# Gray markets: an evolving concern

Unauthorized sales continue to raise costs and damage brand reputation

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"The variance in opinion among OEMs, distributors and resellers about the scope of gray market activity, and whether it has expanded or contracted in recent years, helps illustrate the complexity of the gray market challenge."

**Matt Behan,** Principal, Advisory, Contract Compliance, KPMG LLP (U.S.)

**In our latest examination of gray market activity, original equipment manufacturers (OEMs), resellers and distributors continue to report differing viewpoints about whether the gray market challenge has changed in recent years.**

The "gray market" refers to an alternative channel through which branded products are diverted from authorized sales channels into the hands of dealers, brokers or the open market. Gray market vendors may be unauthorized to sell those items, or may not have permission to offer products in a specific country or region.

This unauthorized activity has long been a problem for OEMs, which can lose significant revenue and margin from price erosion, as well as improper sales and marketing discounts and potential brand reputation risk. Further costs include handling end-customer issues caused by inadequate customer service, product handling and installation, and a lack of warranty coverage (which manufacturers often provide, at no cost, to maintain customer relationships).

To get a sense of the gray market and counterfeit challenge today, we surveyed and interviewed leading companies in the technology manufacturing and distribution ecosystem. We interviewed executives at OEMs representing a sizable percentage (by revenue) of the world's leading technology companies.

In this year's study, OEMs say the gray market remains a significant challenge. Among the manufacturers we surveyed, the vast majority of OEM executives say they've seen an increase in gray market activity since 2008. Similarly, all of the respondents reported expansion in the availability of gray market products and components over the past seven years.

In the face of this expanded risk, more companies are taking aggressive steps to counter gray market and counterfeit activity. Hewlett Packard, for instance, received a settlement from a reseller related to alleged gray market activity, and a judgment against other companies for obtaining discounted equipment for unauthorized resale.

Another global OEM has filed intellectual property litigation against a reseller for allegedly providing its customers with unauthorized access to the OEM's software update and support services.

Resellers and distributors, in contrast, say OEMs' efforts to curtail gray market activity are paying off. Resellers report a notable decline in the availability of gray market products, as well as growth in their purchases from authorized sources.

Similarly, distribution partners report a significant decrease in the availability of gray market products since 2008. We also saw growth in the percentage of respondents saying they don't obtain products via the gray market.

Despite these encouraging reports among distributors and resellers, however, the challenge remains. OEMs say vigilance and monitoring are still required to mitigate the revenue, margin and brand reputation risks introduced by gray market activity and product counterfeiting.

# UNDERSTANDING THE GRAY MARKET

**The gray market has many causes, such as unauthorized dealers obtaining discounted products from OEMs due to price arbitrage and transferring those products to another country for resale, and other misuses of incentive programs.**

An OEM may choose to discount products to increase sales, especially if there is stiff competition in a particular market or category. To obtain deeply discounted products for open-market speculation, a channel partner may make misrepresentations to the OEM about nonexistent or inflated customers, and divert those products to the gray market. Some may provide misleading information during the authorization process and use the resulting relationship to obtain discounted goods for gray market resale.

When the lowest price is a customer's top priority, authorized channel partners and resellers may be unable to compete with deeply discounted gray market products. Feeling they have no choice, they either lose deals or decide to take a chance and knowingly participate in the gray market.

Similarly, channel partners may turn to the gray market in response to shortages in the marketplace caused by rising demand or unplanned disruptions (such as natural disasters, labor strife, political interruptions or other factors) in legitimate distribution networks.

Whenever an unauthorized sourced product enters a market, it competes with the authorized regional source by driving deeper discounting and poses a risk to the OEM's brand reputation. OEMs generally have no visibility into unauthorized sales and cannot ensure that products sold are authentic

**" There is still tremendous pressure on the sales team, and the bad economy has not helped. "**

**—OEM Respondent**

or undamaged, and are installed and supported properly.

Regardless of the cause, however, gray market activity can affect everyone in the supply and value chain negatively.

For end customers, or those in the channel structure, a decision based solely on price can go awry easily. Gray market dealers or brokers may not feel obligated to uphold the OEM's quality and service standards.

As a result of purchasing gray market products from unauthorized sources, end customers could wind up with major data loss or business interruption.

In this environment, branded IT products have to compete not only with lower-cost brands and counterfeits of their own products, but also genuine products offered with gray market discounts. In effect, OEMs often have to compete with themselves.

While channel partners have a responsibility to adhere to the terms and conditions of partner contracts and incentive programs, the burden falls on OEMs to establish clear guidelines for reselling their products and to enforce those guidelines.

**To reduce this risk, companies must have a strategic solution to counter the gray market issue.**

Establishing effective processes to identify and monitor gray market diversion is challenging. We found many OEMs work to identify and monitor gray market activity, but opinions vary about the effectiveness of their efforts. In addition, the effectiveness of compliance programs varies in terms of coverage and the impact on contractual adherence.

## About This Study

As we did in 2008, KPMG and AGMA (the Alliance for Gray Market and Counterfeit Abatement) studied gray market and counterfeiting issues among leading technology companies to better understand how providers are managing their channels and if the gray market challenge is growing or shrinking.

In addition, we wanted to see if any companies were succeeding with gray market countermeasures — and why.

Our study included respondents from nine leading OEMs, 13 resellers and 18 distributors. The study and follow-up interviews provide directional guidance about the state of the gray market today, as well as the effectiveness of measures OEMs are taking to address the gray market challenge.

## THE GRAY MARKET CHALLENGE FOR OEMs

In this year's study, respondents at original equipment manufacturers (OEMs) say the gray market challenge remains significant, with 63 percent reporting an increase in gray market activity since 2008.

### Have you seen a change in gray market activity since 2008?

Increase

**63%**

25%

Decrease 13%

No change
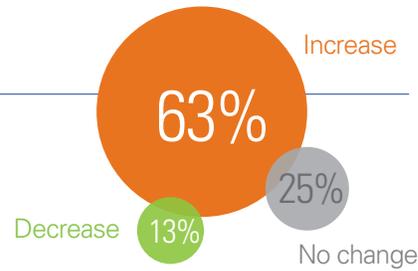
Not surprisingly, the vast majority of OEM respondents reported instances of products and components being available on the gray market.

### Have you found instances of product availability outside of the approved channel?
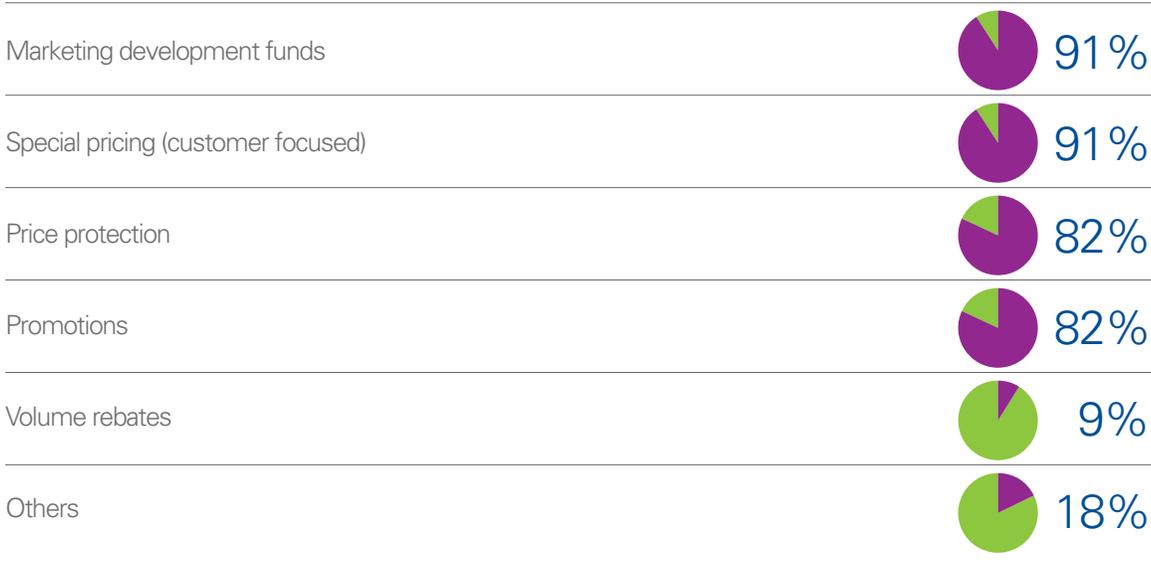
YES

