
The Grey Market Blues

An ominous trend emerging in the music industry is the "grey market," that is, the unauthorized importation and distribution of musical electronics manufactured in the Orient. A differential in U.S. and Japanese wholesale prices makes it possible for certain U.S. firms and individuals to purchase electronic products in Japan and profitably resell them to U.S. dealers at nearly the same price as the authorized distributor.

Measuring the size of the grey market is next to impossible. Given the borderline legality of their operations, most grey marketers keep a low profile. Similarly, dealers who purchase grey market goods are reluctant to discuss the practice for fear of alienating authorized distributors. Nevertheless, considerable anecdotal evidence, and the stepped up promotional efforts of several grey market firms, lead us to the conclusion that the grey market is growing at a steady pace.

To really understand the negative affects of grey marketing, it is instructive to analyse other industries. 15 years ago, 35 mm cameras were marketed almost exclusively by specialized retailers operating on the same gross margin and inventory turnover rates as the average music dealer. Then, about eight years ago, certain companies began purchasing Japanese made cameras intended for sale in Hong Kong, and wholesaling them to U.S. retailers. In a short time frame, the presence of these grey market cameras had a devastating affect on retail margins. Following the widescale introduction of grey market products, retail gross margins plummeted from approximately 40% to 14%, according to industry sources.

Initially, the advent of the grey market seemed to stimulate overall sales by broadening the distribution channel. Commerce department statistics reported substantial increases in camera imports in the late seventies and early eighties. However, what was first perceived as growing consumer demand turned out to be nothing more than placing merchandise on an increasing number of retail shelves. Two years ago, after photo industry analysts concluded that every conceivable distribution channel was filled to the bursting point, the industry witnessed the biggest blow-out in its history as retailers cleared out their inventories. Depressed margins, followed by an industry wide liquidation sale, decimated the ranks of specialty photo retailers. Grey market activity in the photo industry has subsided

somewhat, but the specialty merchant has permanently lost his market position. It is also worth noting that camera sales plummeted in the past two years.

Given the operating procedures and attitudes of grey marketers in the music industry, it is not inconceivable that we could witness a replay of the photo industry debacle. The presence of a large grey market inevitably results in indiscriminate distribution, excessive inventories in the field, and a complete lack of regard for customer satisfaction: three factors that will ultimately take their toll on retail gross margins and total industry sales. If the average music retailer could survive on a 14% gross margin and customer satisfaction was irrelevant, we would dismiss the grey market as an insignificant nuisance. But since that is not the case, we deem it a serious cause for concern.

Consumer demand for musical products is created in large part by the retail community. Profitably creating this demand requires a large inventory commitment as well as healthy gross margins. Any factor, like the grey market, that affects retail margins negatively, undermines the industry's ability to create consumer demand, and is cause for alarm.

Many retailers view the grey market as a boon, because it enables them to obtain products that were previously unavailable. This is ultimately a short-sighted outlook, because what good is a product if no one can sell it profitably and consumers are not fully serviced. Nevertheless, given the competitive nature of the retail market, an individual dealer cannot be expected to refrain from the grey market on principle, if his competitors are involved. Consequently, it is the manufacturers' responsibility to stem this negative phenomenon.

Rolandcorp recently received a temporary restraining order, prohibiting a Los Angeles grey marketer from selling Roland products in the U.S. Here is hoping that other leading manufacturers will successfully utilize whatever methods are available to stop the unauthorized importation of their products. The future of the industry depends on it, for the day product distribution is in the hands of individuals who are not concerned with serving the world of music, all industry members will suffer.

Brian T. Majeski
Editor