

The Effects of Gray Markets in the International Product Distribution Systems

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Abstract

The problem of gray markets has become one of the main concerns to many global marketing firms. Many of the distribution goals of today's firms in the international arena have been thwarted by the activities and issues of gray marketing. This work, therefore, analyzes the incidence of gray markets in the international distribution system. The study is guided by the following objectives: to examine if gray marketing affects product defection as well as encourage increasing customers' complaint; to examine the effects of gray markets activities on the availability of goods in certain part of the world; and to ascertain whether the realization of distribution objectives in the international marketing environment is affected by the incidence of gray market. To achieve the objectives spelled out, the study utilizes descriptive research. The questionnaire was the main research instrument that the study used to sift data from a sample of 50 respondents who were consumers. Based on the analyzed data, the following findings were made: that gray market affects product defection and hence, it leads to increasing customer complaints of certain product in the foreign markets; that gray market leads to negative availability of good in certain parts of the world; and that, gray market affects the realization of distribution goals and objectives of some organizations in international marketing environments. Guided by the findings, the study concludes that gray markets have a very strong effect on the international distribution Systems, causing dumping of good in certain target foreign markets and leading to non-realization of place utility objective by some global firms. The study recommends that gray markets should be minimized through utilization of internet technology, lowering costs to reliable distributors and as well ensuring effective selection of middlemen.

Keywords: gray market, distribution, international systems and parallel importing.

1. Introduction

With the proliferation of mass markets; clustered market segments; digital and revolutionalized age; changing consumer needs and tastes; highly competitive advantages; and more organizational resources, many firms are moving beyond their domain business boundaries and more companies are selling internationally.

Firms that sell in international/global arena face five (5) fundamental problems relating to distribution and pricing and these are *price escalation, dumping, transfer prices, environmental threats and gray markets* (Kotler & Armstrong, 2009). Gray Market(ing) is one of the most daunting difficulties that many companies face in today's global business world. Sometimes used as "Grey", it consists of branded products that are diverted from normal or authorized distribution channels in the country of products' origin or across international borders (Kotler, 2006).

Simply put, gray market is a jiggery – pockery behaviour of some distributors who actually convert the products/services needed in a particular country and re-ship or transfer it to another country in order to gain more economic and commercial benefits and profits. An example is a product that is needed to be sold in Nigeria markets but which unauthorized finds itself in Australian or Russian markets. Gray market has been widely referred also as parallel importing.

Recent industrial research has shown that gray market activities account for over \$40 Billion in revenue each year and many Global organizations are losing much (Jobber, 2009). A fact about the gray market phenomenon is that it usually lends itself to other marketing mix variables such as product, price, place and promotion. Though, it has been widely believed that the gray markets issue is a place – pricing problems in international distribution. Organizations must analyze the phenomenon of the gray market in order to minimize the consequence of the marketing activities.

There are basically two main types of gray markets. The first are those of imported manufactured goods that would normally be unavailable or more expensive in a certain Country, and the second is the unissued securities that are not yet traded in official markets. Sometimes the term dark market is used to describe secretive, unregulated (though often technically legal) trading in commodity futures. This can be considered a third type of "gray market". Since it is legal, yet unregulated, and probably not intended or explicitly authorized. In the context of international distribution, the issues of the grey market phenomenon have resulted in many problems among which is the non-realization of distribution goals and as well causing scarcity of needed product in certain countries and regions.

This work, therefore, reviews the gray markets in the international distribution system, its causes, and effect on the international firms and how it can be effectively and efficiently managed.

1.1 Statement of the Problems

It has been observed that the problem of gray market or parallel importing has become one of the main dilemmas affecting firms today. The issues of product defection, as well as increasing consumer complaints, have grown in modern times due to gray market activities.

Also, scarcity of certain goods has continued to occur in some parts of the world because of gray market activities. Most technological advanced products that are supposed to be available in European countries have found a dumping ground in many developing countries such as Nigeria. These products are therefore marketed at very exorbitant prices.

In addition to the above, it has also been discovered that the realization of distribution goals and objectives in the international environment has been jeopardized by the activities and issues of the gray market. This has made it impossible for some global firms to render and provide all sort of form, place and time utilities that are needed by buyers in the diverse economy of the world. The alteration and diversion of products in international distribution channels have rendered negative effects to many nations where such goods are tailored to be available.

It is in the light of the above problems that this work examines the challenges and management of gray markets in the contemporary international distribution system. At the end, this paper offers necessary recommendations towards reducing the problems of Gray.

1.2 Study Objectives

The specific objectives of this study are:

- (1) To examine if gray market affects product defection
- (2) To identify the effect of gray activities on customers' complaint of certain products
- (3) To determine the effects of gray market activities on the availability of goods in a certain part of the world.
- (4) To ascertain whether the realization of distribution goals and objectives in the international environment is affected by the incidence of the gray market.

