THE ELEPHANT IN THE ROOM

MARTYN FISHER DISCOVERS WHAT STRATEGY WHOLESALERS NEED TO FOLLOW WHEN IT COMES TO BUYING GREY-STOCK.

The so-called 'grey' market has been around for decades. Wholesale consultant Martin Williams, the former managing director of buying group Landmark Wholesale, calls it "just a fact of life". It is also something of an elephant in the room, left there as the industry goes about its business, apparently reluctant to tackle the matter.

It is not just smaller players in the wholesale channel who shop in the grey market. Accounts published by administrator PricewaterhouseCoopers show that wholesale giant Palmer & Harvey (P&H) had a number of grey-stock items on its books when it went under. Indeed, several grey-stock wholesalers are owed significant sums of money and could collapse as a result of P&H's demise. This is despite the fact that, in many cases, manufacturers reach agreements with wholesalers to stop them from buying grey-stock.

James Bielby, chief executive of the Federation of Wholesale Distributors (FWD), is suitably troubled: "Our concern as the representative body for wholesalers is that while our members operate transparently and legally, other wholesalers do not. Success in the channel requires wholesalers and suppliers to be open with each other about sourcing and prices."

So what is the most sensible grey-stock strategy wholesalers should adopt?

SUGAR TAX

David Lunt, retail director at buying group Confex, thinks that the term grey-stock is a misnomer. "Reference made in the wholesale and cash & carry arena to grey-

> ***Success requires wholesalers and suppliers to be open with each other about sourcing and prices***
> ***James Bielby***

Many wholesalers shop in the grey market because of the additional margin available

stock does not reflect the true description, which is open market pricing," he says.

Nevertheless, 'grey' in this context has an immutable presence in the wholesale lexicon. While this is unlikely to change, it would appear that wholesale's relationship with the grey market is set for a new chapter.

From 1 April, the new soft drinks industry levy – commonly referred to as the 'sugar tax' – is set to add a new layer of cost onto fizzy drinks products containing more than 5g of sugar per 100ml. With soft drinks and confectionery the two primary categories in which grey-stock is popular, there is a risk that some wholesalers will seek to boost their share of margin by buying stock from overseas companies.

Scores of FMCG manufacturers would not discuss the topic of grey-stock at all. However, one admits that the tax may have some bearing on this: "I think the fact a lot of manufacturers will not speak about the subject is tacit acknowledgement that the situation is about to get worse once the soft drinks industry levy comes in," he says.

Emphasising this point, FWD's Bielby notes: "The grey market is about to become a lot greyer in soft drinks, as the new rules on UK sales of high-sugar products will effectively make the importer responsible for paying a levy of up to 8p per 500ml to government. That differential will make imported products appear more attractive, but failing to pay the levy on imports into the UK makes the deal black market rather than grey.

"Our concern is that this creates an opportunity for unscrupulous importers and wholesalers to undercut FWD members by evading the levy, and we are seeking assurances from HMRC that a regime will be in place to police this potentially devastating criminal activity."

It is not illegal, but it is a nuisance. Suppliers have the answer to this problem, but they have not laid down strong enough rules

David Gilroy

WHEN ONE DOOR CLOSES

How has it reached a point where myriad wholesalers – including the likes of P&H – shop in the grey market? Phil Jenkins, the former managing director of wholesale buying group Sugro, who is now working with the business as a consultant, says: "The profitability within wholesale is very pressurised, so the opportunity to purchase secondary stock is always attractive due to the additional margin.

"There are excellent reasons for doing it and for not doing it, and it has been going on for as long as I have been in the industry, during which time people have made a considerable amount of money from it."

David Gilroy, the managing director of consultancy Store Excel, adds: "I see it from wholesalers' point of view – they need to buy from the sources offering the best value possible and in the grey market, cases can often be £2-3 cheaper.

"Grey-market sources also do not have the restrictive minimum order quantities that some suppliers impose, meaning that for some smaller wholesalers, the only way they can buy brands is by buying them off another wholesaler."

However, Gilroy says, suppliers need to "bear down" on it. "It is not illegal, like it is on alcohol and products with duty on them, but it is a nuisance as it disrupts the market and the consumer does not gain from it either. Suppliers have the answer to this problem, but they have not laid down strong enough rules."

Confex's Lunt commends the likes of Coca-Cola European Partners (CCEP), Red Bull and KP Snacks for taking steps to address the grey market, but admits that "when one door closes, another one opens," meaning that the market continues apace.

A SUPPLIER SPEAKS

Those three suppliers – hailed by several wholesalers for taking action to nullify the grey market – did not want to talk to Better Wholesaling about the grey market.

One supplier who did, albeit on condition of anonymity, revealed that her company did not intervene in the grey market, believing it would be "anti-competitive to do so".

She believes the causes of the grey market are complex and numerable, although the common perception is that suppliers are "doing something underhand".

She says: "People talk about it as a negative, but sometimes it is just a way of getting stuff to market. The wholesale food and drink industry has historically grown up because of the discount rebating structures we have. Supply grows in one channel, and then it needs to expand in different channels and markets. So what has happened over time is that as this growth comes, it creates complex pricing models and that is perceived as negative."

She adds: "It ends up being complicated and lacking transparency. It is all very well wholesalers saying, 'Stop it', but they will always take the cheapest price if offered it.

"There are a lot of branded suppliers out there who probably do not even understand it anymore and I cannot see a situation where suppliers try to fix it, as while it would please some customers, it would upset others. There would be lots of awkward conversations, a potential loss of customers and short-term revenue loss. If you are a plc, this is not a way to appease shareholders. As a result, most suppliers look to kick it into the long grass."

WHAT TO DO?

The appetite for change, then, seems minimal. So how should wholesalers approach the grey market?

Confex's Lunt says: "We encourage members not to purchase stock from the open market pricing available, as ultimately this is fuelling the people who continue to drive this agenda. Sometimes, the stock shown is not always what is actually advised and stock can have date issues, the lead time is excessive, and so on."

Where possible, Confex supports its members from the central office to combat this type of activity, and to encourage them to work with manufacturers in a relationship built for the long-term.

Sugro consultant Jenkins notes: "I have always advised wholesalers to buy direct from the manufacturers, as ultimately, they are the ones investing in the channel, and the ones who will be around long-term. When you take the volume away from the brand owner, as tempting as that can be for short-term gains, the loss of trade perceived by the manufacturer can prove problematic in the longer-run. It is tough to turn it down, but always remember that it is a total false economy."

Our anonymous supplier adds: "I think, in 10 to 20 years' time, as channels merge and customers consolidate, FMCG suppliers will have no choice but to redo their pricing models. This is a deeply embedded structural problem.

"It is always good to be as close as you can be to your suppliers, and to understand their needs and challenges, too. Suppliers could do more to empathise with the problems grey causes wholesalers, but it runs two ways."

As she also points out, wholesalers must be aware that the consequence of grey is value being eroded from the market, discounts not being used for their intended purpose, and margin being fiddled artificially.

Ex-Landmark boss Williams concludes: "The problem for wholesalers is that you know that if you do not buy it from the grey market, your competitor will. Until action is taken, it is hard to see how things will change. But prevention is always better than the cure and I hope something comes to pass here."

You know that if you do not buy it from the grey market, your competitor will
Martin Williams