

# Why Europe's IT channel must face up to grey market growth

From Amsterdam to Athens and from Brussels to Bratislava, the European IT market is facing an unprecedented crisis. Welcome to the murky and mysterious world of the grey market. Never has the channel faced an issue so inherently less black and white, or one so crucial to its destiny. Painted by vendors as nothing more than dodgy outfits shifting boxes for a quick buck, **IT Europa** investigates whether the continent's grey marketers actually play an invaluable role in keeping the European IT channel running smoothly. Is the rise of the grey market the direct result of decaying relationships between vendors and their distribution and resell channels? And can the rapid growth of grey trading be controlled - or more crucially - *must* it be controlled before the days of the authorised channel model are officially numbered..?

by **Joe Warner**

Imagine there was a directory detailing Europe's top 1,250 distributors (actually, there is - see **IT Europa's** list of database reports on the back page for details). Dial a telephone number at random and ask them to explain Europe's growing grey market problem and you will be greeted with the universal response: 'Oh no, we don't trade in grey market goods anymore'. Instead of illuminating the problem, quizzing the market's movers and shakers highlights a subject more controversial than a Ukrainian election.

The grey market is the most consequential issue Europe's IT market has ever faced. And with resellers blaming distributors, distributors blaming vendors, and vendors blaming everybody else, this battlefield is leading the channel to the brink of civil war. The issues of what exactly the grey market is, who it affects, and the ultimate consequences of its unrestricted growth are as complicated as they are contentious. But one thing is perfectly clear - whether good or bad, grey market activity is increasing at a mercurial rate.

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**Martin Smith, Gamma Global**

The facts and figures speak for themselves, with one source claiming the European grey market is now worth a whopping €1.5bn a year. Many channel players point to the expansion of the European Union for the spike in the volume of grey trade. 'Grey market activity is becoming more prevalent,' reckons Earl Graham, VP at Polish HDD distributor Incom. 'The expansion of the EU and the increasing maturity of these small open markets has meant the freeflow of goods has increased, creating more opportunities for grey business.' With living standards in eastern Europe 30pc

lower than in the west and the cost of IT hardware and software reflecting this gap, the extension of the EU has inevitably allowed an influx of cheaper goods into 'Old Europe'.

But first things first. The current grey market catalyst is also its cause. Grey trading exists thanks to the establishment of the European Economic Area (EEA) in 1994 by the then 12-strong European Union, in addition to the signatures of Iceland, Liechtenstein and Norway. To wrap 40 years of legal, political and economic wranglings into one sentence, it is essentially an extension of the 1957 Treaty of Rome agreement on the notion that the movement of goods, persons, services and capitals should be free between member states. Switzerland, although not a member, has a similar bilateral agreement with the EEA as it does with the EU, allowing easier trade with the member states.

In line with the founding principals of the EEA, any distributor or reseller is free to purchase products from one member country and sell them in another without contravening any law, so long as the product is genuine, remains in the original packaging, and is in no way tampered with. This is the most accurate definition of the grey market (technically called parallel imports) and despite protestations of illegality from companies afflicted by grey trading, in reality Europe's governing body encourages cross-border trade.

It seems simple enough. But it is dubbed the grey market for a reason, and it soon becomes painfully clear that grey is the hardest colour to define.

Firstly, the term 'grey market' often extends beyond parallel imports to include the influx of IT hardware and software into the EU that was originally intended for the markets of Asia and the Americas. It is an important distinction to make as this intercontinental trade is illegal. To complicate matters further, the channels used to distribute grey goods in Europe are often the same used to supply counterfeit and non-EU designated products,

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so the two practices become almost synonymous.

Martin Smith, managing director at UK-based grey broker Gamma Global, explains this overlap with illegal and counterfeit trade is giving his company a bad name: 'This is one of the main problems we face,' he says. 'The vendors are confused with who is doing what, so it is all labelled as grey market activity. If they say grey means counterfeit then I agree. There is no place for hardware or software piracy and it must be stamped out. But what we are doing and what we're talking about is the protected right to parallel import between EEA countries.' While this practice is perfectly legal, the growing level of grey activity directly correlates to the impact on certified distribution channels. It is a problem that has rocked the European market to its very foundations.