2. Brief Review of Literature

2.1 Overview of Gray Market

Generally, a manufacturer works with a single importer who can sell and support their products in a given region. The importer usually has local dealers and distributors who resell the imported products; this is called a "distribution channel". Gray Market according to Jobber (2006) is the merchandise that is imported and sold by methods other than these normal channels.

Gray Marketing/parallel importing has been a widespread international practice, and one of concern to manufacturers and retailers since the mid-1980s (Baldo, 1985; Barlass, 1988; Mitchell, 2008). Estimates of the size of international "gray" markets range from \$US7Billion to \$US10Billion (Mathur, 2005). We are unable to locate any more recent estimates of the market size. There is evidence of tensions between attempts to remove any restrictions on the practice and attempts by organizations such as the European Union to protect its members from its impact (Mitchell, 2008)

Parallel importing is not counterfeiting. However, the use of term synonymously with "gray marketing" suggests that there is something suspect about the practice. Duhan and Sheffet (2008) suggest that "gray" may imply an "almost black market". Gray involves the selling of trademarked goods through channels of distribution that are not authorized by the trademark holders (Duham & Shefft, 2008). When gray marketing occurs across markets, such as in an international setting, the term used most commonly is "parallel importing". It provides the opportunity for companies, usually major retailing chains to bypass official franchise holders or agents for particular, usually high-priced, branded goods and to source them direct from overseas suppliers. It is only illegal when gray market goods violate either product registered or a licensing contract for the trademark's use in a specific Country, or where the trademark owner is based in the country into which parallel imports are intended to be shipped.

The practice of parallel importing represents an uneasy balance between the protection of intellectual property rights such as trademark and patent rights and the liberalization of trade in goods and services promoted by organizations such as the World Trade Organization (Bronkers, 2008). For gray markets to operate there must be a source of supply, easy access from one market to another, and price differentials that are large enough to make the venture financially viable. Much of the debate in the academic literature centers on whether parallel importing is a legitimate response to discriminatory pricing strategies or a free rider problem (Malueg & Schwatz, 1994).

2.2 Perceived Benefits of Gray Marketing / Parallel Importing

In the international context, Parallel export channels may assist in penetrating foreign markets or in increasing overall market share (Mitchell, 1998). Domestically, Tapsell (2008) reports the leading New Zealand Parallel importer, the discount retail chain “The Warehouse” as being equatorial about the future of the practice in boosting growth prospects for the organization. This is consistent with Buchanan, Simmons, and Bickart (1999), who conclude that retailers often prefer to display high equity brands in close proximity to lesser or unknown brands in order to leverage the value of the high-equity brand across other brands. Conversely, manufacturers who have builds equity in their brands want them to be displayed with brands of similar position and status. “Proximity to lesser or unknown brands, they believe, may cause their consumer to question the brand” (Buchanan et al, 1999).

Protecting parallel importers is perceived as providing a check on the near monopoly held by many large manufacturers, and as acting in the interests of consumers, resulting in lower prices, better products and, in developing countries at least, a higher quality of life (Chang, 1993). Indeed, much of the evidence to support the legalization of parallel importing came from examination of cases where a small number of companies were claimed to be extracting excessive profits from consumers (Davison, 1992).

Malueg and Schwartz (2004) support the view that parallel importing has arisen primarily as a response to international price discrimination. They contend that consumers view parallel imports as perfect substitutions for authorized goods. Tan, Lim and Lee (1997) take a slightly different view and suggest that parallel importers generally do not offer the same warranties as those (higher priced) goods available through official channels. Risk-adverse consumers will thus be prepared to pay higher prices for the security of warranties and after sales services. Risk-preferring consumers will purchase parallel imports in the knowledge that they do not have the same level of security.

2.3 Perceived Disadvantages of Gray Marketing / Parallel Importing

Consumers may purchase parallel imported trademarked goods without being aware of the difference between these goods and those purchased through “official” distribution channels. If problems arise, and customers find that they do not get the expected post-sale service and warranty protection, it may be the goodwill established by the official distributor/trademark owner which will suffer (Krieger, 1985; Duham & Sheffet, 2008).

Brands are rarely created by Marketing Communication activity alone, however, advertising and other related marketing communications activity help communicate and position brands. Tan et al (1997) and Michael (2008) claim that parallel importers gain a free ride on the market demand and brand image of the product created by the authorized distributor, without sharing in the marketing communications efforts and expenses which have built the demand and associated image. Thus parallel importers and gray market distributors are not concerned with developing and expanding the market, but rather with acquiring a share of the market developed by (and at the expense of) authorized channels.

