

A MANAGERIAL COGNITION MODEL OF GRAY MARKET INTERPRETATION

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ABSTRACT

Gray markets are defined as unauthorized channels of distribution that exist in addition to authorized channels of distribution. Why do sales managers, facing gray markets in their geographical, adopt responses of differing intensity? Given the abundant academic and practitioner literature urging firms to counter or eliminate gray markets, why is it that some sales managers respond extremely mildly, to the extent that it seems that they are condoning or at least ignoring the occurrence of gray markets?

This paper addresses these questions by using an issue management approach wherein gray markets are categorized as ambiguous and complex. A complementary framework is that of "sensemaking" wherein managers make sense of certain issues based on issue characteristics and other contextual factors. This paper relaxes three assumptions implicit or explicit in previous gray market research: that gray markets are viewed negatively, that gray markets are viewed similarly across all levels of the firm, and that the manner in which gray markets occur does not affect their interpretation. In this paper, gray markets are assumed to have both negative and positive effects, sales managers of specific geographic territories are the unit of analysis, and the manner in which gray markets occur affects sales managers' interpretations.

The paper develops a typology of gray markets that is based on two levels of two criteria: perceived locus of

gray market creator and perceived locus of gray market impact. The term locus refers to whether the gray product originates from or affects distributors either within or outside of a particular sales manager's territory. The resulting four types of gray markets are then defined as: *external gray markets*, in which there is an outside locus of gray market creator and gray market impact, *inbound gray markets*, outside locus of gray market creator and inside locus of gray market impact, *internal gray markets*, inside locus of gray market creator and inside locus of impact, and *outbound gray markets*, inside locus of gray market creator and outside locus of gray market impact.

The paper then develops hypotheses about the relationship between the type of gray market and managerial interpretation of them. Important moderating variables include the type of compensation incentives for the sales manager—*outcome-based incentives and behavior-based incentives*, and level of dependence on channel member—*high dependence and low dependence*.

Hypotheses are tested using a 3 x 2 x 2 within subjects experiment administered to managers. The study's results provides strong support for the importance of the typology of gray markets in affecting managers interpretation of the gray market. It also indicates how channel dependence and managers' incentives interact with the type of gray market in affecting their responses to gray markets. Implications for theory and practice are discussed.

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