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**Rolf Foster, Actebis**

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In fact, the only point the European channel agrees on is where the blame for the creation of the grey market lies. 'If a vendor varies the price of its products from one country to another, then you'll have grey imports,' says Rolf Foster, director of components and supplies at pan-European broadband disti Actebis. 'The bigger the price jump between markets, the bigger the grey market potential.' Kaur Lohk, managing director at pan-Baltic distributor TDBaltic, agrees: 'The vendors that operate a policy of equal pan-European pricing are less likely to see their products end up on the grey market.' Additionally, if the vendor has poor control of its inventory and supply chain stock levels, it will invariably lead to product abundance or shortfalls, both of which exacerbate the grey market problem.

Jos Brenkel, EMEA VP at HP's Solutions Partner Organisation, concedes there is 'an element of truth' in the claim that vendors are responsible for creating an environment in which grey marketers can flourish. But he is equally quick to blame Europe's grey brokers themselves, and those partners that don't need much encouragement to wander from the authorised channel route: 'If companies stopped buying from the grey channel then the problem would disappear overnight,' he argues.

The final contributory factor, and for once one outside the vendors' control, is the varying VAT rates from one country to the next. 'The VAT havens of Spain, Italy and the Netherlands are often the starting point for grey market movement,' explains Jens Hartmann, CEO at northern European distributor, ELKO Group. This, combined with dramatically different vendor pricing across

Europe and poorly supplied official supply chains, makes going grey an attractive proposal for many cash-starved distis and resellers.

The biggest weapon in the armoury of the certified channel was that purchasing components, printers, PCs and digital cameras, often invalidated vendor guarantees and warranties. This alone was sufficient to persuade many distributors and resellers to stick with the traditional supply chain in case the goods purchased were either counterfeit or faulty. But with so many vendors now offering worldwide warranties on products, any incentive for staying whiter than white has disappeared. Foster at Actebis explains: 'The vendors with global warranties have no incentive to support local distis if grey goods flood the market. So long as someone is doing business in the market, most are happy.'

But just as it is impossible to tar all brokers, distributors and resellers with the same brush, the rule also applies to vendors. Well, almost. 'The crux of the problem for the vendors is that some country managers are missing their numbers while seeing the grey brokers do more business,' reckons Smith at Gamma Global. 'That's why they want to stamp it out.'

Despite its legitimacy, grey trading is far from a victimless crime if you listen to the channel faithful. Maria Mayers, VP of the US-based Anti-Grey Market Alliance (AGMA), explains how the grey market problem is more complex in Europe than the US as grey traders are not breaking the law: 'Instead of a legal perspective, it becomes a question of good business practice,' she says. 'Parallel imports may be legal, but they affect the authorised channel in the same way as illegal imports. So essentially it is the same model.'

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**Maria Myers, AGMA**

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Richard Baker, European partner relations manager at global chip vendor AMD agrees, arguing that the grey market hurts all 'honest' channel players: 'Our channel means putting the right people in the right places, and it takes a lot of time and effort to build an effective channel strategy. All the grey channel does is disrupt this for us and our partners.' For the vendors, the loss of control of the channel, reduced margins and the heightened threat of counterfeit products joining genuine goods in the grey supply chains are significant headaches.

The situation is even worse for the distributors that want to stay within the confines of partner agreements, as Foster at Actebis explains: 'We are losing business every day! Our role as central suppliers into each country is being eaten away, and we are in

danger of losing marketshare to the grey distributors.' He reckons the consequences can be far-reaching: 'It hits our business with the vendor and our business with our customers. If it is left unchecked it can kill a market.'

