UNWELCOME DIVERSIONS

Diversion (also known as gray market, parallel distribution or parallel importation) is the trade of a genuinely branded product through channels of distribution that are unauthorised or unintended, and not supported by the original manufacturer or authorised distributors. Ross Bulla looks at how to deal with it.

Diversion is generally a legal activity that is usually a civil contractual matter, and is intended to take advantage of available price differences. Diverted products are often imported from markets in which manufacturing costs or taxes are lower, or reimported (a process called the 'U-boat', after the u-turn that a ship makes after departing the dock) to evade taxes and tariffs altogether.

In fact, major retail chains and warehouse clubs are known to buy diverted product in order to satisfy consumer demand for lower prices, and the industry is represented by lawyers and lobbyists. Diversion is so profitable that one New York diverter earns over $2 billion in yearly revenues and won a copyright case that was heard by the US Supreme Court, which ruled that a manufacturer cannot prohibit the reimportation of its own product.

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Diverters use deception and fraud to acquire products, and diversion harms everyone in the supply chain, from manufacturer to distributor, retailer and consumer. Diversion costs brand owners billions of dollars in lost revenues, damages relationships with trusted suppliers and distributors, and can erode brand value. Expired, contaminated or diluted products, or products with formulas not approved by the presiding agencies, can cause injury, illness (or be ineffective at curing illness), or death. And to make matters worse, counterfeit products often accompany gray market shipments.

The Alliance for Gray Market and Counterfeit Abatement recommends three ways to mitigate diversion: corporate awareness, review of entities in the company's distribution channels and effective serial number tracking. Proactive and preventative measures include: the review of distribution channels, partner contracts and reseller programmes; performing due diligence on companies and their subsidiaries seeking to become authorised resellers or distributors; developing policies and procedures to address returns and replacements, discount and warranty claims, auditing of distributors and resellers to verify compliance with contractual programme terms and conditions; and records management for serial number verification.

Because diverters continuously adapt techniques and technologies to counter those used by brand owners, the use of multiple (layered), overt and covert authentication, and track-and-trace technologies are advised. Options include:

- Electronic article surveillance technologies, such as embedded and inconspicuous radio-frequency identification (RFID) chips or smart labels, which can locate and track product throughout the entire distribution chain and activate alarms when unauthorised movement is detected (RFID chips can be prohibitively expensive)
- Invisible or encrypted 2D barcodes, which are more difficult to copy, alter or obscure
- UV (invisible) ink
- Taggants, which are microscopic, inert or rare elements, dyes or fluorescent fibres embedded in products or packaging
- Digital watermarking, which is ideal for print or online media
- Gas chromatography/mass spectrometry or covert markers for the identification and quantification of organic molecules
- High-security holograms that contain covert authenticators, such as polarising sheets, UV radiation or chemical reagents, or moisture-reactive capabilities (the hologram reacts to human breath)

Many of these techniques are used to fight counterfeiting (the absence of a device is an indicator that the product has been repackaged) and prevent product tampering, as well as to enable brand owners to trace a discovered, diverted product back to a specific manufacturer or authorised distributor. Because diverted product might not appear in the marketplace for many months, such technology is critical to tracing a unique barcode or other technology to the manufacturer or distributor with which it is associated. Brand owners might also print a notice that products are not packaged for individual or retail sale, that they are for export only or that they are for sale by specialty stores, such as the sale of hair care products only in salons. Unique trade dress or packaging can be used to identify sales channels—exported products, products sold in specialty stores, institutional products, etc.

Employees, sales agents, distributors and other supply chain personnel should be educated about the consequences of diversion, and encouraged and rewarded for reporting it. Often, the most actionable intelligence comes from sales staff and distributors that are losing income from reduced or absent sales.

Potential indicators of diversion include:

- A steep decline in product orders from a single customer, but not from others in the same market or market segment. This might indicate that it is obtaining diverted product
- Distributors ordering quantities of product intended for a market that cannot support equivalent sales. This might indicate that they are diverting product to other markets or market segments
- Missing or obscured barcodes, or damaged or worn packaging
- Only a foreign language appearing on product packaging
- Products labelled for sale through other marketing channels.

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Ross Bulla is president of The Treadstone Group, Inc., which investigates and anonymously acquires trademarks and domain names on behalf of many of the world's largest brand owners and law firms. Bulla has managed complex, international investigations in more than 42 countries, including the Middle East, and has negotiated the acquisition of thousands of trademarks, domain names and patents. Actively involved in many professional organisations and committees, Bulla is on the forefront of establishing industry best practices. He is an active member of INTA, for which he serves on the INTA Internet Committee and Internet Governance and Contractual Relationships Subcommittee.