**90%**

NO 10%
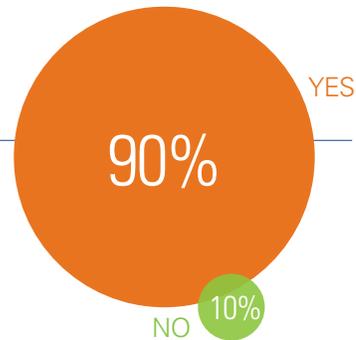
> **"** We're seeing a change as a result of more used product entering the market. Used products are being sold as new products as a result of the slowdown in the economy and more customers sourcing from retailers.**"**
>
> **OEM Respondent**

# LEGITIMATE INCENTIVES

OEMs use legitimate incentives, such as rebate programs and shared marketing investments, to spur sales, penetrate new markets, increase sales in developing markets, and promote brand loyalty among end users. However, these companies often end up offering discounts or rebates on gray market sales that should not qualify under their incentive programs. The result is higher costs with no compensating payoff to the OEM.

## What type of incentive programs do you offer? (Select all that apply)

| Incentive | % |
|---|---|
| Marketing development funds | 91% |
| Special pricing (customer focused) | 91% |
| Price protection | 82% |
| Promotions | 82% |
| Volume rebates | 9% |
| Others | 18% |

Unfortunately, and perhaps not surprisingly, most OEMs report incentive programs are prone to misuse and inappropriate claims. Respondents reported incentive program abuse through duplicate claims, fraudulent supporting documents, two resellers claiming discounts on products with the same serial numbers, potential counterfeit products being submitted for incentives, and other suspected abuses.

## Have you identified situations where inappropriate claims have been made under your discount programs?
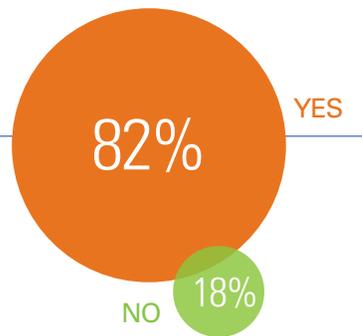
**100%** YES
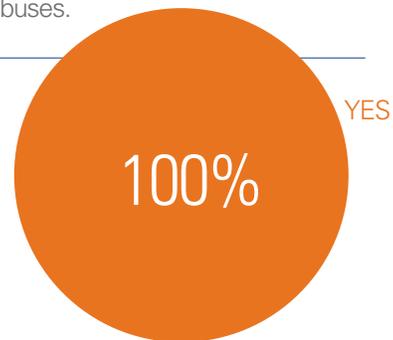
In response, OEMs report enacting countermeasures such as site visits, due diligence checks, credit and trade compliance verification, and other methods.

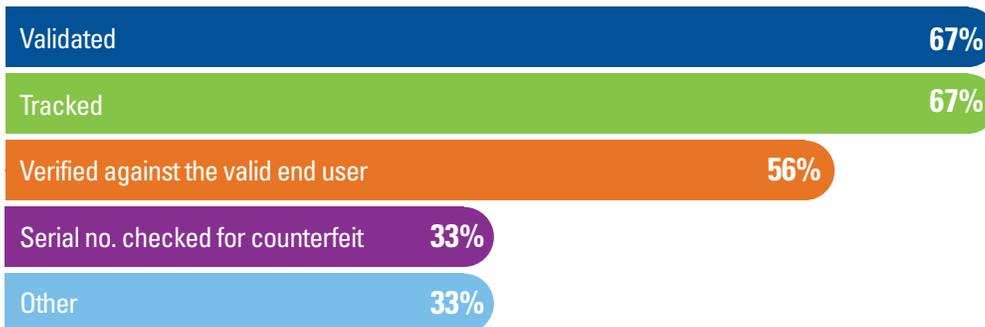Serial number verification is among the most common method chosen to verify rebate and incentive claims.

## Are serial numbers used to identify gray market/counterfeit activity?

**90%** YES

**10%** NO
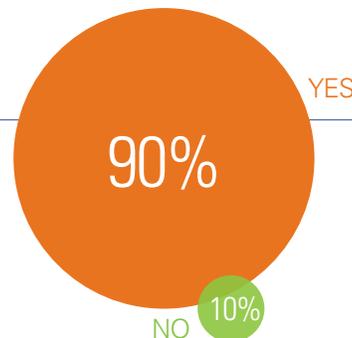
**Does your company require distributors to track and report product serial numbers on sales out to customers?**

82% YES

18% NO

**Are serial numbers?** (Select all that apply)

| | |
|---|---|
| Validated | **67%** |
| Tracked | **67%** |
| Verified against the valid end user | **56%** |
| Serial no. checked for counterfeit | **33%** |
| Other | **33%** |

Although fewer than half of the OEM respondents said their company uses serial numbers to support rebate claims, doing so provides an opportunity to enhance compliance with incentive programs and the broader terms of their distribution agreements.

**Do you require serial numbers to support rebate claims?**

44% YES

56% NO
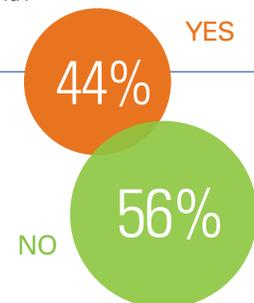
**" Serial numbers are validated on an ad hoc basis when there are irregularities, such as whistle-blowing, not typically part of the rebate process. "**

— **OEM Respondent**

## PREVENTATIVE MEASURES

OEMs continue to bear most of the burden to mitigate the flow of their products into the gray market. Current weaknesses in channel management may encourage, and in some cases reward, noncompliant behavior. The measures being taken are largely proving insufficient to dissuade channel partners from taking advantage of a trusted relationship.

If gray market discounts go as high as 40 percent or more, it's hard to argue that authorized channel adherence is a benefit. However, when adding the other issues that channel partners see as risks such as threats of compliance reviews or of jeopardizing a business relationship, the argument becomes easier for OEMs to make.

