

Hazbo Skoko
Lecturer in Economics and Finance
Charles Sturt University, Bathurst, NSW 2795 Australia
hskoko@csu.edu.au

THEORY AND PRACTICE OF PARALLEL IMPORTS: THE NEW ZEALAND CASE

1 Introduction

Few commercial events in recent years have generated as much controversy as parallel importation. Parallel trading has emerged as one of the major issues of ongoing discussion in the theory of international trade and practice. It contains a variety of pragmatic issues, including economic, legal, and marketing matters. On the one hand, it is desirable to shield the public from possible confusion or deception regarding the origin of a branded good. On the other hand, there are considered to be good reasons for preventing copyright and trademarks from being used to divide markets and to create artificial barriers to free trade. Therefore, there is no consensus about the current policy relating to parallel imports.

Every year billions of dollars worth of products in the world market are imported outside (in parallel to) manufacturers' (or copyright owners') authorised distribution channels. The term parallel imports is used to emphasise the fact that unauthorised products are *imported* across country borders and a *parallel* channel is created to rival authorised ones.

In New Zealand, the Copyright Act 1994, which included software, and additional legislation (The Copyright Border Protection Regulations 1994), strengthened the parallel import ban. That restriction on the parallel importation of copyright goods should have a significant impact on the market for those goods, and on competition within the respective industry.

An impression of the speed in which computers and computer software was developed and has become part of everyday life can be gained from the fact that computer software is not even mentioned in the major copyright legislation drafted in New Zealand in 1959, and succeeding the New Zealand Copyright Act 1962 (Brown and Grant 1989).

Despite the lack of specific legislation, and several recommendations for the inclusion of software in the earlier legislation, protection for computer software in New Zealand until the mid 1980s was dealt with under the existing (the Copyright Act 1962) law. *"In New Zealand the issue of protection for computer programs was the subject of two reports by the Industrial Property Advisory Committee (IPAC) on 10 December 1984 and 18 March 1986. In its final report, the Committee pressed for the urgent introduction of new legislation. The Committee particularly recommended that the Copyright Act 1962 be amended to apply in relation to a computer program as it applies in relation to a literary*

work and that to be a retrospective amendment to confirm existing rights."(Brown and Grant, 1989, 320-321)

Concerning parallel imports *"the Copyright Act 1962 contained limited border protection for copyright works (by virtue of s 29 and the Copyright (Customs) Regulations 1963). These enabled the copyright owner of any published literary, dramatic, musical, or artistic work to file a notice with Customs requesting them to treat any printed copy as a prohibited import. Both counterfeits and parallel imports were covered but the term 'printed copy' introduced real restrictions. This term was narrowly interpreted by Customs. The narrow interpretation of printed copy by Customs led to considerable ingenuity by copyright owners in the use of copyright labels and manuals to inhibit importation particularly parallel imports"*(Brown, 1995). Because of this lack of protection, New Zealand was under pressure to adopt new enforcement measures for intellectual property rights.

In order to meet requirements imposed by GATT (General Agreement of Tariff and Trade) the Copyright Act 1994 was introduced, and took effect from the 1 January 1995. It is worth noting that in the original Copyright Act 1994 there was no border enforcement provision for parallel imports. However, as a result of lobbying by interested parties, a provision was introduced late in the legislative process – the Copyright (Border Protection) Regulations 1994, S. 144(5) and 1(2), (s. 144 repealed and substituted on 1 October 1996 by No. 27, s. 289(1) and 1996/229/2). The border protection provisions are now contained in Part VII of the 1994 Act and in the additional regulations, the Copyright (Border Protection) Regulations 1994.

Thus, with the new treaties, the Copyright Act 1994, and the Copyright (Border Protection) Regulations 1994, New Zealand has fully enforced parallel import restrictions and extended its application by explicitly including software in new legislation. This change, from an "ill-defined" prohibition of parallel imports to firmly determined and strengthened restrictions, and its application to software, will be used in the theoretical model of this thesis as justification for the use of the dummy variable to control for any influence of restrictions on software prices.

Since the mid-1980s there has been a growing interest in the international business literature in so-called "grey market", or what is referred to, in this study, as parallel imports. Imported parallel goods are products that entered a market in ways not intended by the original manufacturer. In fact, the term "parallel import" is a loosely used expression intended to explain any goods sold outside "normal", authorised distribution channels. Taking about the topic Rothnie (1994) wrote: *'Taking advantage of the lower price, some enterprising middleman buys stocks in the cheaper foreign country and imports them into the dearer, domestic country. Hence, the imports may be described as being imported in "parallel" to the authorised distribution network.'* In addition, Rothnie (1994, p. 193) extended the legal meaning of parallel imports noting that under most current parallel import provisions the plaintiff is also required to prove that the defendant has:

- *imported copyrighted goods into the domestic jurisdiction (for selling, letting for hire or by way of trade exhibiting, exposing or offering for sale or hire after such importation),*
- *imported without the license of the copyright owner: an article the making of which (a) infringed copyright or (b) would have infringed copyright if it had been made in the domestic jurisdiction, and*
- *with knowledge that the article so infringed, or would have infringed, the copyright subsisting in the domestic jurisdiction.*

The crucial point made here by Rothnie (1994) is that parallel imports have, by definition, been made lawfully. Therefore, the actual making of the imported articles did not infringe copyright. The articles imported in parallel are not “pirate” copies. In effect, a parallel import channel exists alongside the authorised one set up by a manufacturer resulting in intrabrand competition.

