Emerging risks and challenges in Retail and Consumer Products (RCP) sector

A forensic outlook
Recent trends in the RCP sector

- The diverse demographic and economic composition of India’s population makes it imperative that consumers have access to a large range of affordable products. However, going against the norm, many Fast-moving consumer goods (FMCG) players have increased the prices of their products in recent years – a brave step that has paid off for many of them.
- Players have penetrated deeper and entered tier-2 markets with products focused on local consumers.
- The E-commerce wave continues to hit consumer electronics and durables, with the tech savvy modern consumer now opting for “touch of the button” shopping and a digital interactive experience. Companies have also taken to social media in a big way to get close to their consumers.
- Cost reduction – the mantra for profitability. Many big players have taken cost reduction initiatives including using alternative fuel and packaging material, relocating their factories and reducing their manpower costs.
- Dependence on networks of outsourced third-party vendors has increased for both core and non-core functions.
- The sector is witnessing increasing instances of bribery and corruption in recent years. Most such cases relate to administrative approvals for projects, which need to be given by various Government authorities.
- Instances of fraud and corruption have become bigger and better staged than ever before.
Questions you need to ask yourself

Some parameters and related questions RCP companies operating in the Indian market should ask themselves:

1. Supply chain
   - Is the increase in our top line numbers genuine?
   - Are our sales targets realistic?
   - Is our race to achieve numbers compromising our integrity?
   - How secure is our brand in the hands of third parties?

2. Operational efficiency
   - Are our production numbers accurate?
   - Is cost reduction compromising our controls and quality?
   - Are we deriving the maximum benefit from our marketing spends?
   - How well are we addressing the opportunity of organized retail (assortment, inventory, pricing, promotions among others)?

3. Adapting to technology
   - How effective are our internal and external IT controls?
   - Has our initiation of new communication channels with customers (e.g., via mobile and the internet) helped us?
   - Is digital data security a high priority for us?

4. Good governance
   - Do we have standardized processes, systems and robust approval mechanisms in place?
   - Are our internal controls capable of preventing/detecting fraud and other malpractices?
   - Is management of multiple compliance requirements giving rise to new problems for our organizations?
Déjà vu?

Given below are some situations that have been faced by many corporates in the sector recently:

**Case 1**

**Background**
- A large-scale FMCG manufacturer faced a recurring issue – counterfeiting of one of its leading products in select Indian states. The client had undertaken investigations and multiple enforcement actions on counterfeiters in the past, wherein large quantities of spurious products of its brand were seized.
- During the course of such enforcement actions, large quantities of genuine packaging material components were seized.

**Problem: leakage in supply chain leading to counterfeiting**
- Slow moving/obsolete stock sold to scrap dealers for defacing and destruction was being sold in the market for re-use.
- An unauthorized manufacturer in the vicinity of the FMCG manufacturer was using packaging material for spurious products and was sourcing some of genuine packaging materials from the company’s regular supply chain.

**Case 2**

**Background**
- A consumer product giant allocated a large portion of its marketing spend to host events to promote multiple brands across India.
- It had a contractual arrangement with an agency, which stipulated payment at actuals for promotional activities and a fixed percentage as agency commission.
- An allegation was made by a whistle-blower to the company’s management, alleging inflation of invoices by the agency.

**Problem: fraud in events and promotions**
- The company initiated an investigation and found evidence of invoices submitted by the agency to be inflated and that some of its employees were receiving gifts from the agency.
- The agency was found to be earning large profits in addition to the fixed agency commission paid to it.

**Case 3**

**Background**
- A multinational beverage company floated multiple channel support schemes to promote secondary sale of its product in various markets in India. The retailers claimed scheme benefits based on slab eligibilities set by the company.
- The company received complaints from retailers in certain markets that they were not receiving the total scheme benefits despite their best sales efforts.

**Problem: manipulation of promotional schemes**
On investigating the issue, the company unearthed the following modus operandi of manipulation of the scheme:
- Manipulation of secondary sales numbers by clubbing multiple retailers to claim increased benefits
- Claims being approved by sales teams for increased benefits and not passing on the benefits to retailers
- Incentive eligibility slabs were manipulated post actual sales made by the retailers
- Claim cheques being made in the name of the families and friends of distributors/employees

**Case 4**

**Background**
- A global manufacturer of consumer products noticed sudden fluctuations in the sale of its two key products in select markets.

**Problem: manipulation in distribution management system**
A detailed investigation conducted by the company revealed the following irregularities:
- Manual invoices (outside the system) being made for sale to certain retailers
- No documentation maintained by distributor for addition or deletion of retailers in the system
- Sales made to export agents and recorded in the system as domestic sales to dummy retailers
- Huge quantities of domestic sales were diverted to company’s key export markets
In recent years, there has been a change in motives for committing fraud – from need to greed. Most cases of recent fraud were committed by individuals who wanted to make “quick money” to support their opulent lifestyles.

Building networks of outsourced third-party vendors for both core and non-core functions, though cost effective, companies often fail to upgrade control and monitoring measures to counter the increased risk of fraud. This has been a major deterrent in preventing fraud incidences.

