have failed to successfully replicate, is the driving factor for the fall in the grey market percentage. The FMCG - packaged foods sector is a key user of the packaging industry.

Thus, as the data suggests, although companies are increasingR&D expenditure, it is not increasing in tandem with total operating expenditure.

As the Indian economy moves up the value chain, to become the world's third largest economy, efficiency enhancers like innovation will play an increasingly important role. It will likely be the distinguishing factor between economies that continue to grow and those that stagnate after a certain level of development. India is however currently languishing at 41st position on the Innovation Index with a score of 3.62 out of 7 in the Global Competitiveness Report 2013-2014, World Economic Forum.

Large and increasing grey market sizes, and low and falling expenditure on R&D clearly establish a link between illicit markets and innovation in these industries. In order to encourage innovation and indigenous manufacturing therefore, a lot needs to be done towards patent protection, as well as to counter the growth of the illicit markets. Analysis of these industries shows that there is great potential for growth in India. If investments in R&D are expected to generate high returns, for an industry faced with the challenges of a large and increasing grey market, the returns will end up being significantly lower on account of the risks associated with illicit markets.

Impact of Illicit Markets on Investments

That investment is undoubtedly one of the most important drivers of economic growth is a well-established fact. More so for a developing economy like India which has emerged as one of the most sought after investment destinations in the developing world in the recent times. However one of the many concerns of domestic and foreign companies investing in India has been the threat of counterfeiting and illicit markets and its impact on their investment and profitability.

The three proxies studied to evaluate the impact of illicit markets on investments, particularly the level of domestic investments by Indian companies, has reasonably established a link between the level of investment and the extent of illicit markets. These proxies are:

- Gross value added (GVA) by Indian companies
- Use of indigenous and imported inputs and imports of goods into the country
- Analysis of capital employed over sales

Gross Value Added (GVA) by Indian companies

In the analysis of value added by companies over a period, we conclude that a high dependence on imports and the consequent high grey market presence result in low gross value added as a percentage of total output. It also hints at the possibility of counterfeited products, particularly in sectors that require a high degree of innovation and technology use which is not readily available in India, being smuggled into India through various channels. This was visible in the auto components and computer hardware sectors, which are most affected by the illicit markets, amongst the sectors under study. In the case of FMCG-personal goods, while GVA steadily increased over a period (from 18.04% in 2010 to 36.7% in 2012), grey markets also remained high (at 31.6% in 2012), possibly due to the low degree of innovation required for these products, thereby attracting counterfeiters. Despite the low percentage of GVA over total inputs, it was established that low grey market percentages in the FMCG-packaged foods sector could possibly be due to smarter and efficient use of technology in the packaging of products that continue to bedifficult for counterfeiters to replicate. The alcoholic beverages sector shows the least average percentage of gross value addition over total output and the largest increase in grey markets. It was also found, that while the proportion of imported raw materials over total consumption of raw materials in the alcoholic beverages industry was low (around 3.5% in 2008 and 3.22 % in 2012), the industry did see a significant increase in dependence on imports over this period. This analysis quite clearly demonstrates through a combination of these factors a link between value addition and the illicit markets.

Use of Indigenous and Imported Inputs and Imports of Goods into the Country

The analysis of imports of inputs and finished goods also points to a clear relationship between the presence of illicit markets and the degree of investment and innovation in the country with companies preferring to import in order to avoid the risks involved with loss of investment. It was found that higher grey market percentages in various sectors resulted in greater dependence on imports of raw materials and finished products. Imported raw materials were either a significant percentage of total raw materials used in production in these industries, or showed a significantly increasing trend over a period indicating unwillingness amongst manufacturers to invest in technology in order to shift to indigenous raw materials. This could be, in no small measure, due to the risks of loss due to illicit markets including counterfeiting and smuggling. This holds true even for finished products which have shown an increasing trend in most industries in comparison with total production. Therefore, higher counterfeiting, smuggling or piracy is a significant factor leading to lesser investment in technology or incentive to innovate by Indian companies.