2.2 The treatment of parallel imports under the Copyright Act 1994

In New Zealand, an interdepartmental committee considered the restriction on parallel imports contained in the Copyright Act 1962. They found no conclusive evidence that the restriction led to across-the-board higher prices or anti-competitive behaviour in the market (Brown, 1995). The Ministry of Foreign Affairs and Trade was also concerned that a removal of the restriction could seriously change New Zealand’s trade relations with the United States, since New Zealand appeared on the United States “watch list” of countries whose IPRs law is of concern to the States (Brown, 1995 p. 2). The decision therefore was to retain and strengthen the restriction of parallel importation. Thus, the existing copyright laws and related rights under the 1962 legislation were rewritten and amended for the Copyright Act 1994 in order, *inter alia*, to give effect to obligations under the TRIPs Agreement and the US concerns.

On 1 January 1995, the Copyright Act 1994 came into force in New Zealand, replacing the Copyright Act 1962. The new Act is based largely on the United Kingdom Copyright, Designs & Patents Act 1988, although there are a number of significant differences. The major change was that for the first time specific protection for computer programs, multi-media works and databases were included.

As required by the TRIPs Agreement, the new Act expressly states that computer programs should be included, that is copyright protection should be extended to cover software as a literary work. A literary work must be written, spoken or sung to qualify for protection. “Writing” is broadly defined to include “any form of notation or code, whether by hand or otherwise and regardless of the method by which, or medium in or on which, it is recorded.” This clearly means that both the object and source code of a computer program will amount to a “literary work.”

While computer programs are now specifically included in the definition of “literary works”, there is no definition of “computer program” in the new Act. This was a deliberate decision, because the speed with which technology is advancing creates a significant danger that any definition of “computer program” in present terms will not cover developments. This is consistent with the UK legislation, as mentioned earlier, which was used as a basis for the New Zealand Act.

The new Act and the Copyright (Border Protection) Regulations 1994 introduced new provision relating to copyright border protection as well. Owners of copyright works may, in the case of pirated copyright works, lodge a notice with the New Zealand Customs. On acceptance of this notice and the posting of security and/or on indemnity to the satisfaction of Customs, Customs must detain any infringing copies. To ensure that the copies remain detained the copyright owner must initiate court proceedings within 10 days of being notified that Customs have detained goods. The border protection measures relating to parallel imports are similar to those relating to pirated goods except that Customs have no ability to detain parallel imports.

The parallel importing provision of the Act has been strengthened and more precisely clarified. The Act now provides the provisions for secondary infringement of copyright to knowingly import, other than pursuant to a copyright licence, infringing copies (which are defined to include not only pirate copies but also copies which may be genuine articles made by an overseas manufacturer/copyright owner).

The restriction of parallel importation was contained in s. 12 and 35 of the Copyright Act 1994. Section 35 provides that: *“Copyright in a work is infringed by a person who other than pursuant to a copyright license, imports into New Zealand otherwise than for that person’s private and domestic use, an object that is and that the person knows or has reason to believe is an infringing copy of the work.”*

Section 12 (3) defines infringing copy as: *“An object that a person imports or proposes to import into New Zealand is an infringing copy:*

- *If, had that person made the object in New Zealand, that person would have infringed the copyright in the work in question . . . ”*

Section 12: (3)(a) clearly covers parallel imports and in conjunction with later legislation - The Copyright (Border Protection) Regulations 1994, Section 144 (5) and 1 (2) - strengthen the restriction of parallel imports. In addition, the 1994 Copyright Act substitutes civil for criminal penalties for parallel importers. It is now the responsibility of the copyright owner to inform New Zealand Customs that goods are being parallel imported into New Zealand (notice forms are to be accompanied by a fee of \$1,631) and to take civil action against an importer.

It is worth noting that the Copyright Act 1994 prohibits parallel imports except for private use. However, the legislation does not make a distinction between an “end user” and “private use”. This means that libraries and educational institutions, for example, are not exempt from this restriction.

This area of New Zealand law has been the subject of several reviews by the Ministry of Commerce in the last few years. These have always been contentious, with strong pressure to maintain the existing copyright protection. However, the Ministry of Commerce has expressed some concern that the current copyright protection may be overly strong. In 1997 the Ministry of Commerce initiated a review of these controls. One of the catalysts for this was threatened action by a major car manufacturer (Chrysler), in respect of used imports and parts. However, backgrounding this, have been a number of High Court decisions and consent orders granting injunctions to restrain the importation of such products as jet skis, heavy trucks, chainsaw chains and even second-hand snow boards and skis. The latest the Ministry of Commerce review was carried out in 1998 under contract by the New Zealand Institute of Economic Research. The Institute conducted a series of face to face interviews with parties from both (pro and con) sides of the parallel import ban. As a result of the discussions and reviews, the New Zealand Government, in its 1998 Budget, removed the ban. Previously, the Copyright Act 1994 disallowed parallel importing unless it was for a person's private and domestic use. Now the Government is removing these provisions completely from the Copyright Act 1994. For example, if a New Zealand entrepreneur finds that he or she can buy Windows '95 in the United States, import it to New Zealand, and sell it more cheaply than other retailers, he or she will now be able to do so without breaching copyright. Because *"the prohibition on parallel importing of goods protected by copyright is a form of import licensing which often prevents New Zealanders and New Zealand businesses from purchasing at world best prices. Removing the prohibition will mean increased competition, which will mean lower prices and increasing choice for consumers. As part of the Government's strategy to promote an open and internationally competitive economy, we will be removing the prohibition on parallel importing of such goods that are protected by copyright. Copyright holders will still be protected. The maximum fine for importing pirated goods will increase from \$50,000 to \$150,000"* (New Zealand Treasury 1998).