The first line of defense erected by most OEMs include contractual provisions against distributing products through unauthorized channels:

**Does the distributor agreement contain sourcing restrictions?**

YES **89%**

NO 11%

**89%** YES

NO 11%
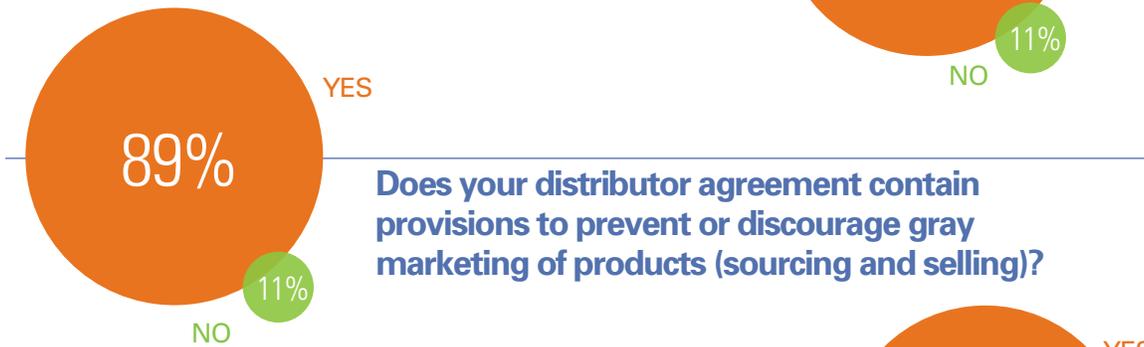
**Does your distributor agreement contain provisions to prevent or discourage gray marketing of products (sourcing and selling)?**

**Does the distributor agreement contain sanctions for sourcing from or selling to the gray market or buying and selling counterfeit?**

YES **88%**

NO 13%
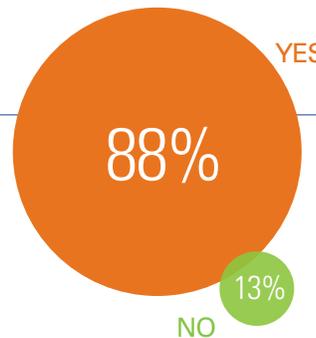
> " One of the themes that emerged repeatedly in our conversations with OEMs is the importance of consistent vigilance in combating the gray market challenge. OEMs that feel they've addressed the problem, and reduce their compliance efforts, can open the door to a resurgence of unauthorized gray market sales. "
>
> **Matt Behan,** Principal, Advisory, Contract Compliance, KPMG LLP (U.S.)

Similar contractual provisions are commonly used to encourage resellers to restrict purchases to authorized channels:

**Do reseller agreements contain provisions to prevent or discourage the gray marketing of products (sourcing and selling)?**

YES

**88%**

N/A **13%**

YES

**71%**

NO **29%**
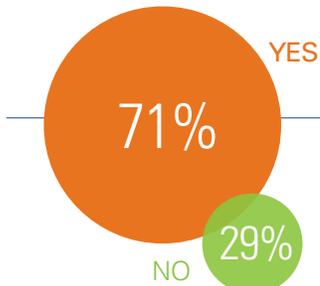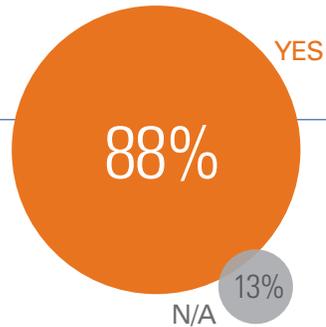
**Does the reseller agreement contain sourcing restriction?**

**Does the agreement contain sanctions for sourcing from or selling to the gray market or buying and selling counterfeit?**

YES

**86%**

NO **14%**

YES

**70%**

NO **30%**
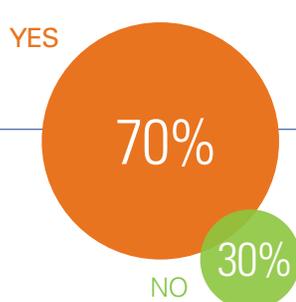
Tech companies have also developed formal training programs to help staff and partners better understand the gray market challenge, and to identify potential violations of channel agreements.

**Does your company have any formal training programs to educate staff on the gray market?**

For many OEMs, complacency about the gray market can compound the challenge. Some companies with long-standing anti-gray-market verification programs and compliance reviews may scale back those efforts if, thanks to those programs' success, they see lower returns or reduced evidence of gray market activity.

This can create an undesirable cycle as scaling back verification programs can lead to higher gray market activity if channel partners return to unauthorized behavior. This would create a corresponding need to ramp up compliance efforts to reset the target. Consistency is a vital factor in effective gray market compliance programs.

## MONITORING AND POLICIES ARE CRITICAL

Because awareness is a critical early step in addressing gray market activity, leading OEMs have enacted a number of policies against unauthorized product purchases. OEMs also monitor global pricing trends and product availability to identify potential violations of their distribution and resale agreements.

**Does your company have any formal policy or policies related to gray market?**

YES

**64%**

**36%**
NO

YES

**67%**

NO **33%**
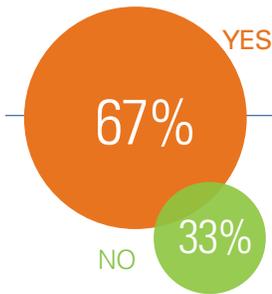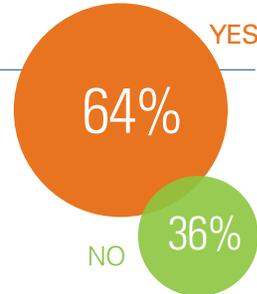
**Does your company have any formal policy or policies related to counterfeit?**

Hoping to stem gray market activity through enhanced business partner education, most OEMs have enacted on-boarding programs that outline the importance of using only authorized channels. Successful programs go beyond basic requirements such as credit and legal checks to ensure potential partners are willing and able to comply with the terms and conditions of the distribution or resale agreement, and are able to meet the OEM's reporting requirements.

**Do you have a formal on-boarding process for new partners?**

YES

**78%**

NO **22%**
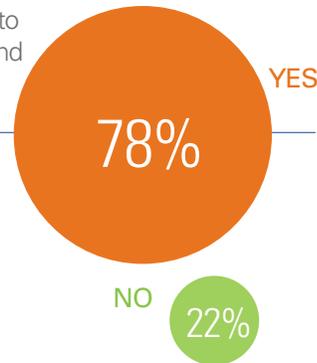
Tech companies need to pay attention to the marketplace to identify where and how, and for how much, their products are reaching the channel. If distributors or resellers perceive a lack of marketplace monitoring by the OEM, the incentive to engage in gray market activity rises.

## MONITORING THE MARKETPLACE

Once policies are in place, the next important step is monitoring the global marketplace to identify pricing trends, product availability and other signs that may indicate gray market or counterfeit activity is taking place.

