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Parallel Imports: Challenges from Unauthorized Distribution Channels

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Abstract

We examine the problem of parallel imports: unauthorized flows of products across countries, which compete with authorized distribution channels. The traditional economics model of a discriminating monopolist that has different prices for the same good in different markets requires the markets to be separated in some way, usually geographically. The profits from price discrimination can be threatened by parallel imports that allow consumers in the high-priced region some access to the low-priced marketplace. However, as this article shows, there is a very real possibility that parallel imports may actually increase profits.

The basic intuition is that parallel importation becomes another channel for the authentic goods and creates a new product version that allows the manufacturer to price discriminate. We propose a two-country, three-stage model to quantitatively study the effects and strategies. In the third stage, and in the higher priced country where parallel imports have entered, we characterize the resulting market segmentation. One segment of consumers stays with the authorized version as they place more value on the warranty and services that come with the authorized version. Another segment switches to parallel imports because a lower price is offered due to lack of country-specific features or warranties. Parallel imports also generate a third and new segment that would not have bought this product before. Unlike counterfeits that are fabricated by imitators, all parallel imports are genuine and sourced from the manufacturer in the lower-priced country through authorized dealers. Therefore, the manufacturer's global sales quantity should increase, but profit may rise or fall depending on the relative sizes and profitability of the segments. A profit-maximizing parallel importer should set price and quantity in the second stage after observing the manufacturer's prices in both countries. There will be a threshold of across-country price gap above which parallel imports would occur. In the first stage, the manufacturer can anticipate the possible occurrence of a parallel import, its price and quantity, and its effect on authorized sales in each country to make a coordinated pricing decision to maximize the global supply chain profit. Under some circumstances the manufacturer should allow parallel imports and under others should prevent them. Through a Stackelberg game we solve for the optimal pricing strategy in each scenario. We then find in one extension that when the number of parallel importers increases, the optimal authorized price gap should narrow, but the prices and quantities of parallel imports may rise or fall. In another extension, we find that when the manufacturer has other means—such as monitoring dealers, differentiating designs, and unbundling warranties—to contain parallel imports, the authorized price gap can widen as a function of the effectiveness of nonpricing controls.

In summary, parallel imports may help the manufacturer to extend the global reach of its product and even boost its global profit. If the manufacturer offers a discount version through its authorized dealers, it is running a high risk of confusing customers and tarnishing brand images. Parallel imports may cause similar concerns for the manufacturer, but unauthorized dealers are perceived as further removed from the manufacturer. Therefore, there is less risk of confusing consumers when parallel imports are channeled through unauthorized dealers. Furthermore, they are more nimble in diverting the product whenever their transshipment and marketing costs are small enough not to offset the authorized price gap and the valuation discount. This may explain why some manufacturers fiercely fight parallel imports, while others knowingly use this alternative channel.
(*International Marketing*; *Parallel Imports*; *Pricing*; *Intrabrand Competition*; *Channel Conflict*; *Stackelberg Game*)

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