Reluctance to change from a traditional approach toward business. A robust process is not popular, since it can be tedious. Furthermore, there are an increasing number of fraudulent instances due to inadequate segregation of duties and a high degree of trust being placed on a single employee rather than organizations being reliant on robust processes.

It is not always middle or senior employees, but top management personnel who are also equally capable of perpetrating fraud. In difficult market conditions, management members may also succumb to the pressure of “keeping up appearances” and ignore controls created to safeguard the interest of stakeholders.

Control is sometimes overridden, usually under the pretext of it being “good for business,” and ends up promoting a wrong practice that makes the process vulnerable to fraud.

Most cases of bribery/corruption in the RCP sector relate to the need to obtain administrative approvals from various approving authorities. An easy way out taken by companies is to route such transactions through their third-party vendors (channel/sourcing/manufacturing partners).

Inadequate data protection controls has increased the threat of data theft and cyber-crime attacks. In most cases perpetrators of fraud are generally allowed or authorized to access sensitive information or data to execute their routine jobs.
Is your business geared to address fraud-related risk in key areas?

The constant evolution of the RCP sector in India has resulted in significant changes in the nature and type of risks faced by companies. Given below are some emerging trends in fraud scenarios:

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<tr>
<th>Sr. No</th>
<th>Area</th>
<th>Fraud scenarios</th>
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</table>
| 1.     | Sales & supply chain      | **Leakage in supply chain**  
|        |                            | ▶ Theft of finished products/packaging material  
|        |                            | ▶ Collusion with vendors of scrap and leakage of product/packaging material scrap to counterfeiters  
|        |                            | ▶ Sale of stolen stock to B2B vendors  
|        |                            | ▶ Supply of counterfeit/cheap products through the grey market  
|        |                            | **Diversion of products**  
|        |                            | ▶ Creation of deliberate/artificial stock-out situation by distributor in select markets for high selling products and sales made to retailers at an inflated price  
|        |                            | ▶ “Piggybacking” of slow-moving Stock Keeping Units (SKUs) by forcing distributor to buy these along with fast-moving ones  
|        |                            | ▶ High dependence on select favoured distributors being selected to sell bulk of stock  
|        |                            | ▶ Kickback received from distributor/wholesaler for favorable contractual terms and annuity business  
|        |                            | ▶ Diversion of domestic sales to export market through unauthorized exporters  
| 2.     | Logistics & distribution  | **Transportation fraud**  
|        |                            | ▶ Excess or fraudulent payment made to transporters on the basis of forged invoices and supporting documents  
|        |                            | ▶ Allocation of business on non-contracted/non agreed routes to favored vendors for kickbacks  
|        |                            | ▶ Huge difference in rate at which trucks are hired from the spot market  
|        |                            | ▶ Payments made for two trucks by sharing the load of one truck  
|        |                            | ▶ Weighbridge-related fraud including manipulation of gross/net reported weight of trucks or partial unloading of trucks/tankers  
|        |                            | ▶ Siphoning off and diversion of goods by transporters  
|        |                            | **Distribution management**  
|        |                            | ▶ Manual invoicing outside distribution management system  
|        |                            | ▶ Unauthorized sale of free products/gifts  
<p>|        |                            | ▶ Dummy customers created to inflate sales |</p>
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<tbody>
<tr>
<td>3.</td>
<td>Sales promotion</td>
<td><strong>Manipulation of trade promotion schemes</strong></td>
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<td>▶ Leakage in disbursement of funds for secondary trade schemes through distributors</td>
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<td></td>
<td>▶ Manipulation of secondary sales numbers considered for disbursement of trade scheme</td>
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<td></td>
<td></td>
<td>▶ Dummy cartels (groups/syndicates) created to claim increased incentives under promotional schemes</td>
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<td></td>
<td>▶ Routing of scheme claim cheques in favor of family and friends</td>
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<td>▶ Incentive eligibility slabs manipulated on the basis of actual sales to claim higher amounts.</td>
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<td></td>
<td></td>
<td>▶ Manipulation of sales return numbers to reflect an increase in sales and claim higher incentives</td>
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<td>▶ Splitting sales to reflect the improved performance of low-sale regions to increase incentive claims</td>
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<td>4.</td>
<td>Marketing (events/ media)</td>
<td><strong>Manipulation of marketing spends</strong></td>
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<td>▶ Inflation of vendors’ invoices by media agency and use of additional funds to buy expensive gifts for customer’s employees</td>
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<td></td>
<td>▶ Manipulation of cost estimates to include inflated amounts and kickbacks paid to employees</td>
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<td>▶ Vendor invoices routed through intermediaries owned/operated by agency’s staff (including a mark-up)</td>
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<td>▶ Invoices raised for dummy events</td>
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<td>▶ Kickbacks paid on outdoor media and cinema advertisements</td>
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<td>▶ Payment made for displays for brand activation without actual renting of display/shelf space</td>
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<td>5.</td>
<td>Payroll</td>
<td><strong>Payroll fraud</strong></td>
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<td>▶ Inclusion of ghost employees in payroll processing documents including salary register/bank's payment files</td>
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<td>▶ Ghost employees/Ex-employees included in sales incentive pay-outs/travel allowance/Dearness Allowance payouts</td>
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<td>6.</td>
<td>Bribery/corruption</td>
<td><strong>Bribery/corruption</strong></td>
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<tr>
<td></td>
<td></td>
<td>▶ Improper payments various approving authorities</td>
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<td></td>
<td></td>
<td>▶ Appointment of third parties to make payments to obtain licenses/certificates/sales orders</td>
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<td>▶ Misrepresentation of transactions in accounting records</td>
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<td>▶ Invoices submitted and paid for goods not received/services never performed</td>
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How can EY help you?