### Do you have a monitoring tool to manage and control global pricing?

YES
**75%**

NO **25%**
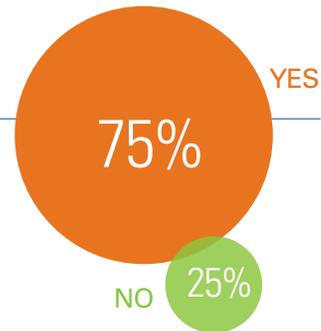
YES
**80%**

### Is there formal monitoring for gray market/counterfeit?

NO **20%**

## MONITORING THE MARKETPLACE (continued)

### What department monitors gray market and counterfeit activity?

**Gray market**

| | |
|---|---|
| Sales | 67% |
| Security | 44% |
| Finance | 44% |
| Internal Audit | 44% |
| Marketing | 22% |
| Other | 44% |

**Counterfeit**

| | |
|---|---|
| Sales | 33% |
| Security | 56% |
| Finance | 33% |
| Internal Audit | 44% |
| Marketing | 22% |
| Other | 56% |
| No Team | 33% |
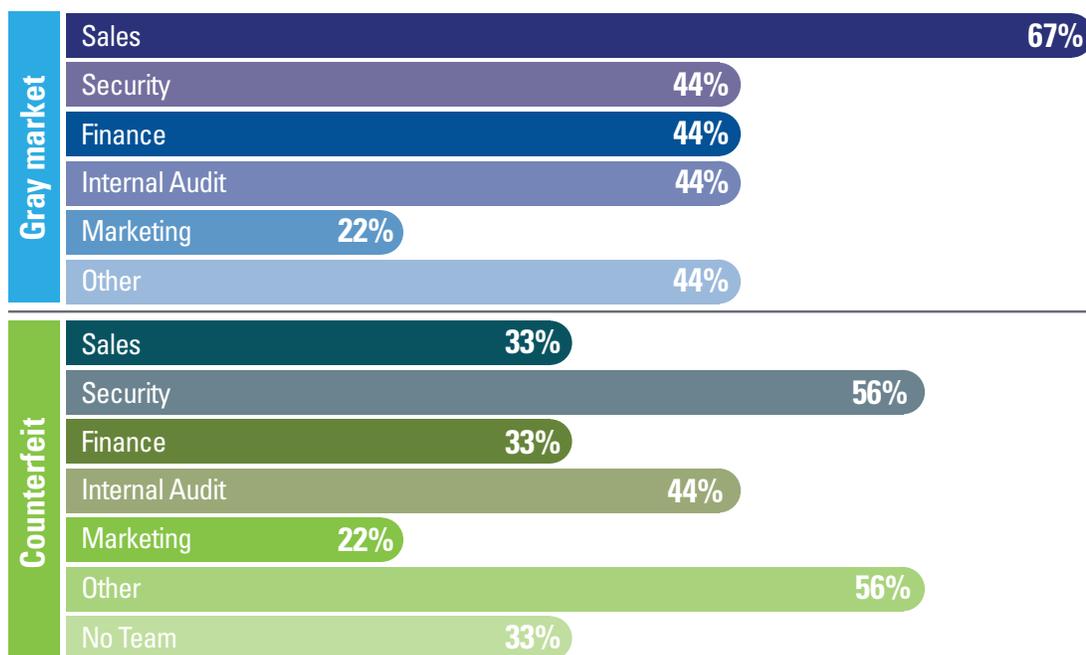
Categories with no responses (0%) were omitted from tables.

### Do you use third parties to monitor the trade boards to identify potential gray market and counterfeit activity?

YES **67%**

NO **33%**
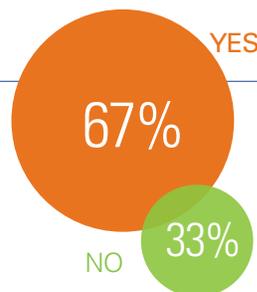
The majority of respondents say their company has enlisted some forms of technological assistance such as item-level RFID chips, customized inks and dyes, holograms, track-and-trace packaging and other measures in their efforts to identify counterfeit products.

**78%** YES

NO **22%**

**Does your company use technology to distinguish genuine product from counterfeit?**

## RESPONDING TO VIOLATIONS

Although most OEMs would prefer to preserve existing marketing and distribution agreements by addressing suspected gray market violations informally, two-thirds of the respondents say their company has taken technological and legal action in response to gray market activity.
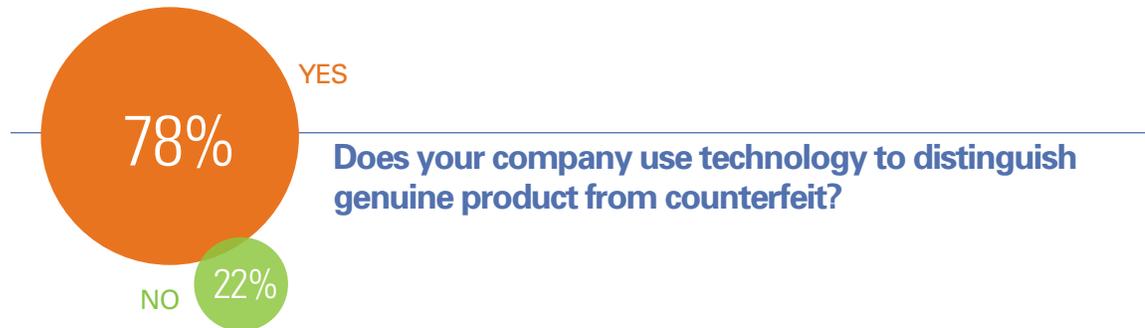
HP, for instance, received a settlement from a reseller related to alleged gray market activity, and a judgment against other companies for obtaining discounted equipment for unauthorized resale.

Another global OEM has filed intellectual property litigation against a reseller for allegedly providing its customers with unauthorized access to the OEM's software update and support services.

In addition, a growing number of companies make anonymous or undercover "sample buys" to uncover channel partners willing to disregard the requirements of their distribution agreements.

Given the time and expense associated with legal action, as well as risk to the business partner agreement, such action is typically taken as a last resort or in response to particularly egregious gray market violations. Termination of the relationship is another, and less expensive, option.

**Has your company ever taken legal action (civil or criminal) against gray market activity?**

**67%** YES

NO **33%**

Competing on price alone can make technology companies more vulnerable to gray market activity. It's important for companies to identify compelling services or support offerings that provide enough customer value to make gray market savings less attractive.

## DISTRIBUTION PARTNERS

In this year's study, distribution partners expressed an increased reluctance to go into the gray market when compared with our look at the topic seven years ago. Distribution partners say, for instance, the availability of gray market products has declined, they are making fewer gray market purchases, and their competitive position would improve if the gray market were eliminated.

In the face of more stringent efforts by OEMs to reduce gray market activity, and a desire to comply with their OEM agreements, more distribution partners say they are restricting their product sourcing to authorized channels.

This opinion marks a notable disagreement with OEMs' beliefs that the gray market has expanded since 2008.
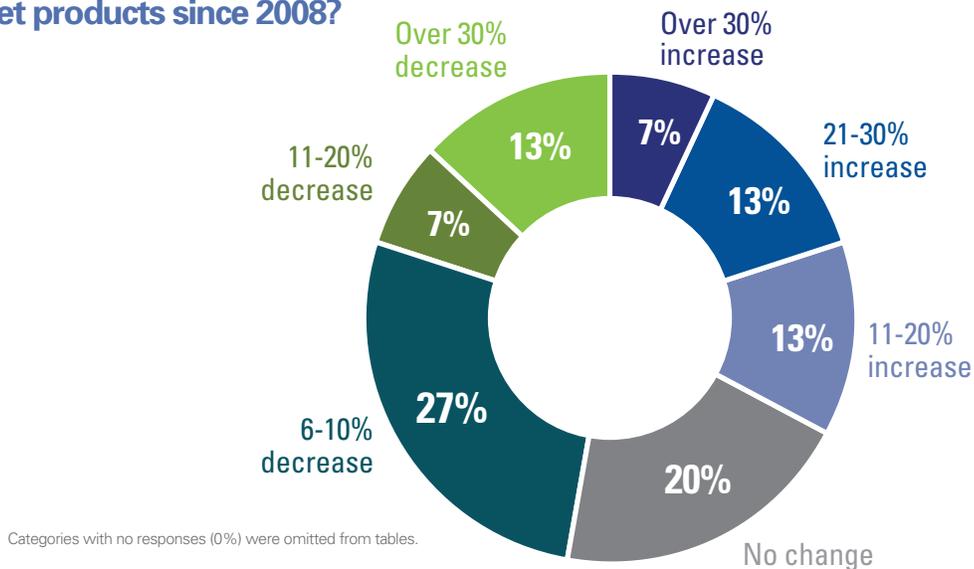
## LOWER AVAILABILITY

In this year's survey, distribution partners report a sharp decrease in the availability of gray market products, when compared with the 2008 results. The percentage of respondents reporting a decrease rose to 47 percent (compared with 7 percent in our 2008 gray market study).