The recent NZIER (1998) review found that liberalised import laws would generally benefit consumers. Books, for example, cost up to 30% more in New Zealand than elsewhere, and copyright holders do not supply all titles. Parallel importing should bring these prices down, as well as broaden the range of books available for local sale.

Although the Copyright Act 1994 is the statute that has been most commonly used to prevent parallel importing, and this amendment allows considerable parallel importing, other restrictions remain in force. For example, if the goods in question have a trademark, or they are patented or registered as a design, there are some remaining restrictions on parallel importing. There may also be other restrictions on importation, such as under the Medicines Act 1981, etc. However, these are beyond the scope of this research and will not be discussed.

2.3 The process of parallel imports

Goods imported in parallel, also known as grey goods, are genuine products that are imported without the authorisation of the trademark or copyright owner in a country. In other words, parallel importation takes place when a third party acquires branded goods from a source other than the producer of those goods, imports such goods into a country and sells them directly to the public, or sells them to retailers who then sell them directly to consumers.

Parallel imports affect a wide range of industries, spreading from traditional luxury and brand-name consumer products (wines, cameras, and watches) to industrial products. Industry sources estimate that parallel imports account for 10% of IBM's PC sales, 20% of Sharp's copier sales, and 20% to 30% of the world cosmetics and fragrances sales (Ahmadi and Yang, 1995). Belgium, for example, despite the fact that it has no automobile industry is a major car exporter in Europe—more than 25,000 cars some years. This export success story is because cars are cheaper in Belgium than in nearby countries, due to tax differences (Weigand 1991).

Another trend relating to parallel imports, is that this has evolved from basically a U.S. problem in the 1980's into a world-wide phenomenon in the 90's (Ahmadi and Yang, 1995). When the U.S. dollar was strong, during the 1981-1986 period, the number of cars purchased in Europe by U.S. tourists grew 2,000%. In 1986 the total value of products distributed through unauthorised channels in the U.S. reached a peak of \$10 billion (Palia and Keown, 1991). This direction was reversed in subsequent years as other parts of the world, especially Asia and Europe, experienced rapid appreciation in their currencies and a corresponding surge of parallel imports (Ahmadi and Yang, 1995). A 1991 survey of U. S. exporters to Asia showed that 41% of 141 respondents reported having problems with parallel imports in the past five years (Palia and Keown 1991). In 1990 pharmaceutical parallel imports in the European Community stood at \$500 million (Lynn 1991, quoted in Ahmadi and Yang, 1995, p. 3). In an increasingly integrated world, the annual growth rate of parallel imports has been estimated to be 22%, and this is expected to rise as new trade agreements, like NAFTA and GATT, further lower trade barriers across nations.

Since parallel importation yields a net profit to the parallel trader, such practices obviously, take place. There are essentially two reasons why parallel imports occur in international markets. The parallel import or "grey market" exists because foreign manufacturers practice price discrimination among countries and grey market sellers arbitrage these price differences. Second, parallel importers are more efficient than authorised sellers because parallel imports compete with the goods of authorised sellers, in turn leading to lower prices that are beneficial to consumers.

Those favouring parallel imports argue that international price discrimination or distribution inefficiencies in authorised distribution channels artificially restrict competition to the disadvantage of consumers in countries having higher prices. They say that parallel imports foster competition and efficiency, thus benefiting consumers in importing countries.

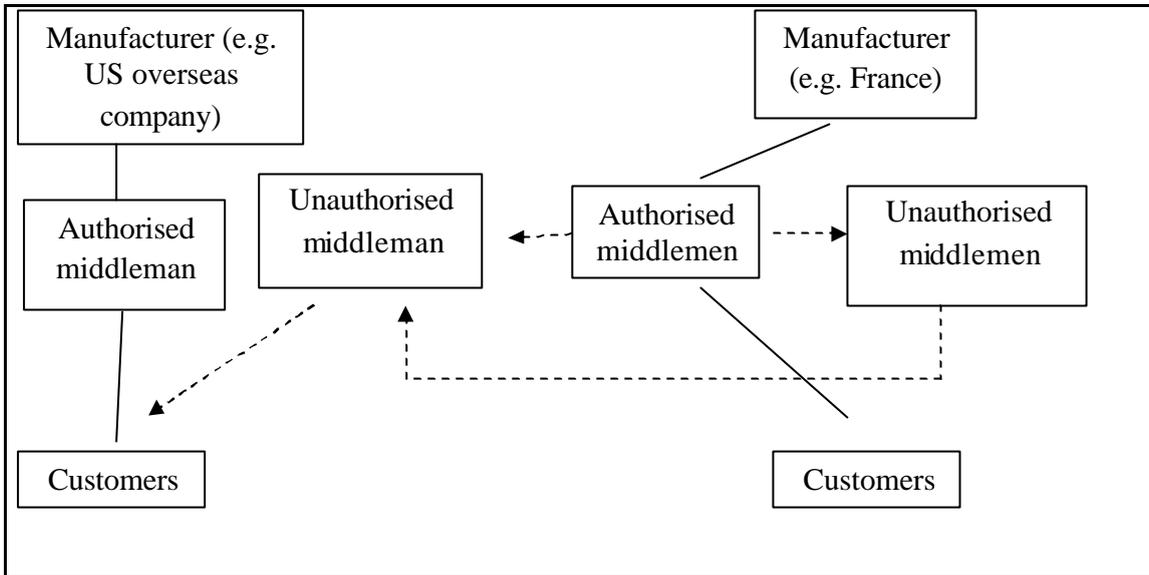
Some researchers argue that, while it is clear that active parallel imports cannot exist without price differentials between countries, the source of these differentials is not quite so apparent (Weigand, 1991). Depending on the type of goods involved and the character of the market for the product, price differentials can be the result of a variety of factors, several of which are likely to exist in every case. These factors can range from honest enterprise, such as a diverter who takes advantage of favourable foreign currency exchange rates and engages in a sort of product arbitrage, to a manufacturer who attempts to discriminate by price in different (usually foreign) markets. Finally, the sale of quality, cancelled-license or distressed goods can also be considered an arguably honest endeavour that place goods into a parallel import category.