For example, the grey market in the FMCG-packaged foods industry has fallen from 23.4% in 2010 to 21.7% in 2012, during the same period, he indigenous inputs increased by 249% whereas imported inputs increased only by 154.7%. In the auto components industry which has the highest grey market percentage in both years (29.6% in 2010 and 33.7% in 2012), imported inputs increased 121.8% while indigenous inputs increased by a mere 39.4%. Similarly, the mobile phones industry which witnessed a 22% growth in grey markets (from 20.8% in 2010 to 25.4% in 2012), is increasingly depending on imports for sales of its goods. Finished goods imported in this industry were 92.3% in 2008, increasing to 93.75% in 2012.

Ratio of Capital Employed over Sales

Businesses invest in capital with a view to generate increased sales revenue. The ratio between sales and capital employed helps to understand what level of sales are being generated by each rupee worth of assets invested in the business. The level of investments made in the business is also a barometer of the confidence or expectation of returns from such investments. Our analysis reveals that in the sectors under study, the ratio of sales to average capital employed remains fairly steady, indicating that there has been no dramatic increase in investments in the years under review against which higher sales can be expected in the coming years. At the same time, the sectors under study have shown an increase in the level of illicit markets. This increase implies that these sectors are wary of making patient long term investments to generate revenue from the capital base for fear of loss of investment.

The three ratios-GVA over total output, the ratio of indigenous with imported goods (raw materials and finished goods) and the ratio of capital employed to sales-reveal that both the quantity and quality of investments made in Indian production processes are inadequate to boost the contribution of these sectors to India's manufacturing revenue. We have also established a causal relationship between low investments and increasing levels of illicit markets in the sectors under study.

The Media & Entertainment Industry

Size of the Illicit Market: Motion Pictures Industry

As per the International Intellectual Property Alliance (IIPA) 2012 Special 301 Report on Copyright Protection and Enforcement, India has the potential to be one of the world's leading markets for the creative industries - both foreign and domestic. The country produces the greatest number of films in the world (over 1,000 full-length feature films per year), boasts a creative and diverse music market, a prolific publishing industry (19,000 publishers producing 90,000 titles per year), and a vibrant software market. However the illicit markets in India thrive in this sector too.

Of the various revenue streams of the motion picture industry and with the available data this report has made an estimate of the grey markets in two of the sub-categories of the motion picture industry, viz., domestic box office and home video. These two categories are also representative of the industry, constituting 78% of the total industry as per the 2012 actuals provided in a 2014 FICCI-KPMG study. Accordingly, the grey market percentage of these two segments has been estimated at 12% and 55% respectively in 2012. The resultant losses are to the tune of ₹ 1,100 crores and ₹ 210 crores respectively. Applying these grey market percentages, the loss to the industry for 2014 is expected to be ₹ 1,226 crores and ₹ 66 crores respectively, i.e. a total loss of ₹ 1,300 crores approximately.

Size of the Illicit Market: Broadcasting Industry

According to industry experts, generally there is no counterfeiting in the broadcasting industry. There may be some cases of unauthorised recording of broadcasts or sale of DVDs, USB sticks etc., as if these are done by the broadcaster. However, this is not known to be prevalent in the Indian broadcasting industry. Cable operators do not produce any channel signals and sell them under the broadcaster name without authorisation. The loosely defined term "piracy" in the broadcasting industry are acts of theft/ criminal breach of trust which also result in infringement of copyright as distinguished from counterfeiting in the film industry, garment industry, software industry etc., where imitation goods are produced and sold. Counterfeiting in this industry only results in infringement of copyright and cannot qualify as theft/ criminal breach of trust.

Thus, going by industry perspectives and definitions of counterfeiting under the Indian Penal Code, there is no physical 'good' that is being fraudulently imitated and sold in the broadcasting sector. Under-declaration of subscription may certainly qualify as theft, which results in loss to the broadcasters (in terms of subscription fee) and loss to the government (in terms of entertainment tax and service tax). However, this may not qualify as piracy under Indian Copyright Act. Retransmission of signals without any authorisation would result in a case of theft apart from infringement of copyright. Similarly, area transgression (providing signals beyond territory) and providing un-encrypted feed in DAS area would result in the offence of criminal breach of trust apart from infringement of copyright.