A third of the distributor respondents say gray market product availability has increased since 2008.

The percentage of respondents saying there was no change in gray market availability fell slightly.

### What percentage change have you seen in the availability of gray market products since 2008?



Over 30% decrease — 13%
11-20% decrease — 7%
6-10% decrease — 27%
No change — 20%
11-20% increase — 13%
21-30% increase — 13%
Over 30% increase — 7%

Categories with no responses (0%) were omitted from tables.

Only a small minority of distribution partner respondents said that counterfeit products *increase* as gray market product availability *decreases*. From an OEM perspective, OEMs most often said they have not noticed any correlation between the change in gray market and counterfeit activity.

Similarly, a growing number of distributors expressed concerns about selling gray market products.

## Do you have concerns about selling gray market product to your end customers?

YES
75%

NO
25%
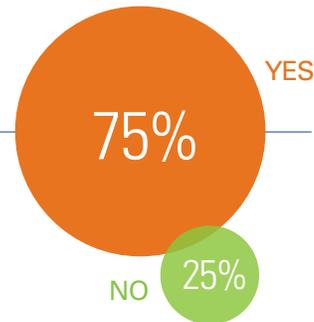
## Which of the following are the cause of your concerns about selling gray market products to your end customers? (Select all that apply)

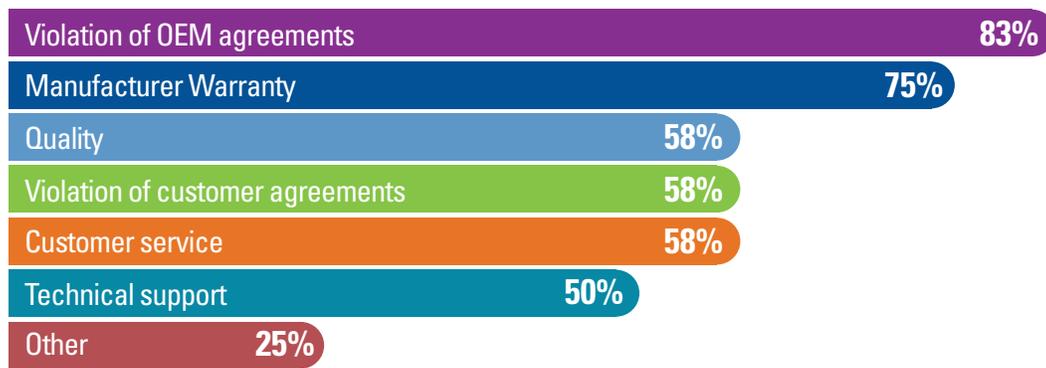| | |
|---|---|
| Violation of OEM agreements | 83% |
| Manufacturer Warranty | 75% |
| Quality | 58% |
| Violation of customer agreements | 58% |
| Customer service | 58% |
| Technical support | 50% |
| Other | 25% |

Asked about the speed of delivery of gray market products, a majority of respondents state the question wasn't applicable because they purchase from authorized sources exclusively, and receive the products as quickly as they would via the gray market. Except in rare instances, distributors say buying products from brokers isn't any quicker than from the OEM.

## If you purchased products from the gray market, is delivery typically faster, slower or about the same as when you place an order from an OEM?

Faster
18%

About
the same
18%

N/A
Only purchase
from authorized
sources
65%
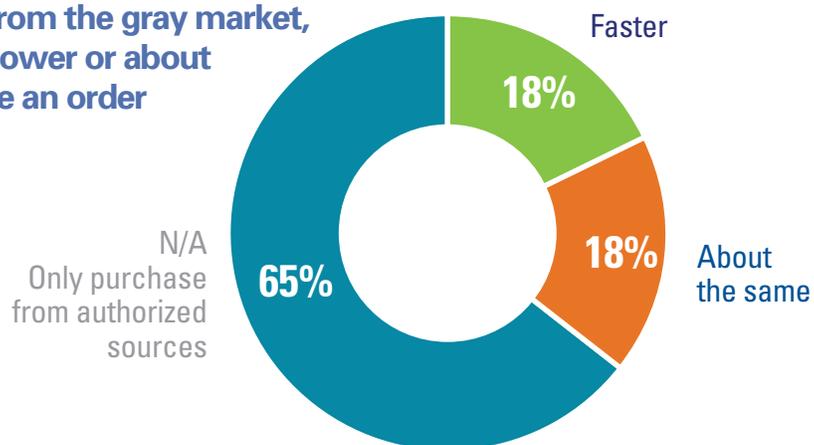
Categories with no responses (0%) were omitted from tables.

## LOWER AVAILABILITY (continued)

Indicating a potential decline in another unauthorized practice, the majority of distributors say they aren't willing to purchase products in one country or region and move it to another for sale. They say purchasing products in Asia-Pacific and reselling them (via the gray market) in Europe, for instance, is becoming less common thanks in part to more uniform pricing and product availability.

**Do you purchase OEM products in one country at a price advantage and move it to another country for sale?**

NO
88%
12%
YES
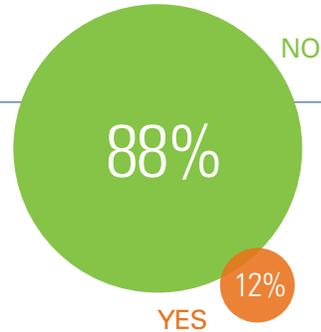
Asked about warranty coverage, less than a third of the respondents said such protection is available for gray market purchases. In many instances, however, OEMs may choose to provide warranty coverage to products they suspect have been purchased via the gray market to maintain customer loyalty.

NO
69%
YES 31%

**Do you receive warranty coverage on products purchased from the gray market?**
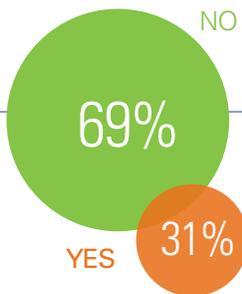
In another potential indication of reduced gray market activity, distribution partners cited a lower risk of receiving counterfeit products from unauthorized channels.

**Have you received counterfeit products from gray market sources?**

NO
100%
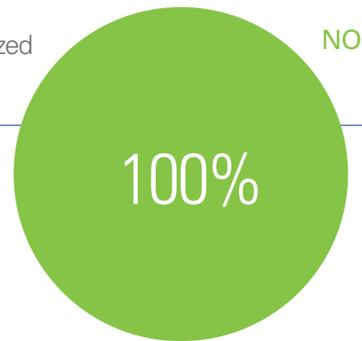
**"We are getting smarter about pricing, so we are not creating situations for price arbitrage."**

— OEM Respondent

Despite these reports of lower gray market activity, however, a majority of distributors say gray market procurement would be relatively easy if they chose to pursue that avenue.

