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Fraud Risks in the consumer products and retail sector

Deloitte Forensic

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The Consumer products business is among the fastest growing businesses in India, growing at a CAGR of 14.8 percent and expected to be worth USD 12.5 Billion in 2015¹. The consumer opportunity in India rests on the changed business dynamics observed today - a large and growing youth population that is digitally savvy and knowledgeable, rising incomes and purchasing power that place importance on superior product quality, growing urbanization with emphasis on a 'convenient' shopping experience, emergence of organized retail that provides consistent quality in products and shopping experience, and relatively easy availability of credit to pay for purchases.

These developments have prompted a change in the way consumer products companies operate. For instance, the consumer product lifecycle has been significantly shortened with customers expecting new variants every six months. This had led to changes in the marketing and sales cycles. The proliferation of online sales models has resulted in increased dependence on third parties in the supply chain. Small and medium enterprises are now battling large established companies for a pie of the consumer market by adopting eCommerce platforms to market and sell their products, further driving up competition.

Such changes in business models and consumer preferences can expose consumer products and retail companies to the risk of fraud. In addition, the pressure to report consistent sales results amidst intense competition, and the need to comply with regulatory requirements, can push companies towards adopting unethical business practices to survive in the market.

¹ Source: Survey by Corporate Catalyst India Pvt Ltd - <http://www.cci.in/pdfs/surveys-reports/Consumer-Durables-Industry-in-India.pdf>



Decoding frauds in the consumer products and retail sector

Fraud can be a pressing challenge for the consumer products industry, with the potential to impact finances, erode customer trust and impact brand value. Consumer market companies tend to have several third-party touch-points, such as vendors/ suppliers, transporters, third-party manufacturers or subcontractors, packers, stockists, distributors or other third party service providers, that can significantly increase the risk of collusive frauds that are difficult to detect. According to the Deloitte India Fraud Survey, released in 2014, around 54 percent of survey respondents belonging to the consumer products sector said they had most frequently experienced theft/ diversion of goods, and bribery and corruption over the last two years.

Further, with e-commerce emerging as a new distribution channel for consumer products companies, the supply chain has become a source of new fraud risks such as counterfeiting. For instance, protection of the brand from unauthorized online sale by third-party sellers, who may sell branded products at highly discounted prices, usually obtained through leaks in the supply chain. Various market studies indicate that counterfeiting of consumer products and economic adulteration of food products shaves off at least over INR 1,000 crores from the Indian exchequer annually². Also, brands can lose up to 20 percent of their market share and roughly 10 percent of their revenue and profit due to counterfeit products in India³.

² Source: Asian Patent Attorneys Association India anti-counterfeiting committee report 2011
http://www.apaaonline.org/pdf/APAA_59th_council_meeting_Manila/AntiCounterfeitingCommitteeReports2011/2-INDIA-Anti-CounterfeitingCommitteeReport-ANNEX2011.pdf

³ Source: Media article -
<http://www.thehindubusinessline.com/economy/counterfeiting-costs-india-78-b-annually/article5562416.ece>

Regulatory landscape

Regulatory bodies today are more sensitized to the risk of fraud than before. The Companies Act, 2013, has amplified the roles and responsibilities of the Board of Directors to fight fraud, including accountability for fraud. There is increased emphasis on fraud and integration with operational audits, mandates for companies and statutory auditors to report fraud incidents to the government, and stringent punishments and penalties imposed for any non-compliance. Further, there are other sector specific laws focused on preventing fraud and malpractice in the areas of product packaging, such as Food Safety and Standards Act, 2006, Food Safety and Standards (Packaging and Labeling) Regulations, 2011, and the Food Safety and Standards (Licensing and Registration of Food Business) Regulations, 2011, which consumer products companies have to comply with.



Safeguarding yourself from fraud

Globally, it is estimated that organizations can lose up to 5 percent of their revenues to fraud⁴. In India, organizations can lose an average of between Rs 1 crore and Rs 10 crores to fraud⁵. Given the extent of damage possible, it is important that organizations take measures to safeguard themselves against fraud.

The below table illustrates the key risks and corresponding measures necessary to mitigate fraud in the consumer products and retail sector.

| SN | Fraud vulnerabilities | Manifestations | Perpetrators/ accomplices to fraud | Mitigation efforts | Preventive solutions |
|----|-------------------------------|--|--|--|---|
| 1 | Procurement and Supplier Risk | Involves bid rigging, price manipulation, bribery, kickbacks, non-existing vendors, conflicts of interest and dubious vendor relationships | Employee in collusion with Supplier/ Third Party | <p>Procurement and Supplier Risk Management</p> <ul style="list-style-type: none"> • Fraud Risk Assessment of the Procurement function. • Identify unusual relationships in non-financial data – using demographic details of employees, customers, vendors, contract workers’ attendance records, etc. • Analysis of unauthorized logs identified from the IT systems in use | Forensic Diagnostics in ‘Procure-to-Pay’ process to identify control gaps and recommend effective antifraud controls or a risk mitigation plan |
| 2 | Supply Chain Risk | Diversion of goods or pilferage of stocks or undisclosed commission payment, related party arrangements, quality compromise or product substitution schemes by suppliers | Employee in collusion with Supplier/ Transporter | <p>Supply Chain Integrity Management:</p> <ul style="list-style-type: none"> • Fraud Risk Assessment of the supply chain function to address risk of pilferage or diversion of goods from the books and records. • Conduct an effective due diligence on all business partners to gather meaningful information, assess potential risks across the enterprise and devise risk mitigation plan. • Background check of key personnel and business partners, such as, suppliers, contractors, C&F Agents, transporters, and other third parties. • Additionally, to comply with international anti-bribery and corruption regulations, such as the US FCPA & UKBA, it is essential to conduct due diligence on business partners and counterparties to understand and mitigate financial and reputational risks | <ol style="list-style-type: none"> 1. Forensic Diagnostics in ‘Buy-to-Sale’ process related to inventory to identify control gaps and recommend effective antifraud controls or a fraud risk mitigation plan 2. Counter Party Due Diligence 3. Forensic Audit of Sub-Contractor or C&F Agent (stockist) or Distributor |