In Serbia, computer components were exempt from taxation until January 31st this year, so grey market imports were practically nonexistent as prices were as low as they could possibly go. Marija Malovc, marketing manager at 70-strong Serbian AMD, BenQ and Microsoft distributor Intel, explains: 'We don't know the impact of the tax change yet, it is still too early to tell as everyone stocked ahead of the law change.' She hopes grey market activity won't affect the Serbian market as it will damage the company's control of its business: 'Grey goods will be very harmful to us if a market develops. We can't compete with companies charging up to

18pc less than us for the same goods.' She adds: 'We don't get much help from the vendors. They don't see it as their problem.'

For resellers and customers the risks of grey trading are obvious. They do not know precisely what they are buying; in some cases it forfeits vendor guarantees and warranties; and they sacrifice all after-sales care and support services. 'It's a big risk for the sake of a bargain buy,' asserts one channel source.

The evidence is compelling and you would be forgiven for thinking the situation was hopeless. But the channel does have a choice as the Anti-Grey Market Alliance has proved. AGMA was founded in the United States six years ago by an initial vendor coalition of Compaq and 3Com to pro-actively tackle the grey market. A European franchise was launched last year, and the alliance is in the process of recruiting European vendors to address the

## The grey market brokers - channel friend or foe?

It is easy to dismiss grey marketers and brokers as the villains of the piece, holding authorised distributors and resellers to ransom, while dislocating the vendors from their channels. But with an issue that is neither black and white by both name nor nature, and in line with the most basic economic thinking, there must be a demand for grey market goods otherwise the market wouldn't exist. Just listen to Martin Smith, managing director at UK-based grey goods broker Gamma Global: 'Our sales grew well in to the double digits last year. Try and find a distributor in Europe showing those rates of growth. You won't. The demand for our services is higher today than it's ever been.'

Gamma Global has been in IT brokerage for 15 years and despite the negative press these players get, Smith maintains his company plays an important role in the dynamics of the European IT market: 'We have over 1,000 dealers who buy from us and hundreds of these customers are not interested in price alone.' He claims vendors' supply chains are ultimately doomed as they only build to deliver to forecast, and if demand is higher than expected, shortfalls will occur. He explains: 'By manufacturing to predetermined targets, vendors cannot cope with a sudden increase in demand in the UK for instance. But if there is less than expected demand in Germany, products sit in warehouses and don't get sold. We provide a level of availability the traditional channel cannot. It is our business, that's why we keep £4m (€5.8m) worth of stock at all times.' But Maria Myers, VP at the Anti-Grey Market Alliance, rejects this: 'It's a good story, and one we hear a lot,' she says. 'But it's a question of supply and demand, and from our experience, many brokers look to upset the supply and demand balance to make money.'

Smith also cites the lack of credit in the distribution channel as part of the bigger problem: 'If a reseller has a £50,000 (€72,600) credit line with four distributors and business is good, those limits will be maxed out very quickly. What if an end of month deal pops up and the reseller wants to fulfil the order?' He not only argues the channel may not have the stock, but if credit has been already used up, the distributor has no choice but to pass on the deal. 'No one wants to turn down good business,' continues Smith. 'So we also offer an incremental credit line to Europe's undercapitalised dealers to cater for these instances.' However, David Allen, international marketing manager at networking vendor 3Com, finds fault with this logic: 'There is absolutely no excuse for the grey market, and any company that can't get credit through the authorised vendor or distributor channel obviously has a bad credit rating.'

Despite the vendors' criticism, Gamma Global believes that by offering price, availability and credit to dealers, the broker channel is vital in filling gaps the 'white' channel simply cannot fill, and helps penetrate markets the vendors' authorised channel can't reach due to the large price difference over the local brands. One global vendor can see the logic in this argument: 'Some vendors are more than happy to miss out on margins to increase their market coverage in under-represented areas. The grey channel is the best way of achieving this.' But what of the claims the broker channel is notoriously lax in meeting validations for quality and warranties? 'Our standards are the same as authorised distributors, if not higher,' says Smith. 'We fully validate every product we buy and if it isn't satisfactory we send it back. But I concede many brokers are not so reliable. That's exactly why I have called on the vendors to work closer with the trusted brokers to help eradicate those suspect companies that bend the rules and happily deal in counterfeit goods.'