### Since 2008, how easy or difficult has it become to source from the gray market? (Among channel partners that receive offers for gray market products)
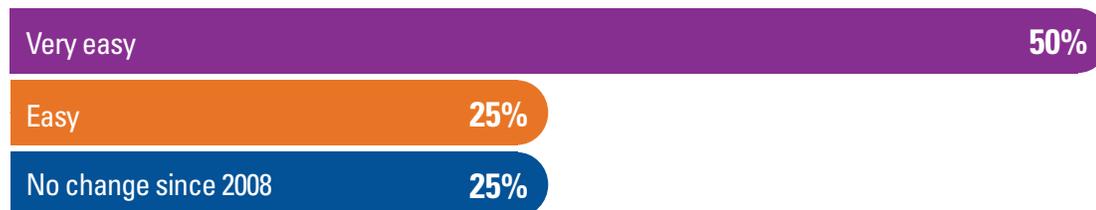
| | |
|---|---|
| Very easy | 50% |
| Easy | 25% |
| No change since 2008 | 25% |

Categories with no responses (0%) were omitted from tables.

As is the case with OEMs, distribution partners say their competitive position would improve if the gray market were eliminated. Potential reasons could include stronger collaborations with OEMs, as well as a reduction in the time and effort associated with inventive eligibility verification.

In addition, many distributors said they would prefer not to participate in the gray market, but are compelled to do so to remain competitive with companies more willing to violate OEM contracts and incentive program terms and conditions.

Given the seeming intractability of the gray market challenge for OEMs, discussions about its complete elimination should be considered theoretical at best.

### How do you believe your company's competitive position would be affected if all gray market activities were eliminated? (Among channel partners that receive offers for gray market products)

**100%**

Would benefit
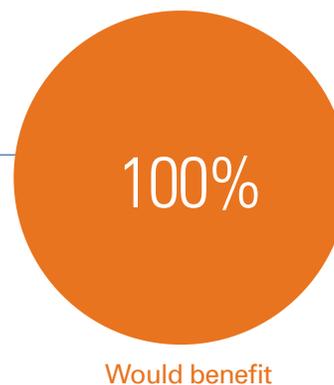
# RESELLERS

Resellers, for their part, report a higher degree of compliance with OEMs' purchase requirements than they did in 2008. Eighty-three percent of the reseller respondents to this year's survey say they source new OEM products from authorized distributors, compared with 31 percent in 2008.

Similarly, 67 percent say they obtain products directly from the OEM, compared with 44 percent in 2008.

## Where do you source new OEM products? (Select all that apply)

- OEM authorized distributor **83%**
- OEM directly **67%**
- OEM authorized reseller **50%**

Categories with no responses (0%) were omitted from tables.

There is a notable increase in the percentage of respondents who say obtaining products from the gray market has become more difficult since 2008. This is a marked contrast from our 2008 survey, when two thirds of reseller respondents reported it had become easier in the preceding two years to source products on the gray market.

## Has sourcing products from the gray market in the last two years become easier or harder?

No change/same **25%** — 23 (2008)
Easier **42%** — 2015 / 67 (2008)
Harder **33%** — 10 (2008)
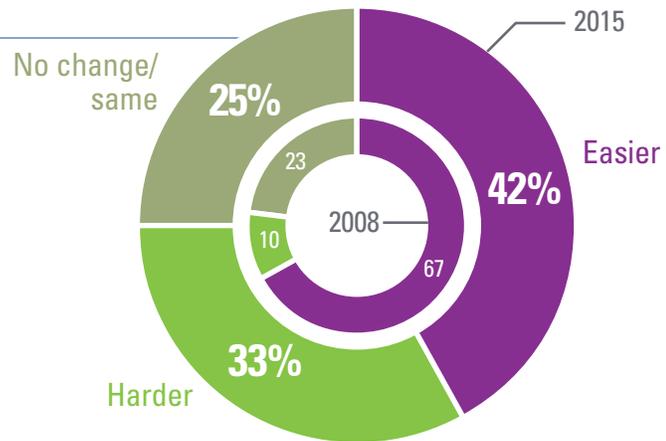
YES **75%**

Resellers also reported growth in the tracking and reporting of product serial numbers to OEMs.

## Do you track serial numbers in a manner that can be reported back to the OEM?

NO **25%**

Together, the results to these questions suggest greater caution among resellers about sourcing products from the gray market. They also suggest the steps OEMs are taking to reduce gray market activity are having a positive effect on promoting purchases from authorized sources.

## VARIETY OF SOURCES

Despite their growing reliance on OEMs, resellers say they obtain products from a number of sources. Most resellers report sourcing products from a mix of OEMs, distributors and other resellers:

**What percentage of new OEM products total annual purchases are from OEM authorized distributors?**

0%
8%
11-20%
15%
41% +
54%
23%
21-30%
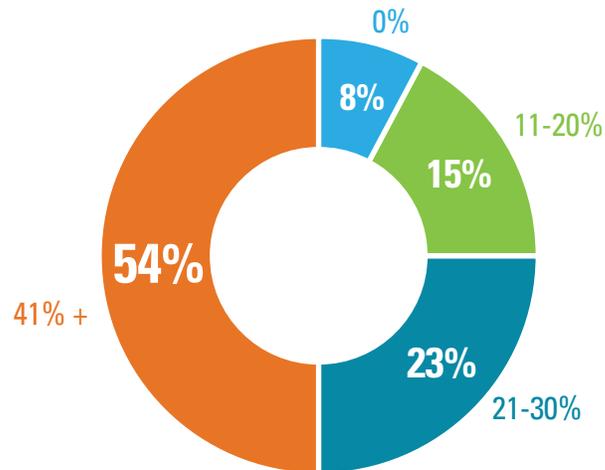
**What percentage of new OEM products total annual purchases are from the open market?**

41% +
8%
0%
25%
11-20%
25%
25%
1-5%
17%
6-10%
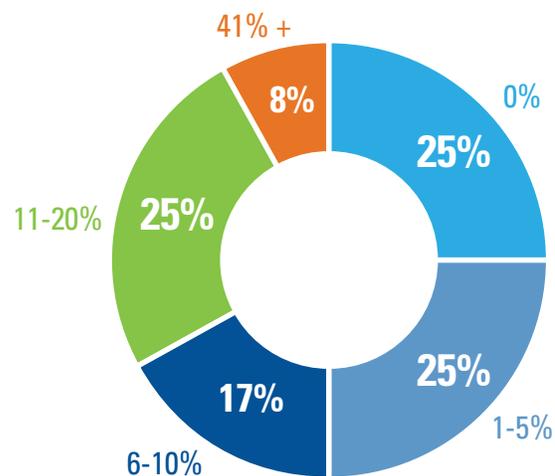
Categories with no responses (0%) were omitted from tables.

# RESELLERS AND CUSTOMERS

In this year's report, resellers reported notable growth in a target customer base that includes higher percentages of corporate buyers, other resellers, end users, service providers and OEMs.

The growth in their ability to reach corporate buyers and service providers may provide another disincentive for resellers to turn to the gray market for product sourcing.

