GRAY MARKETING AS AN ALTERNATIVE MARKET PENETRATION STRATEGY FOR ENTREPRENEURS: CONCEPTUAL MODEL AND CASE EVIDENCE

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EXECUTIVE SUMMARY

Gray marketing is said to occur when authentic branded products reach the consumer through marketing channels other than that of the authorized distributor (Weigand 1991). Free-riding was first offered by Tan et al. (1995, 1997) as an alternative explanation for the occurrence of gray marketing. We extend the authors' work to show that free-riding can be an alternative strategy to niching for entrepreneurs contemplating entry into established markets.

Almost exclusively, the existing literature on gray marketing treats the phenomenon as a pricing problem and fails to recognize it as a market entry opportunity for start-up entrepreneurs. The gray marketing strategy is appropriate for start-up entrepreneurs in view of their resource limitations and the risk of being a first-mover in market development. We show in this paper that an entrepreneur can successfully penetrate an established market by following a gray marketing strategy. This is because it can be optimal

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for the incumbent supplier to accommodate the entrepreneur/gray marketer even if the former could force the latter out of the market through aggressive counter actions.

We developed a conceptual model using game theoretic concepts to aid entrepreneurs in understanding the strategic interactions amongst parties involved in gray marketing and to identify the conditions under which entrepreneurs can successfully penetrate a market via gray marketing. The deductive or game theoretic approach, we feel, is most appropriate because gray marketing involves multiple-party interactions and conflicts of interests. As Moorthy (1985) showed, the game theoretic methodology is most suited to analyzing the behavior of market participants in such a situation.

This paper identifies the conditions under which gray marketing would be profitable and sustainable for entrepreneurs. First, by targeting markets that are already well established by the larger firms, the entrepreneurs' risk of failure due to demand uncertainty is reduced. In addition, they need not incur substantial costs for market developmental efforts. Furthermore, the free-riding strategy provides entrepreneurs with the opportunity to enter profitable markets that are currently supplied by larger firms, instead of being restricted to markets ignored or disdained by the latter. Second, entrepreneurs are able to benefit from the second-mover advantages in following the free-riding strategy. As late entrants into the market, entrepreneurs could learn from the experiences of the larger firms and avoid costly mistakes. By imitating the product strategy of the larger firm, entrepreneurs could also achieve cost savings in R&D and product development costs. All these effectively reduce the entrepreneur's cost of entry into the market. Hence, even with limited resource at their disposal, entrepreneurs could still enter the market successfully.

Finally, by following the free-riding strategy, entrepreneurs are able to "nibble" at the market shares of the larger firms. This is possible because of the difficulties and costs faced by the larger firms in countering entries made by the entrepreneurs. Thus, the larger firms are left with little choice but to accommodate the entry of the entrepreneurs into the market. When the costs of countering the entrepreneurs' entry are sufficiently large, the free-riding strategy becomes feasible for entrepreneurs even if they do not posses competitive advantages over the larger firms.

Our paper thus demonstrates that entrepreneurs do have an alternative market entry strategy besides the commonly prescribed niching strategy. It also shows them when such a free-riding strategy would be most beneficial and most likely to succeed. These are further illustrated and supported through two real-life cases involving companies in the luxury cars and cosmetics industries in Singapore.

INTRODUCTION

Entrepreneurs and start-up companies often face resource constraints. They lack financial and manpower resources, do not have wide distribution networks, and do not have the sales volume nor the product range to take advantage of scale and scope economies. All these limit their strategy options (Chaganti 1987; Miller and Toulouse 1986; Wright and Parsinia 1988) and hamper their growth and successes (Vesper 1980; Cooper et al. 1986; Weinrauch et al. 1991; Eden et al. 1997).

The extant literature on business strategies (see, for example, Porter 1980; Grieve-Smith 1990; Collis and Montgomery 1997) often does not specifically address small businesses in that they do not take into account resource constraints faced by start-up companies in their strategy prescriptions (Lee et al. 1999). These researchers often recommend that start-up companies seek out unmet market niches and avoid direct competition with the bigger incumbent firms in order to maximize their chances of success [see, for example, Table 1 of Carter et al. (1994), p. 24–25]. This niching strategy, similar to what Porter (1980) referred to as the focus strategy, is perhaps the one most often advocated in the small business literature (see, for example, Cohn and Lindberg 1972; Kao 1981; Cooper et al. 1986; Rugman and Verbeke 1987/88; Weinstein 1994; Kotler