A more questionable strategy in regard to parallel imports, is free riding or the practice of selling goods identical to those sold by full-service dealers without incurring the expenses of promoting and servicing the product. Such free riding falls into two categories: advertising free riding and point-of-sale free riding. An advertising free rider takes advantage of the advertising and marketing efforts of authorised sellers, reaping consumer recognition and other benefits that flow from this advertising without incurring the attendant expense.

The second but distinct form of free riding, point-of-sale free riding refers to the failure of an importer to provide various ancillary services that consumers desire. Such services range from product instruction, to the maintenance of an inventory of spare and auxiliary parts, or the provision of warranty or repair services. Another type of free rider may also sell trademarked goods without taking sufficient safeguards to ensure product integrity. For example, by compromising on packing, transportation, storage, or inspection costs in order to keep the price of goods lower.

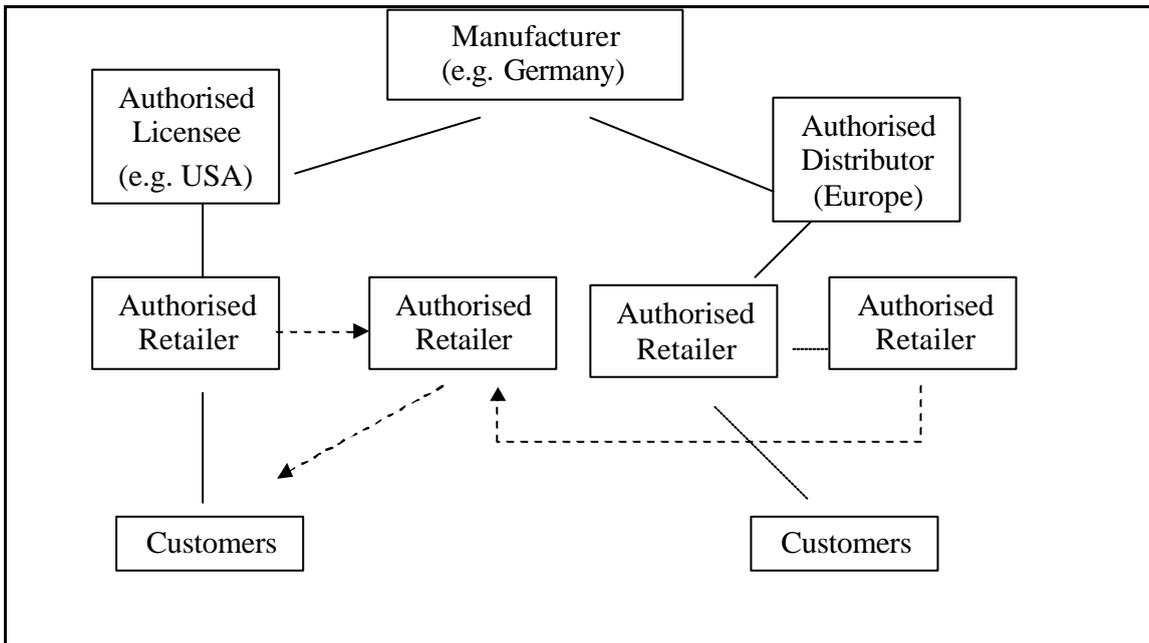
Therefore, in regard of the process of parallel imports, there is no end to the imaginative ways used to bring parallel imports to market. Four methods, however, represent the bulk of market imports and are focus of much of the economic and legal attention. First, are those products made overseas by for example American firms (see Figure 1). These foreign units may be subsidiaries, joint venture companies, or some other entity which have a commonality of interests with the American company. This foreign affiliate may sell to nearby authorised distributors, for example, a French firm. Somewhere in the authorised channel, however, distribution control is lost and the product gets into an unauthorised channel and some of it is exported back to the United States. Here it competes with identical domestically produced products.

Figure 1. First case of the parallel imports process



Source: Weigand, E. R. (1991) p. 54.

Figure 2. Second case of the parallel imports process



Source: Weigand, E. R. (1991) p. 55.

A second method (depicted by Figure 2) of parallel importing is when a foreign manufacturer (e.g. German) licenses a company to be the exclusive importer of a product bearing a foreign name or trademark.

That company registers the foreigner's name and becomes the legal trademark owner in their own market and agrees to pay royalties. Now, suppose that a third party trader purchases this same product which was intended for a third market. They then ship the product to the licensee's market as parallel imports.