The practice of parallel importing (gray market), if seen as openly condoned by the manufacturer, may strain manufacturer, official distributor relationships. Loss of Goodwill may be accompanied by a loss of marketing channel support as some “official” channel members lessen promotional efforts put behind a product which is also, parallel imported, cease to promote it or perhaps drop it entirely.

Opponents of parallel importing and Gray Market suggests, in calling for the imposition of restrictions on distribution, that selective distribution enables the guarantee of high levels of product and service quality. Mitchell (1998) argues that such is a stance in a specious argument – if customers want the “better” service and advice provided by a specialist outlet, they will go there artificially, restricting distribution that merely denies choice. He argues that marketers who want to protect brand’s name should restrict production rather than distribution.

2.4 Causes and Solution to the Problems of Gray Marketing

Having analyzed the positive and negative effects of gray marketing and parallel importing, it is very important to also analyze the causes and how it can be tackled.

The company that wants to reduce the problems of Gray Marketing starts by first identifying its causes. Five (5) pivotal forces have been widely believed to be the chief contributors to the problem of “Gray”:

- Impossible Goals of the Organization
- Confusing policies between Company and the Middlemen
- Insufficient Corporate Support for the Distributors
- Inadequate selection of intermediaries
- Lackadaisical attitudes of the Middlemen.

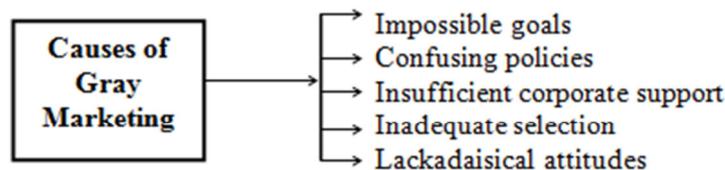


Figure 1: Cause of Gray Markets. Researchers' Illustration
 Source: Researchers' Illustration.

Adequate profile of the causes of the gray market problems will facilitate ability of marketing firms in providing limits. The reliable organization employs some dimensions in reducing the obstacles. These according to Kotler and Keller, (2006) are:

- *Altering the product components* such as warranty and guaranty services. Nokia products lines have been altered for use in some Countries only e.g. Nokia 2310 that have different Nigeria basic languages.

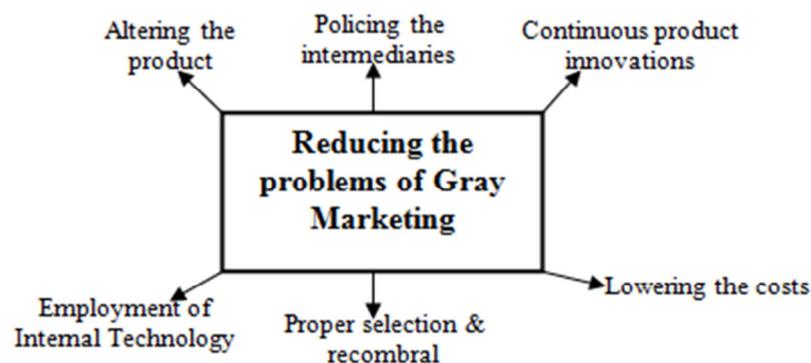


Figure 2: Solution to the Problems of Gray;
 Source: Researchers' Illustration.

- *Policing the intermediaries* is another major remedy. This involves employing exclusive dealings. Though, sometimes it may be difficult in the long run.
- *Continuous product innovation and inventions* which will help to shape the curve of the product that has reaches maturity in the "life-cycles".
- *Application of Internet Technology* which enable various consumers irrespective of their location to know more about the product, its price, distribution policies etc.
- *Adequate employment and selection of effective, efficient and consistent intermediaries* that will follow the organization policies, objectives, and systems.
- Multinational organizations can also reduce the problems of the gray market by *lowering the cost to the distributors* to enable them to enjoy more profits.

In addition, Michael (2008) reports that more pragmatic solutions, such as reducing export prices to authorized distributors have commonly been used to counter parallel imports. The main problem encountered with this strategy appears to be that price discounts intended as a temporary tactical measure have been perceived as a permanent strategy. Certainly, large price increases in a previously purchased brand do much to facilitate cognitive dissonance.

Tan et al (1997) review a number of reactive and proactive strategies. These center primarily on pricing adjustments and on the restructuring of manufacturer/distributor agreements in order to prohibit gray marketing/parallel importing. Thus, pricing strategies include engaging in price wars and scaling down promotional activity to regain cost advantages. The success of such strategies would, of course, be dependent on the ability to withstand the loss of profits through a price war period and/or whether competitors were able to capitalize on reduced promotional activity in order to grow competing brands at the expense of embattled marketers.

3. Research Methodology

To make this study meaningful, the work adopted the descriptive research method and design. Therefore, this form of research is appropriate in this study. The primary source of data was used in the study. The primary data are sources originally and specifically designed by the researcher for generating the data by him/her. The main primary source instrument used was a questionnaire. The secondary sources are those other than primary sources, which the researchers relied upon for additional materials to support the information available to them for the

primary sources. These secondary sources include magazines, journals, books, the internet etc.