Based on our vast experience in the sector given below are solutions to counter certain key areas of concern for the RCP sector:

### Proactive

- Data driven intelligence
- Trend analysis and visualization
- Field enquiries and market intelligence-led investigation into the following:
  - Leakage in supply chain
  - Diversion of products
  - Shrinkage
  - Counterfeiting
  - Grey market

### Reactive

- Investigation around specific allegations/suspicions around third party frauds, employee involvement, collusion, misconduct etc.
- Financial misstatement fraud investigation

### Solutions

- **Fraud analytics**
- **Background search services**
- **Anti bribery Anti corruption services**
- **Anti fraud services**
- **Dispute advisory services**
- **Forensic Technology & Discovery services**
- **Brand Integrity services**

### Proactive

- Background check of vendors/dealers
- Reputation checks of companies and individuals
- Anti-corruption (FCPA) due diligence
- Anti-corruption compliance program advisory
- Anti-corruption investigations
- Fraud risk assessment
- Developing anti-fraud policy
- Recommendations on controls and processes to manage fraud risk
- Assistance in monitoring and improving anti-fraud controls and processes

### Reactive

- Dispute advisory
- Arbitration & litigation support
- Evidence gathering through disk imaging and analysis
- Response to IT-related incident
Our sector experience

70+ clients we have worked with (domestic and international) in the last four years

300+ sector focused professionals including 25+ dedicated corporate intelligence team members

Client engagements executed by us in last four years:
- Proactive compliance reviews
- Supply chain leakage investigations
- Employee fraud and embezzlement investigations
- Brand protection engagements
- FCPA investigations
- ABAC review and training

50+ qualified and experienced team in the area of:
- Accounting
- Information technology
- Data analytics
- Market intelligence

Employee hours expended by qualified and experienced forensic professionals: 2,000,000+

Closely worked with domestic and international law firms in responding to the various regulatory requests:

Sector highlights:
- Two of the largest FCPA engagements on behalf of EY member firms in the RCP sector in the recent past
- Over 15 brand-protection engagements in the last three years to address issues relating to counterfeiting, supply chain leakage etc.
- Over six proactive ABAC compliance reviews for multinationals

Interviews:
- Over 100+ interviews of senior executives, and functional and state heads

Emerging challenges in Retail and Consumer Products (RCP) sector • A forensic outlook
Dealing with complex issues of fraud, regulatory compliance and business disputes can detract from your efforts to achieve your company’s potential. Enhanced management of fraud risk and compliance is a critical business priority – whatever the industry sector. With our more than 2,000 fraud investigation and dispute professionals around the world, we will assemble the right multi-disciplinary and culturally aligned team to work with you and your legal advisors. In addition, we will provide you the benefit of our broad sector experience, our deep subject matter knowledge and the latest insights from our global activities.

FIDS India

- Deep competencies: Our FIDS team has specific domain-related knowledge along with wide industry experience.
- Forensic technology: We use sophisticated tools and established forensic techniques to provide requisite services to address individual client’s challenges.
- Global exposure: Our team members have been trained on international engagements and have had global exposure to fraud scenarios.
- Market intelligence: We have dedicated field professionals, who are experienced and trained in corporate intelligence, and are capable of conducting extensive market intelligence and background studies on various subjects, industries, companies and people.
- Thought leadership: We serve a variety of leading clients, which gives us a deep insight into a wide range of issues that affect our clients and business globally.
- Qualified professionals: We have a qualified and experienced mix of Chartered Accountants, certified Fraud Examiners, lawyers, CIAs, CISAs, engineers, MBAs and forensic computer professionals.

Our services:

- Anti-fraud and Fraud Risk Assessment
- Fraud Investigation
- Anti-bribery and Anti-corruption Compliance Services
- Brand Integrity Services
- Dispute Advisory Services
- Competition and Trade Services
- Ethics and Integrity Due Diligence
- Third-party Due Diligence
- Whistle-blowing Services
- Supply Chain Compliance
- Forensic Technology and Discovery Services
  - Computer Forensics
  - Forensic Data Analytics
  - e-Discovery
  - Software License and Forensic Disputes Services
  - Cybercrime Investigation and Intelligence Services

Emerging challenges in Retail and Consumer Products (RCP) sector - A forensic outlook
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