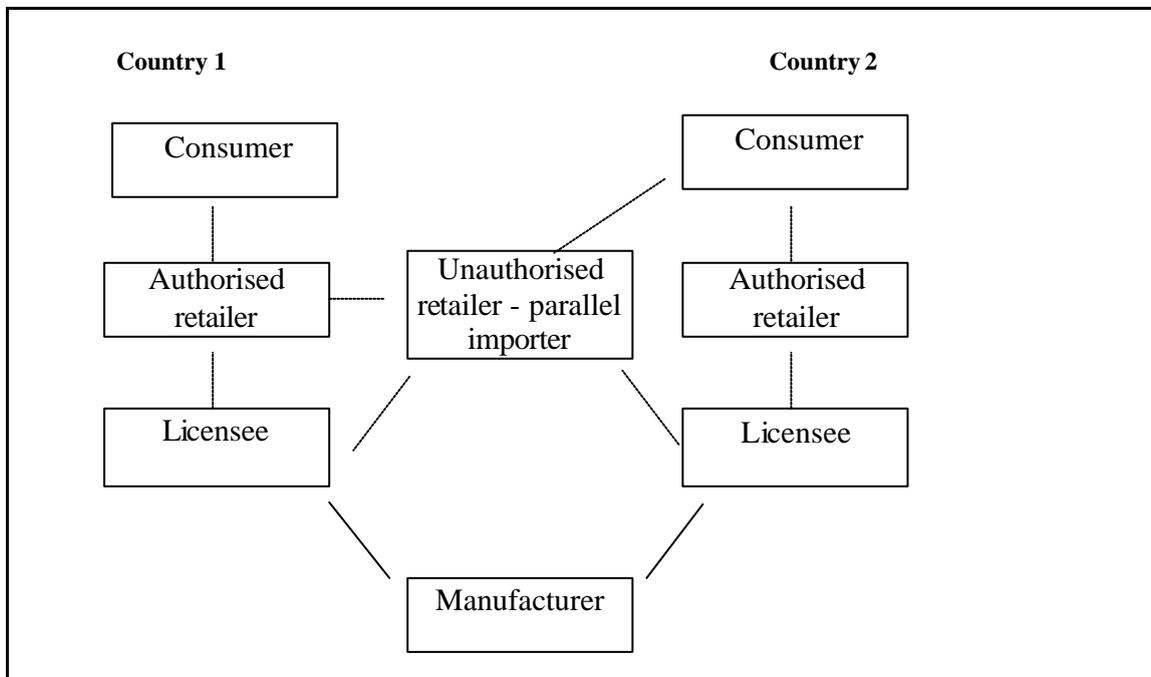
A third possibility of parallel importing arises when a manufacturer exports from its producing plant, only later to have the exports diverted back to the home market. This parallel importing strategy is known in official import statistics as re-importing.

Re-importing is particularly attractive when:

- the manufacturer's strategy is to sell into the foreign market at a substantially lower price than in the home market, due either to the market being poorer or there being dramatic exchange rate differences, and
- the foreign market is geographically close to the home market, thus minimising return transport costs.

This way of importing in parallel may also be developed on premises that an active parallel import cannot exist without price differentials between international markets. Figure 3 illustrates this. It shows a two-country representation of product flows along a manufacturer-distributor-retailer-consumer channel. When parallel importing occurs, products are leaked from every possible level of the supply chain, and an unplanned distribution flow is formed. Sales revenue and profits may therefore be re-allocated across supply chains in different countries, creating tension between the manufacturer and different distributors, which affects the manufacturer's overall profitability.

Figure 3. Third case of the parallel imports process



Adapted from Ahmadi, R. (1995) p. 3.
 Note for Fig. 1-3: Authorised trade _____
 Unauthorised trade - - - - -.

The ability to exploit price differentials appears likely to result in the creation of parallel imports. However, price differentials inevitably invite arbitrage behaviour, if transportation costs, duties and tariffs between the countries are modest or negligible, as is the case in the software industry. Because of a favourable price differential, a parallel importer can enter the market and compete with authorised products. In contrast, if parallel imports are not allowed, buyers have no other choice than to purchase products priced well above the marginal cost in non-segmented markets.

A fourth way of parallel imports is the use of mail orders. This type of unauthorised channel is emerging with Internet development and is a very important source of parallel trade. Retailers and consumers can currently purchase products either from catalogues from large, local retailers or going directly to mail order houses in different market. Anyone with a credit card and access to an Internet-linked computer can order CDs, software, books and whatever from overseas suppliers.

After identifying the variety of parallel importing strategies, the next section discusses the effects of these unauthorised channels.

2.3.1 The effects of parallel channels

There are a number of effects of all of this parallel importing activity. Here, the predicaments and opportunities created by these parallel distribution channels are discussed in more detail.

First, consumers may be prejudiced against buying products which have been parallel imported because sometimes they cannot be properly serviced or maintained. They also may be worried that the so-called technical requirements for certain products may not met by grey importers.

It needs to be made clear that parallel imports are not counterfeits but genuine products that are often sold at a lower price to consumers than these distributed by regular channels (Ahmadi and Yang, 1995). However, these may not necessarily have a lower profit margin because they can free ride on the promotional efforts of authorised dealers. Consequently parallel imports may undermine authorised dealers' selling efforts. For example, by discouraging their investment in a sales-force or shelf-space.

In other words, parallel imports may have financial consequences for licensed distributors, if they do not derive sufficient revenue from the sale of these branded goods. In such instances they may not be able to continue with their advertising and promotional efforts.

Parallel importing of trademarked goods may also create confusion for consumers (e.g. recently a bulk store chain "The Warehouse" imported in parallel in New Zealand Phillips TV sets, Calvin Klein's cosmetics and jeans, etc). However, some authors argue

that because parallel importers sell genuine trademarked goods there is no possibility of confusion about the origin or source of the goods. Although, modern trademark law does not support this view, involving an unauthorised channel or outlet increases the likelihood of consumer confusion about product source and quality.