## Who are your target customers? (Select all that apply)

| Category | Percentage |
| --- | --- |
| Corporate | 67% |
| Other resellers | 50% |
| End users / individuals | 58% |
| Service providers | 50% |
| OEMs | 42% |
| Other | 17% |

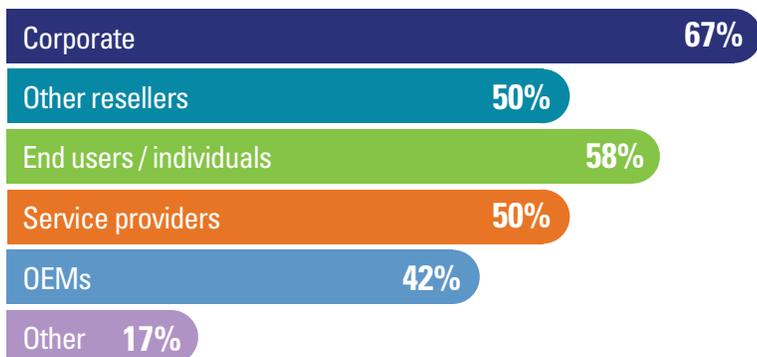Hoping to be known more as a business partner than merely a low-cost provider, resellers report providing a greater variety of value-added services to their end customers than was the case in our 2008 survey.

This growth in offering more sophisticated services may indicate a further willingness to avoid gray market products. Channel partners interested in preserving good relationships with OEMs, for instance, are therefore less likely to risk compliance issues by using the gray market.

## What additional value do you provide to your customer? (Select all that apply)

| Category | Percentage |
| --- | --- |
| Customer service | 92% |
| Product availability | 75% |
| System integration | 75% |
| Price discounts | 67% |
| Technical support | 67% |
| Warranty | 58% |
| Quick delivery | 42% |
| Financial solutions | 25% |
| Other | 8% |
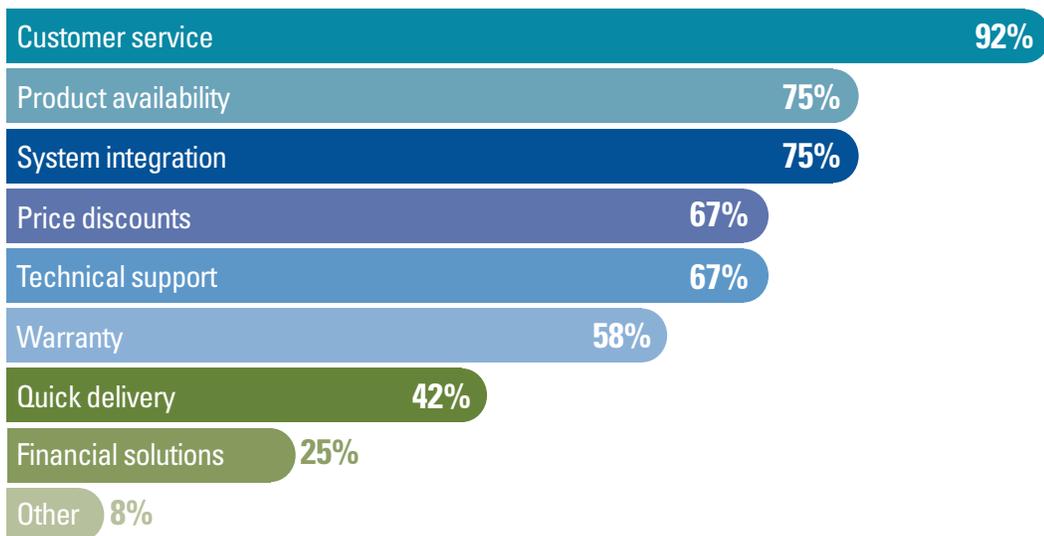
The methods resellers use to communicate with their customers are largely consistent with their reported choices in 2008.

## How do you promote your products to your customers? (Select all that apply)

| Method | Percentage |
|--------|-----------|
| Word of mouth | 58% |
| Internet | 50% |
| Sales force | 50% |
| Telephone | 25% |
| Info flyers | 25% |
| Advertise | 17% |
| Other | 17% |
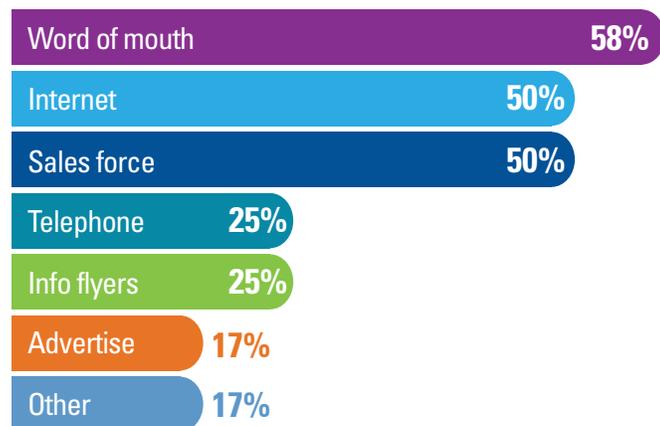
## CONCLUSION

**OEMs create authorized channels to ensure channel integrity and expand their reach to end customers. Authorized channels help OEMs target deep discounts on their products, when competitively necessary, by controlling the flow of product to the market through authorized distribution partners and resellers while protecting end users with quality service and support.**

Similarly, distribution partners and resellers are protected from a competitive free-for-all by meeting the OEM's service and support standards. The gray market disrupts this business model by creating an alternative channel that rewards unauthorized resellers engaged in dubious discount practices.

Not surprisingly, our survey found that most channel partners believe their market positions would benefit by eliminating gray markets, and most are concerned with the multiple issues that can arise when they stray outside the authorized channel. As a result, OEMs have a great opportunity to promote strong gray market mitigation programs and collaborate with the channel to drive out noncompliant behavior that is feeding the gray market problem.

OEMs do not have to create a perception change among their channel partners since these partners already believe it is better to stay within authorized limits, but these partners may require a push in the right direction through improved monitoring and enforcement efforts.

**As a result, there are four keys to stemming the unauthorized flow of goods into the gray market:**

1) **Establishing a strong authorized channel** by partnering with channel partners using contracts that set boundaries for authorized selling

2) **Monitoring sales to ensure contract compliance** by tracking serial numbers and end users to verify incentive eligibility and proof of performance

3) **Performing contract compliance reviews** on a consistent, nonadversarial basis

4) **Taking measures to enforce contracts** and compliance review findings through consistent consequences for noncompliance.

OEMs can achieve much more effective channel management by taking action when partners go astray. Contracts should have clear-cut terms and conditions that provide a roadmap for permissible reselling.

OEMs could start by establishing a clear corporate policy and providing their authorized channel partners with an unambiguous policy statement about the gray market and how management of incentive programs fit within that policy. The OEM sets the policy for who can buy and sell its products as well as the qualifications for receiving an incentive or rebate through authorized channels.

The effectiveness of incentive programs depends largely on how well those policies about unauthorized reselling are communicated, monitored, and enforced. OEMs must establish an effective monitoring contract compliance program, which includes tracking how products move through

the channel to end users; establish a channel partner review program; and ensure that only products and customers that are eligible receive incentives or rebates.

A particular challenge is stopping "side agreements" in which an OEM's sales force expresses a willingness to short-cut some verification requirements to make a sale that includes discounts that a channel partner may not qualify for under the terms of its agreement with the OEM.

Internal education about the importance of adhering to contractual terms and clear verification procedures can help reduce this common risk. Driving home the impact to the business of the gray market may counter a sales force's revenue-focused desire to "sell at all costs" that reduces profitability (and therefore the pool of net income available to pay commissions).