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growing problem across the continent. VP, Maria Myers, explains: 'We are committed to working with vendors and partners at managing their relationships better to diminish the opportunities grey market players look to exploit.'

The most popular and effective ploy is to tackle the problem at its source, but that means taking a tough line with the vendor.

## Top tips to tackle grey

*Is the grey market making you blue? IT Europa evaluates the top industry advice on how to compete against parallel traders...*

**1 Add Value** - While grey market brokers will invariably offer the lowest price, authorised channel players can add value to their services to distract customers from the lure of a bargain. 'Distributors and resellers can offer after-sales care and basic support services relatively easily,' reckons Earl Graham at Polish disti Incom. 'Even simple credit schemes will instantly give a significant advantage over the grey market box-shifters.'

**2 Differentiate** - By expanding the range of products it carries, a distributor can gain the edge over parallel traders. 'If a customer has a sizeable order, it is more likely to go to one disti or reseller for all its requirements rather than hunting out the cheapest option every time,' argues one channel source. 'This can be a big differentiating factor in favour of the authorised players.'

**3 Scale** - While the big guns of distribution can strong arm the vendors into helping them tackle the grey marketers, the national players do not have that luxury. But, as Kaur Lohk at TDBaltic reasons, the vendors don't just need the big pan-European distributors: 'They also need small, national distributors and resellers with local market knowledge and skills to build their grass roots business,' he says. National outfits could work together to pressure the vendors into taking action. 'Even serialising goods for basic tracking would make a huge difference,' adds one embattled distributor.

**4 Build bridges with vendors** - Mike van de Lindeloof at Dutch disti Dataman, suggests: 'You need to know who your grey competitors are, as this makes it easier to go to the vendors. In such competitive conditions, they will generally help.' He reasons: 'They want the sale of their products to go through the official channels as it keeps them in control of revenue streams and more importantly, their margins. Also insist on standardised European pricing.'

**5 If you can't beat them, join them** - but be warned. Vendors are more likely to discipline perpetrators than ever before as they try to prevent the grey market boom spiralling out of control. Jos Brenkel, VP at HP's Solutions Partner Organisation, warns: 'Partners have a legal responsibility to only sell to an agreed customer base. If they don't, we will strip them of their certification.' Still fancy your chances? 'In the majority of cases, you cannot guarantee the quality or authenticity of the products you are buying when you don't go through the authorised channel,' counsels one channel player. Ultimately, if a deal seems too good to be true, it probably is.

Understandably, many distributors are reluctant to risk this approach for fear of retribution. One distributor with the power to confront its vendors is €2.5bn-a-year sales giant Avnet. Suhk Rayat, VP and European managing director for components at the company, explains: 'You will get grey market trading with all vendors, it's inevitable. But the extent of activity can be controlled.' He insists vendors should be challenged if they are ignoring the problem which is directly hurting partners: 'We can try to educate them and demonstrate that if they are more patient with their distribution channels, everyone will benefit.'

For the largest distis and resellers, another option is available. Mike van de Lindeloof, sales manager at the Dutch office of server and storage distributor and solutions provider Dataman, explains: 'We were a big player in the Dutch grey market a couple of years ago, but have since moved into systems integration work.' He thanks 'several big business opportunities' that aided the move back into the authorised channel. 'We now need the continuous support of the vendors to help fulfil these contracts. It wasn't worth our while to stay in the grey market as it would have been too difficult without the support services vendors offer authorised partners.'

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Pan-European broadliners possess the clout to face the vendors head-on, and large distis and resellers have the option of adding value to their service fairly easily, but Europe's smaller guys are stuck between a rock and a hard place. 'The national players don't have this power,' says Foster at Actebis. 'In effect they are forced to choose. Either struggle against grey players or start trading in grey too. If I was a local player I wouldn't have a choice, and this is exactly how the situation can very quickly spiral out of control.'