As a result, one of the significant hurdles in estimating the illicit markets in this industry was the absence of a definition of the term piracy/counterfeiting, since theft and counterfeiting are two different things. Furthermore government data on this industry appears to be limited to production and consumption of equipment, and not signals, hence it is not possible to make an estimation of the size of the illicit markets in the industry based on the methodology used for other sectors covered in the FICCI-CASCADE study.

Illicit Markets, Terror Organisations and Criminal Networks

While statistical data is available for the number of terrorist attacks that have taken place in India, it is difficult to directly correlate it to the grey market data in the absence of sufficient information and research, which are lacking at present, especially in the Indian context.

Furthermore, despite the existence of requisite laws in India and arrests of suspected criminals by the police, the scale of illicit markets is huge and the criminal networks and illicit markets organisations continue to thrive. Clearly, the existing laws and police operations are not resulting in the desired outcome and do not act as a deterrent. This could be due to the low conviction rates in India.

According to a RAND Corporation[4] report on film piracy, organised crime and terrorism, DVD piracy has a higher profit margin than narcotics and minimal risks of enforcement. As a result it is attractive around the world as an element of criminal portfolios that also include drugs, money laundering, extortion and human smuggling. 14 case studies in this report provide evidence of a broad, geographically dispersed, and continuing connection between film piracy and organised crime. Three cases provide evidence that terrorist groups have used proceeds of film piracy to finance their activities.

The lack of adequate data based on search and seizure in India makes it difficult to link the increase in illicit markets to terror funding. Establishment and determination of the extent of such a link calls for strategic intelligence gathering and preparation of robust databases, which are clearly missing at present. Given the security implications, if not outright financial considerations, there is little to argue against carrying out such exercises. This would be the first step to contain counterfeiting and its corollary, terror and ensure that genuine business interests do not suffer.

[4] *"Film Piracy, Organised Crime, and Terrorism by Gregory F. Treverton, Carl Matthies, Karla J. Cunningham, Jeremiah Goulka, Greg Ridgeway, Anny Wong (RAND Corporation, 2009)"*

Way Forward/ Recommendations

Data Collection and Analytics

As a significant and first step stakeholders must work in tandem to improve information sharing on illicit markets which will enable collation of credible statistics. Credible statistics will help to draw up and implement action plans that could undermine the activities of the perpetrators of this crime. Quality information would provide a solid basis for establishing the scope of illicit markets and form a key input in assessing the magnitude and effect of illicit markets.

Encouraging Innovation & Investments in the Manufacturing Sector

As the Indian economy moves up the value chain, to become the world's third largest economy, efficiency enhancers like innovation will play an increasingly important role. It will likely be the distinguishing factor between economies that continue to grow and those that stagnate after a certain level of development. Accelerating the level of innovation activities in the economy will require:

- Curbs on illicit markets by enforcement agencies
- Bridging the gap between academia and industry
- Improvements in the regulatory framework for patent protection
- Using superior technology to identify counterfeit products
- Creating an enabling environment conducive to innovation
- Transfer of technology, knowledge and industry best practices between Indian and multinational companies

Greater investments in the manufacturing sector in India to improve the overall economic and business climate can be encouraged by:

- Providing incentives (including tax benefits) for greater use of indigenous inputs over imported inputs;

- Creating tailor-made and innovative financial instruments to encourage capital investments by various industry sectors, including venture capital funds
- Improving oversight of loan repayments by banks and financial institutions to reduce defaults and non-performing assets
- Special efforts to build capacity in the MSME sector which accounts for 45% of manufacturing units in India; and
- Promoting special funds focussed on innovation and sector-specific investment.

Simplifying & Streamlining the Tax Regime:

Tobacco Industry

A high and multiple incidence of tax regime often results in loss of state revenues, lowering of state GDP, red tape and corruption. If the intention of higher taxes is to reduce consumption, particularly of highly taxed products like tobacco, this rarely occurs at the ground level. On the contrary, consumption either remains the same, or consumers turn to neighbouring states for their consumption or they turn to smuggled or counterfeit products. In case of tobacco, the proposed Goods and Service Tax (GST) is a step towards this harmonisation process.