Finally, OEMs can achieve more effective channel management by taking action when partners go astray. Contracts should have clear-cut terms and conditions that provide a roadmap for permissible purchasing and reselling. If agreements are broken, there should be consistent consequences for noncompliance. This kind of contract compliance monitoring can help drive results and behavior change in the channel that is beneficial to OEMs, channel partners, and end customers alike.

## THE PATH FORWARD

**How can OEMs enhance contract compliance, revenue and business value by reducing the financial and reputation risk posed by gray market activity?**

**At right are some approaches that are becoming leading practices:**

Review incentive programs to identify potential areas of weakness that could be exploited by channel partners deliberately or accidentally. If they are uncovered, take steps to strengthen them.

**1** **Give someone in the company the responsibility to manage channel integrity.** That function needs to provide ongoing communications, training, and guidelines to channel partners to explain how the company will respond to incentive abuse, reporting manipulation, and gray market behavior. Make this person or his or her team a focal point for communications internally, with the market, and with industry groups such as AGMA.

**2** **Issue a comprehensive channel policy** that outlines expectations for data reporting integrity and overall contract/program compliance. Spell out consequences for noncompliance and follow through.

**3** **Monitor your channel reporting** and look for unexplained sales spikes or atypical customers, and put automatic alerts in place. Act on those alerts appropriately and in a timely manner.

**4** **Implement a channel partner review program** that includes on-site comparison of sales data from their "live" system, with information provided through the point of sale (POS) and/or sent to support incentive claims. Ensure robust consequence management is supported by executive and sales management.

**5** **Review incentive programs** to identify potential areas of weakness that could be exploited by channel partners or brokers. If they are uncovered, take steps to strengthen them.

**6** **Identify specific requirements and performance metrics** before agreeing to a special pricing deal. Ensure the deal is genuine and, if possible, track the product until it reaches the expected end user.

**7** **Implement a robust process for performing due diligence** while onboarding new partners. Ensure new partners are capable of meeting contractual reporting and data integrity requirements.

**8** **Promote internal awareness** about the importance of avoiding gray market activity and making sure products are delivered to the proper end users. Ensure the sales function understands the potential impact on the company, and the benefits of "know your customer" (KYC) initiatives.

> **" The mix of gray market, counterfeit, modified, and legitimate product we are seeing in some cases from a given reseller complicates the identification process for customers, law enforcement, and OEMs. It increases the need for OEMs to have a strong identification and enforcement strategy because of the additional safety and brand risks this creates. "**
>
> **Sally Nguyen,** President, AGMA (Alliance for Gray Market and Counterfeit Abatement)

## KPMG: an experienced team, a global network

KPMG's technology professionals combine industry knowledge with technical experience to provide insights that help technology companies take advantage of existing and emerging technology opportunities and proactively manage business challenges.

Our network of professionals has extensive experience working with global technology companies ranging from FORTUNE 500 companies to pre-IPO startups. We aim to go beyond today's challenges and anticipate the potential long- and short-term consequences of shifting business, technology and financial services.

## How KPMG Can Help

KPMG can help reduce the impact of the gray market and recover losses from noncompliant channel partners through a suite of services including:

**Contract Compliance Services**
KPMG's approach to contract compliance helps enable organizations to realize full value from contracts and increase confidence in business partnerships without damaging the business-to-business relationship. We help organizations obtain significant financial benefits by recovering lost revenue related to contractual noncompliance.

**Operational & Supply Chain Management & Restructuring**
KPMG helps organizations improve their financial position and performance by identifying improvement opportunities in a variety of underperforming core operations & supply chain areas across a wide variety of industries. KPMG's Supply/Value Chain Management services can help enhance working capital, improve after-tax profits, and improve return on investment.

**Operations Advisory & Strategy**
KPMG's Operations Advisory services help clients drive growth, penetrate new markets, and improve operational efficiency by building resilient, demand-driven, sustainable, and tax-efficient supply chains. We help companies to become better able to reduce operating costs and working capital, improve customer service, and enhance capital investment while reducing risk and delivering higher quality products and services.

**Enterprise Performance Management Process Transformation and Implementation Services**
KPMG helps clients make more effective decisions, improve performance management capabilities, and reduce reporting risk by standardizing and optimizing the reporting requirements, processes, data, and applications supporting critical finance, accounting, operational, and tax functions.

**Matt Behan,** Principal, Advisory, Contract Compliance, KPMG LLP (U.S.)

Matt Behan is KPMG's Technology Lead for Contract Compliance with more than 20 years of practice in global audit and advisory. His experience resulted in the broadening of KPMG's supplier and channel offerings to provide advisory offerings over the complete life cycle of partner relationships, identifying process/control gaps as well as setting up and performing compliance programs. His clients include semiconductor, consumer electronics, telecommunication and engineering manufacturers.

Mr. Behan is responsible for sharing leading practices both internally and externally at various events. He has written a number of white papers and articles relating to third party contractual compliance. Matt regularly speaks at the Alliance for Gray Market and Counterfeit Abatement (AGMA) and Marcus Evans Annual Strategic Channel Management Conference.

**Dean Hiser,** Director Advisory, Contract Compliance, KPMG LLP (U.S.)

Dean Hiser is a director in KPMG's Advisory Services focused on Contract Compliance Services. He has substantial experience leading and coordinating compliance reviews of suppliers, service providers, and licensees in the energy and technology sectors. Further, he has provided internal audit services in various areas including vendor management and implementation of earned value management systems.

Mr. Hiser has served as project lead on contract compliance audits that focused on the vendor's adherence to both the nonfinancial and financial terms and conditions of the contract, assessment of KPIs and royalty/bonus payments and performance of any cost optimization programs. The audits resulted in the identification and quantification of financial findings due to noncompliance, cost savings and process improvement recommendations.

**Contributors**   **Hasan Dajani,** Associate Director, Primary Research, KPMG LLP (US)

**J. Kevin Davidson,** Marketing Director, Technology, KPMG LLP (US)

**Charles Garbowski,** Director, Primary Research, KPMG LLP (US)

**Robert Rosta,** Associate Marketing Director, Technology, KPMG LLP (US)

**About AGMA®**

The Alliance for Gray Market and Counterfeit Abatement (AGMA®) is a non profit organization comprised of leading high technology companies committed to addressing the global impact of intellectual property rights issues; such as gray market fraud, parallel imports, counterfeiting, software piracy, and service abuse of technology products around the globe. The organization's goals are to protect intellectual property and authorized distribution channels, improve customer satisfaction, and preserve brand integrity. AGMA® uses a variety of avenues to cultivate change in the marketplace including, event speaking, educational initiatives, benchmark studies, industry guidelines, and, where appropriate, public policy advocacy.

To learn more about AGMA®'s initiatives or to become a member, please visit http://www.agmaglobal.org/ or contact: Debbie Corr Operations Manager +1 252 500 0123 debbie@agmaglobal.org

**Contact Us**

**Matt Behan**
Principal, Advisory, Contract Compliance,
KPMG LLP (U.S.)
408-367-7617
mhbehan@kpmg.com

**Richard Hanley**
Advisory Sector Leader, Technology,
Media & Telecommunications,
KPMG LLP (U.S.)
408-367-7600
rhanley@kpmg.com

**Dean Hiser**
Director Advisory, Contract Compliance,
KPMG LLP (U.S.)
214-840-4207
ehiser@kpmg.com

**Tom Lamoureux**
Principal, Advisory, KPMG LLP (U.S.)
206-913-4146
tlamoureux@kpmg.com