But there are options. 'As a local player, we can't exert much pressure on our vendors,' says Graham at Incom, which made sales of €220m last year. 'We have to be more sophisticated in how we do business. Of course price is important, but by offering value add services and credit options, we immediately gain an edge the simple grey traders can't match.' Graham says Incom has learned to live with the grey market, and although it sees a lot of grey activity - and receives regular offers - it has built a strong market position and stable customer ecosystem to resist the temptation.

Rayat proposes a more revolutionary solution. With local players in a much weaker position, he believes Europe's distributors should club together to tackle the problem: 'If we make it clear the

vendors are abusing their position, eventually they will have no choice but to listen. If vendors can create the right environment, we will execute our half of the bargain perfectly. AMD is leading by example, showing the other vendors how it is done.'

**'Good inventory control, equal pricing across Europe and trust between vendor and partner can limit grey market trading.'**

**David Allen, 3Com**

Baker at AMD is pleased with the recognition, but admits the battle against the grey traders is far from easy: 'We've been working very hard at this for the last 18 months to two years, but the effort is being rewarded.' He claims increased security on AMD packaging has made a 'huge difference' in tracking products, while pan-European pricing has also been a factor.

David Allen, international marketing director at networking manufacturer 3Com, reckons there is 'no excuse' for the grey market: 'It's a question of trust issue between the vendor and its partners.' He says this bond is instantly broken as soon as grey trading enters the equation. '3Com works very closely with its partners to combat the grey channel,' he adds. 'We are aggressive on pricing and know exactly where our products are through serial tracking. Good inventory control, equal pricing across Europe and trust between vendor and partner will all help discourage grey market trading.' And if that doesn't work, 3Com will go after those companies that are not authorised to sell its products across borders: 'We will take stringent action against companies that continue to trade through grey channels,' he warns.

Brenkel at HP agrees vendors should take measures to avoid flooding the channel with inventory and better align global pricing. He says HP has doubled its investment in combatting the legal and illegal grey markets over the last 12 months, but the problem can never be truly eradicated: 'We can go after the bad guys, but if you



David Allen, director of international marketing, at 3Com (left) and Sukh Rayat, VP and managing director at pan-European distributor Avnet.

take one down, three more will suddenly appear,' he says. 'Vendors can't stop this, but we can make it more difficult for them to operate.' He believes better policing will help limit the growing problem, but that this is a responsibility vendors and partners must share, stressing: 'Any solution has to be a joint channel effort. It is the only way.'

Tackling every single grey market player is an impossible dream, and Smith at Gamma Global agrees that more grey vendors will quickly fill the vacuum left by one broker's departure. This is why he is calling on the vendors to work with his company in addressing these 'cowboy' operators which give all brokers a bad name: 'Vendors should pick the top two or three honourable brokers and we could work together to bring semi-regulation to the market. There are hundreds of brokers across Europe and many do not take the same care as we do in ensuring the products they deal in are genuine.' He adds: 'I would love to sign a preferential agreement with the vendors. It means they could tell their channel not to use the grey market, but if they absolutely must, only use these guys we are working with. The demand for the dodgy dealers would dry up overnight.'

## our analysis

**1) Varying rates of VAT and import duties across the EEA will ensure there is always the possibility for grey market trading. But the channel must start to use its upper hand to quell the demand for grey goods before the problem becomes insurmountable. Vendors must ensure stable pan-European pricing and good inventory controls, while serialised tracking and regional warranties will play a big part. Equally, distis and resellers must be encouraged to stick with their certified channels to diminish grey demand.**

**2) Semi-regulation of the broker channel is an interesting call and would help cut the opportunities that currently exist for the counterfeit dealers. But there is a fine line between regulated grey market and a price-fixing vendor/broker cartel, and any such discussion would face vehement opposition. The bottom line to this intensely complex issue is that the relationship between vendors and their authorised channels must be healed, otherwise the unrestricted growth of the grey market will cause irreparable damage, much to the suffering of the entire European channel.**

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