The “source function” of a trademark encompasses more than the geographic origin of goods. As a result of modern marketing and distribution techniques, consumers perceive a “genuine” article to be those from the wholesaler, retailer or servicing company they have been able to rely on in the past. The authorised distributor is in effect the “sponsor” of the trademarked good, providing many ancillary services. Consumer confusion is possible if the parallel importer does not disclose that they are not the authorised distributors or they do not offer the same warranty protection or services, which the consumer has come to expect.

The “quality function” of the trademark does not replace the “source function” but stands alongside it as a “guarantee” of consistent quality. In the grey market, genuine trademarked goods possess identical product quality when shipped from the factory. Product quality, however, is not simply measured at the factory, it is also determined at the time of retail sale. Many trademark owners thus invest in their product by careful shipping, storage, inventory control, and quality management. This investment is a natural adjunct of their desire to build and protect the reputation of their product. In contrast, grey marketers may unknowingly or unknowingly sell inferior products because they provide less quality control and have less incentive to make these expenditures. Inferior products however, confuse and deceive consumers and may negatively impact genuine products and their image.

Manufacturer-distributor relations can also be strained by the appearance of parallel imports. Distributors feel frustrated by having them in their markets and look to the manufacturer to reduce or eliminate this unforeseen competition. Manufacturers profits also may decrease because of parallel imports. Sometimes they may be forced to buy back old stock from authorised distributors because parallel importers create an over-supply in the market.

Despite the problems caused by parallel imports, there are also opportunities for consumers and for manufacturers as well.

- *“There is some evidence to indicate that parallel import channels from the United States have been used to penetrate foreign markets.*
- *Some United States’ manufacturers recognised that parallel channels could be used to increase overall foreign sales and market share” (Michael, 1998).*
- Furthermore, when a final decision on an exclusive distributorship was pending, a parallel channel gives the manufacturer an opportunity to evaluate one distributor against another.
- Parallel channels may help overcome a weak distributor’s performance at no additional costs to the manufacturer.

- Sales that go through parallel channels may expand a manufacturer's market coverage if the authorised distributor lacks the capacity for covering the whole market. This situation may be very common in developing markets where distributors often lack the financial and marketing resources to effectively push and pull products through the distribution chain.
- *“Parallel channels may also help to identify consumers in foreign markets whom the manufacturer may not be aware of”* (Ibid, p. 30).
- However, by far the most interesting opportunity created by parallel imports is when manufacturers use it to circumvent trade restrictions. In other words *“non-tariff trade barriers exist in the form of quotas or import licences, the authorised importer has limited sales opportunities. The parallel exporter, who sells to a different importer under separate quota or license, provides the manufacturer with additional sales* (Ibid, p. 30).

The next section now examines the available strategies for combating parallel imports.

2.4 Combating parallel imports

The problems posed by parallel or “grey” imports have become a hot topic in international intellectual property law and business planning.

The issue of parallel imports is a contentious one throughout the Western world. Intellectual property law is usually the instrument through which these activities are curtailed. This is achieved via the Copyright Act. Trademark law also has a role in preventing the unauthorised marking and selling of a product with a trademark. Frequently, however, this does not remedy the situation as the products bought by parallel importers are marked by the manufacturers for export to other countries and therefore infringement does not occur.

As it has been noted earlier, parallel imports, however can have a devastating impact on the orderly marketing of new products by allowing unauthorised vendors to undercut the sales prices of authorised goods, or hurting a brand's reputation through non-compliance with local market requirements or disruption warranty support. Because parallel imports may be cheaper, the exclusive licensee feels that their agreement has been violated, their business threatened, and that these unwelcome competitors have taken advantage of “free rider” benefits from the licensee's investments in brand and market developments. On the other hand, it has been argued that excessive protection against grey market products restrains competition, thereby harm consumers and unduly rewarding IP rights owners who fail to exercise reasonable care in policing their licensed operations.

What can the licensee do to protect their territory from unwanted, grey market imports, which were legally sold in the exporting country? The legal obstacle a licensee faces with

these imports is suggested by the term itself - they fall into a “grey” area of intellectual property and trade law. That is, they arise because of the existence of differing, and at times inconsistent, national intellectual property rights and trade remedies rather than uniform international rights.

National laws governing parallel imports are often unclear. In the past, many courts have adopted a lenient attitude towards these goods based on the belief that the consumer is not hurt and there is no readily apparent wrong. After all, if the goods are sold and were at one time lawfully manufactured, what's the problem? This type of reasoning by the courts has limited and made less clear the legal remedies available to licensees with regard to trademarks. In contrast, there seems to be a greater willingness by courts to protect copyright or patent licensees that are threatened by parallel imports. The result of all of this is a confusing patchwork of national laws. This area really needs to be examined in great detail but it is well beyond the scope of this economic analysis.

Despite the obvious opportunities created by parallel imports, manufacturers mainly prefer to have fewer or no parallel imports in order to gain more control of their marketing efforts. However, manufacturers rarely take reactive measures to prevent the emergence of parallel imports. In fact, they mainly rely on authorised distributors to detect parallel imports.

In effect, parallel importing goes beyond issues of product distribution through controlled or uncontrolled channels. Rather, it raises two broader questions. First, whether channel control will increasingly rest with powerful retailers who earn the allegiance of customers, thus allowing them to dictate the terms under which merchandise is presented to consumer markets. Second, whether manufacturers can find the financial, legal, and marketing power to persuade institutional middlemen to remain part of a loyal channel team.