4 ACFE Report to the Nations on Occupational Fraud and Abuse, 2014

5 Deloitte India Fraud Survey, Edition 1, released in 2014

| SN | Fraud vulnerabilities | Manifestations | Perpetrators/ accomplices to fraud | Mitigation efforts | Preventive solutions |
|----|--|---|--|---|--|
| 3 | Shrinkage/ Loss or Theft of Inventory | Caused mainly by employee theft (picking or packing fraud), misuse, spoilage, shoplifting, bar code/ Point-of-sales (POS) manipulation, process failure and errors. | Employee(s) or Consumer(s) | Current state assessment of the antifraud controls implemented by the company with respect to past cases of frauds investigated (pertaining to shrinkage/ loss or theft of inventory) to evaluate effectiveness of the remediation action planned. | Review of Fraud Remediation Action |
| 4 | Product Counterfeiting or Grey Market | <ul style="list-style-type: none"> Counterfeiting products by way of unauthorized representation of a registered trademark carried on goods, similar to goods for which the trademark is registered with a view to deceive the purchaser into believing that they are buying the original goods. Diversion of goods or pilferage of stocks resulting in proliferation of grey market. | Employee(s) or in Collusion with Supplier/ Transporter/ Packer/ Third party Manufacturer | Brand Protection – Implement proactive and rigorous anti-counterfeiting measures to establish a secure supply chain strategy by fulfilling regulatory obligations, reporting of counterfeit cases, market survey/ intelligence gathering, and taking appropriate corrective action. | <ol style="list-style-type: none"> Anti-Counterfeiting Program Employee awareness programs Fraudulent Activity identification and reporting from the public domain Whistleblowing program Market Intelligence and Mystery Shopping |
| 5 | Economic Adulteration – Threat to Product Safety and Quality | <p>Intentional fraudulent modification of a finished product or ingredient for economic gain.</p> <p>Economic adulteration could also take the forms, such as contamination, concealment, mislabeling, dilution, substitute cheaper ingredient instead of high quality ingredient that is costly, etc.</p> | Employee and/or Supplier/ Transporter/ Packer/ Third party Manufacturer | Brand Protection | <ol style="list-style-type: none"> Forensic Audit of Sub-Contractor or C&F Agent (stockist) or Distributor Fraudulent Activity identification and reporting from the public domain Whistleblowing program Market Intelligence and Mystery Shopping |

| SN | Fraud vulnerabilities | Manifestations | Perpetrators/ accomplices to fraud | Mitigation efforts | Preventive solutions |
|----|---|--|---|---|--|
| 6 | Misuse of Advertisement and Marketing Spends | Misuse of advertising spends, discount coupons, bar code/ loyalty coupons, promotional items, spends on marketing events/ campaigns, etc. | Employee(s) or in Collusion with Supplier/ Third Party | Analysis of data related to advertising and marketing spends, along with billing data of agencies | <ol style="list-style-type: none"> 1. Forensic Data Analytics of Advertising and Marketing Spends 2. Fraudulent Activity identification and reporting from the public domain 3. Whistleblowing program 4. Market Intelligence and Mystery Shopping |
| 7 | Confidential Consumer Data Theft or IP Infringement | Theft of confidential customer data or product information or supplier details, which is then sold to competitor; and/ or theft of company's Intellectual Property (IP) related to new product launch or product development. | Employee(s) or Third Party Manufacturer or Sub Contractor | Restricted access to confidential data or information related to company's Intellectual Property | <p>Computer Forensics:</p> <ol style="list-style-type: none"> 1. Forensic imaging of electronic devices for analysis to find evidence (E.g. e-mail searches and disk imaging) 2. Discover system logs and unauthorized access to secured areas 3. Security testing of IT infrastructure (E.g. trail of enabling and disabling portable drives, virus threats, etc.) |
| 8 | Bribery and Corruption Risk | The consumer product and retail sector is highly vulnerable to risk of bribery and corruption due to high level of third party touch points in the Procurement and Supply Chain and involves interaction with government officials to obtain various approvals/ licenses related to business operations. | Employee(s) or in Collusion with Supplier/ Third Party | Establishment of an anti-corruption control framework that consists of policy and compliance assessment programs; assessing exposure to bribery/ corruption risks; due diligence on business partners; communication and training; and ongoing monitoring and review. | Anti-Bribery and Corruption Compliance Assessment |

Deloitte Forensic can help

Deloitte's Forensic practice in India has helped several leading consumer products and retail companies mitigate the fraud risks listed above.

We are a sector focused practice and our teams comprise individuals with different proficiencies - chartered accountants, forensic accountants, computer forensic specialists, forensic data analytics specialists, engineers, legal/ regulatory and ex-law enforcement officials, MBAs, research analysts, journalists, economists, and business intelligence specialists - and a strong track record of working in the consumer products and retail industry.

Our teams use state-of-the-art forensic technology to ensure that data is handled with maximum efficiency. We have fully equipped analytics and forensic labs set up at Mumbai, Delhi and Bangalore that support our endeavors.

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