The population for this work consists of selected general public, in Sango area of Ibadan, Nigeria. Only 150 numbers of people were randomly selected using convenient sampling and questionnaire were administered to the selected people.

4. Analysis of Data and Results

Information collected through the questionnaire was analyzed using varieties of methods. Frequency distribution and percentage tables were used to analyze the data.

Question one: On if gray marketing activities affects product defection

Table 1: Gray markets effects on Product defection

Responses	Frequency	Percentage
Agree	87	58%
Can't say	36	24%
Disagree	27	18%
Total	150	100%

Source: Field Survey, 2015

The above interview significantly shows that a relationship exists between gray marketing and product defection. Most of the sample respondents agreed that *"Gray market activities affect product defection."*

Question two: On the effect of gray activities on customers' complaint of certain products

Table 2: Gray Activities and effects on customers' complaints

Responses	Frequency	Percentage
Agree	90	58%
Can't say	36	24%
Disagree	24	18%
Total	150	100%

Source: Field Survey, 2015

The above table significantly shows that gray marketing affects customer complaints. Many of the sample respondents who were asked the question agreed that *"Gray market activities affect customer increasing complaints of certain products"*.

Question three: On whether Gray Market activities leads to the negative availability of goods in certain parts of the world (i.e. scarcity of goods).

Table 3: Gray market activities and effect on availability of goods

Responses	Frequency	Percentage
Agree	90	60%
Neutral	30	20%
Disagree	30	20%
Total	150	100%

Source: Field Survey, 2015

The above table regarding the third objective revealed that *"Gray Market activities lead to the negative availability of goods in certain parts of the world" i.e. it leads to scarcity of goods.* This was supported by 60% views of the respondents who agreed with the question.

Question 5: On if the incidence of gray markets can affect the realization of distribution goals and objectives in the international environment.

Table 4: the effect of gray markets in the realization of distribution goals

Responses	Frequency	Percentage
Agree	96	64%
Can't Say	21	14%
Disagree	33	22%
Total	150	100%

Source: Field Survey, 2015

Based on the analysis of the information of the interview made, it can be asserted that *"the incidence of gray markets can affect the realization of distribution goals and objectives in the International environment"*.

Table 5: One-Sample Test

	Test Value = 0					
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
Defection	2.676	149	.116	50.00000	-30.3802	130.3802
Complaints	2.463	149	.133	50.00000	-37.3343	137.3343
Availability	2.500	149	.130	50.00000	-36.0531	136.0531
Goals	2.150	149	.165	50.00000	-50.0771	150.0771

SOURCE: SPSS Analysis Output

4.1 Results and Findings

Having analyzed the data from the questionnaire using z-test to examine if gray markets affect other variables, the table above revealed that the z-test result shows the existence of significant result on the variables ($z = 2.676$; 2.463 ; 2.500 & $2.150 >$ at $p < 0.05$;). The significant level was found to be 0.00, and due to this we reject the null hypothesis and accept the alternate one which states that gray market affects product defection; gray activities affects customers' complaint of a certain product; it affects the availability of goods in a certain part of the world. Finally, realization of distribution goals and objectives in the international environment is affected by the incidence of gray market

The main findings of the study revealed that a significant relationship exists between gray market activities and customers complaints. This is due to the problem of product defection that gray marketing caused. The study also shows that gray market leads to non-realization of place, form and possession utilities by the consumers. Finally, it was also discovered that gray markets issues can lead to inconsistency in the supply of goods and this has thwarted the realization of international distribution objectives

5. Conclusions and Recommendations

Guided by the objectives of this study, a number of conclusions have been drawn which are summarized as follows:

Gray Market/Parallel Importing affects product defection and hence it leads to increasing customers complaints of certain products in the foreign market. Gray Markets significantly lead to the availability of goods in certain parts of the world i.e. it leads to scarcity of goods in a certain part of the world. Also, the incidence of the gray market can affect the realization of distribution goals and objectives in the International environment.

Based on the above conclusions, the following recommendations are offered:

- (a) The international marketing firms and others should utilize internet technology in fashioning out remedy towards limiting the problems of the gray market.
- (b) There should be an effective selection of intermediaries that will support the company objectives, policies, and goals.
- (c) Global firms must constantly lower cost to the middlemen who carry their products in international markets. This will reduce the illegal gray marketing activities because they know that both profit and cost advantages will be enjoyed by them.
- (d) Finally, if after utilizing all of the above strategies and the gray market issues still seem to be unrealistic, the concerned Companies can police and arrest the Middlemen who are found in the act of parallel importing and gray marketing activities.

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