However, the main means of combating parallel imports still reside with in manufacturers. Pricing has been a common mechanism for doing this. Frequently manufacturers frequently use the following pricing schemes:

- Uniform pricing (one-price-for-all policy)—setting prices in all countries exactly the same;

There are many ways to halt or hinder parallel importation, however, the single most effective is to modify international price structures so those parallel traders cannot arbitrage. For example, one can hardly find any parallel imported Coca-Cola products in Taiwan because authorised dealers reduced retail prices significantly (Chang, 1993). Similarly, Weigand (1991) reported that the share of parallel imported BMW automobiles declined from 33 per cent to about 16 per cent in Japan after the retail prices in authorised channels were reduced (almost seven times of the set up selling price) to nearly the same level as in Germany.

This *one-price-for-all* policy can eliminate an important source of arbitrage and allow the manufacturer to reassert a measure of channel control. Nevertheless, this policy often

means the sale of most of the output at lower prices to *all* customers, whether they are big or small, and regardless of transaction costs. This strategy though often forecloses valid price discrimination opportunities among classes of customers who are buying very different benefits from the same product (Weigand, 1991). While price may be the main criterion for some customers, for others continuity of supply and aid in application development may be more important. This strategy is a Darwinian “survival of the fittest approach”. While it may be the answer in the short term, in the longer term it can limit the manufacturer’s access to new and growing market segments and discourage distributors from supporting a manufacturer that refuses to recognise differences in distributors’ market power. This strategy also, may not eliminate arbitrage opportunities. Since cost differentials and different reseller strategies also give rise to grey markets, and may make it harder for the manufacturer to alter its distribution strategy as changing market conditions require.

- A fixed price gap equal to the transshipment cost between countries.

Reducing the price differential between the authorised and grey market product (as a variant of a *one-price-for-all* policy) is a powerful tool for reducing the attractiveness of the parallel import. The issue quickly becomes a standard exercise in pricing—determining whether the manufacturer takes the brunt of the price reduction or if it is shared with authorised intermediaries.

- Price in strong currency

Another effective measure is strong currency price in foreign markets. The most common reason for this practice is to hedge against a currency’s deterioration. However, a second and much less common reason for quotes in strong currencies is to reduce opportunistic parallel import sales.

In addition, there are several non-pricing strategies that may be used to prevent or lessen parallel imports. The following section addresses this matter in relation to environments without parallel import ban, as in New Zealand.

- Product differentiation

Manufacturers often differentiate their products among markets, usually to meet different local tastes, national health or safety rules, packaging requirements, technical standards, income levels, and so on. Products that are likely parallel import candidates are sometimes accompanied by limited warranties that can be used only in the markets for which the product was intended. These may be particularly important to customers where an item is expensive, the manufacturer’s reputation for quality is not well known, the retailers are untrustworthy or unknown and the customer knows there are hidden or complex features of the product that are not readily observable. Proper labels and warnings may also be used to assure public of product’s health and safety, but clearly can also be used to thwart unauthorised parallel importing (Knoll, 1986).

- Packaging changes

A simple strategy in response to parallel imports is to create slightly different packaging for authorised products. This option is relevant, whether the packaging is similar in both

countries, the marking that appears on the product and the message given to consumers (Knoll, 1986).

- “Work out laws”

Here are some examples of how imaginative business strategists have helped preserve their marketing channels by “work out laws”. Weigand (1991, p. 59) cites this example: *“the pharmaceutical company that was shipping its product to a central American country only to learn that it was coming back to the United States, solved the problem rather easily. On products destined for export, it omitted the tiny crimp numbers from the bottom of plastic tubes containing its medicines. The Food and Drug Administration requires such numbers that indicate FDA approval. The company simply told Customs what to look for.”*

Another example cited by Weigand (1991) is the case where the National Highway Traffic Safety Administration mandated that cars subjected to high theft rates must have identifying numbers indelibly marked on as many as fourteen parts. Thus, if a junkyard has in its inventory a left front fender, decklid, or transmission from a Ford Mustang or Dodge Lancer, the potential customer can know whether the part came from a legitimately junked car or from one reported stolen.

- Dealer dismissal

Perhaps the most powerful reactive strategy available to manufacturers who prefer to sell directly is to stop an opportunistic intermediary. However, because to achieve this can be very costly manufacturers must exercise caution in some countries than others.

- Product buy-backs

A few manufacturers have bought back parallel imports items, as a way of combating unwanted distribution competitors. Under certain circumstances, this may be an effective strategy. The most important rules for achieving this are to establish a channel monitoring system to provide information about how the goods move between producer and retailer, and to monitor these searching costs which can be large.

- Disenfranchisement

Disenfranchisement of offenders is a stock response. For example, in an effort to identify suppliers of unauthorised dealers, Lotus Development Corporation recorded the bar-code numbers of its popular 1-2-3-software packages as they were shipped out. Meanwhile, Lotus employees checked advertisements to locate unauthorised dealers and occasionally had shoppers buy the company’s products from mail-order houses and other grey outlets. Eventually Lotus eliminated from its list those distributors doing business with grey marketers and put a temporary freeze on agreements with new distributors (Cavusgil and Sikoru, 1988). Such moves send signals of commitment to distributors who abide by the terms of their franchise agreement. These signals often are in response to complaints from them. Tracking down offenders, however, costs money. Lotus spent more than \$100,000 on the system it developed to label their products and to monitor sales.

Moreover, the manufacturers that selectively disenfranchise dealers run the risk of being sued (Cespedes et al, 1988).