Alcoholic Beverages

In case of alcoholic beverages, multiplicity of levies such as excise, VAT, labelling fee, vend fee, transportation fee, etc., in fact only adds to the cost of compliance while not benefitting revenue. The key therefore is to harmonise taxes across states and inclusion of this industry in GST will go a long way in improving overall tax collections and reducing illicit markets..

Way Forward for the Media & Entertainment Industry

With improvements in technology, internet and mobile penetration, the growing Indian middle class population, and economic prosperity coupled with increasing disposable incomes, the menace of counterfeiting and piracy in the motion picture industry is only likely to increase, unless stern measures are taken to protect the industry, consumer and government. Some of the important measures include:

- Systematic data collection on the demand and supply side of the motion picture industry, to enhance data analysis and resultant estimation of grey markets;
- Improving screen penetration;

- Constant vigilance and raids on retail outlets selling pirated DVDs, VCDs, Blu-ray disks etc.;
- Cooperation between government and the ISPs to design protective measures that prevent access to websites that blatantly infringe copyright.
- Streamlining entertainment tax structures across states.

As far as the broadcasting industry is concerned, keeping the ambiguities discussed in mind, going forward it is important to define by law the term counterfeiting/piracy in the context of the industry, since what is involved are intangible products or works that are protected by copyright. Other measures towards protecting the industry, government and other stakeholders from related losses include stringent KYC norms for purchase of set-top boxes or obtaining cable connections, standardisation of norms for equipment, periodic reporting by distributors to regulators, increased civil and criminal sanctions for crimes related to intellectual property infringement, improving policy, providing technical assistance and enhancing awareness, etc.

Countering Financing of Terrorism

Owing to the extensive research carried out globally on terrorism and its links to proceeds from illicit markets, it can be said with a fair degree of certainty that illicit markets are instrumental in providing the much required funding to criminal networks and terrorist organisations. Therefore, if the threat of terrorism is to be nipped, the access to funding has to be choked. However, many countries do not possess the legal and operational wherewithal and technical expertise needed to zero in on terrorist financing sources and initiate prosecution. It is imperative therefore to build a global framework which incorporates information sharing among countries for prevention of terrorist financing which not only tracks down their financing hubs but also acts as a deterrent for them to ultimately bring down the threat of terrorism. Such a framework will include training and capacity building among enforcement agencies, use of technology to detect and track sources of finance and increasing consumer awareness to empower consumers to take more informed decisions.

For sustainable economic growth, investment and innovation are a pre-requisite. According to a recent Dun & Bradstreet report,[5] rising income levels coupled with increase in the young working-age population will lead private final consumption expenditure to grow steadily over the years, averaging around 7.0% during FY15-FY20. The growing illicit markets however vitiate the environment and restrain such growth, reducing business efficiency, profitability and overall development. To curb this growth collaborative efforts are required from all the stakeholders.

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[5] *Dun & Bradstreet – Manappuram Finance Limited, "India 2020 Economy Outlook"*

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About FICCI

Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence, its industrialization, and its emergence as one of the most rapidly growing global economies. FICCI has contributed to this historical process by encouraging debate, articulating the private sector's views and influencing policy.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry.

Federation of Indian Chambers of Commerce and Industry

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About FICCI CASCADE

In the recent past India's economic growth story has attracted world's attention bringing new challenges for the domestic economy. One of the challenges currently faced is the growing illicit trade in counterfeits, pass offs and smuggled goods. These activities are also threatening brands not only in every region of the country but across the globe.

Contraband and counterfeit products hurt the integrity of the brand, further diluting the brand owner's reputation. This not only results in erosion of sales of the legitimate product but further [CASCADE]s onto affect the consumers in the form of health and safety hazards.

With the above insight the Federation of Indian Chambers of Commerce and Industry (FICCI) took the initiative to dedicate a forum by establishing the Committee Against Smuggling and Counterfeiting Activities Destroying the Economy - CASCADE on 18th January, 2011 at FICCI Federation House, New Delhi.

FICCI Committee Against Smuggling and Counterfeiting Activities Destroying Economy (CASCADE)

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