- Adding distributors

Adding distributors (former parallel import distributors) to the network can be a solution to this problem. By limiting circulation of a popular item to a few dealers, a supplier may inadvertently create demand that can be satisfied only through transshipment to “grey” outlets. Alternatively, a supplier’s dealer service criteria may be unnecessarily high, discouraging dealers from servicing price-sensitive markets and from joining the suppliers’ network. Franchising more distributors may give a supplier better control over the flow of their product to market.

- Local goodwill and brand loyalty

Marketing has suggested that pricing strategies are an ineffective way to compete with non-pricing strategies such as brand loyalty and local goodwill. In regard of parallel imports, it is important to know whether the local seller of products has established brand loyalty and goodwill from local manufacturers, exclusive local distributors, or local warranty or sales force. Another way of looking at local goodwill is question whether consumers would be misled or deceived by outside importation. This may be because a product does not come with a local warranty; the products are not the same and therefore cannot be serviced in the same way. Also, the labelling or instructions may not meet local codes, regulations or packaging standards.

- Licensing and registered user arrangements

It is important to determine the basis of the license if the trademarks are commonly held and used under license in a country. It is particularly important to have the licensee registered as a user, which appears to grant to an exclusive registered user the right to prevent importation of goods in violation of its exclusive arrangement.

- “No-export clause”

This refers to the inclusion of a no-export clause for a manufactured product under a compulsory license, so that the subsequent distribution of the product in another market can be legally prohibited.

In sum, a marketing manager must employ or develop co-ordinated strategy, linking regulated pricing, the legal framework governing a marketing environment, and anti-grey importing efforts to facilitate managerial control of unauthorised channels.

Marketing success has what initially bred parallel imports. Export marketers, and distributors need to assess the possibility of parallel channels being formed for their products and the potential impact these may have on their business, before considering an appropriate strategic response to combat parallel importing.

This section has identified the different types of price discrepancies that can encourage parallel importing. It also noted the benefits that can accrue to distributors and manufacturer from such parallel imports. Finally, recommendations were made to counter the adverse effects of parallel channels. In the following section the future of parallel imports is discussed.

2.5 Future of parallel imports

Rapid advances in communications, open networks (Internet), service provision frameworks, multimedia technologies, inter-operable distributed technologies, object-oriented and agents-based technologies, and interactivity have been opening and providing new opportunities for businesses and new ways of doing business electronically. Internet-based electronic commerce, which is still in its infancy, in particular, is set to burgeon over the next few years and transform the way world trade is conducted, especially in services. By 2000, the global value of goods and services transacted over the Internet is estimated to be around US\$100 billion to US\$150 billion per year. (Quelch and Klein, 1996, p. 2)

In recent years, networked organisations have been recognisable trend. These changes have been driven by market demand for flexibility, management strategies that focus on core competencies, and customer expectations of global organisations. New concepts such as “the virtual enterprise” have provided frameworks for companies to co-operate in increasingly intimate ways. Earlier organisational concepts, such as “the supply chain”, implied boundaries across which products were exchanged for money. Intermediaries or parallel importers are now breaking down these boundaries in order to create an optimum environment for the so-called “value-chain” and with it greater competitive advantage.

The trend towards the globalisation of markets, which is being facilitated by the development of a global communication system, envisages the end to domestic territoriality because of global competition. Similarly, Weigand (1991) pointed out that “*customer and supplier networks operate world-wide, blurring geographic and political barriers and making them increasingly irrelevant to business locations.*” What is perceived is a world becoming much alike and that the globalisation is a trend that may not be deterred. Because of the speed of new technologies and communication developments, parallel importation may be a short-term phenomenon.

The impacts of globalisation on parallel importation are two folds. First, as trade barriers between nations decrease, it will become more difficult to implement price discrimination policies based on country boundaries. Implicitly, parallel traders are therefore likely to gradually disappear, as there will be fewer opportunities for arbitrage. The issue of parallel importation may therefore become less significant as globalisation continues.

Traditionally, under international law, nations have asserted sovereignty based upon the territory that they legally control. Advances in electronic communications, including the Internet, however, have begun to change this. This development suggests that, rather than

sovereignty based on territory, sovereignty will be based on information flows or economic spheres of influence will become the norm in cyberspace. This hypothesised shift will however, require a re-evaluation of present legal doctrines. Since, as Baldwin (1996) points out the present intellectual property provisions, such as copyright, display significant gaps in their coverage when stretched to fit this new jurisdictional terrain.

These bases for asserting future jurisdiction, however, have been controversial, and are likely to be even more so in the uncertain arena of computer networking. It is unlikely that the world is ready to accept this suggestions since it is so far removed from what is currently exists, and statutes based on non-territorial sovereignty and loosening role of the governments are likely to be premature.

Nevertheless, when the world economy becomes far more globally integrated, which is likely in a digitally based economy, it becomes necessary to harmonise the different transactional rules between nations. This means policy co-ordination among different governments will be a critical step in achieving this.

2.6 Conclusion

This study analysed the process of parallel importing to aid understanding of the wider parallel import issue.

In this study how parallel imports are treat by the New Zealand Copyright Act 1994, were discussed. The process of parallel importing, what create this and the opportunities it provides were also outlined. In the final section, strategies to combat parallel importing were presented. The future of parallel importing was also analysed, in the light of the emerging digital age and electronic commerce. It was concluded that, due to rapid advances in communications, networks, multimedia technologies, interoperable distributed technologies, and interactivity, parallel imports may eventually become obsolete. What is particularly important to keep in mind is that all these technological advances create new business models, such as these that were suggested without political or trade barriers.

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