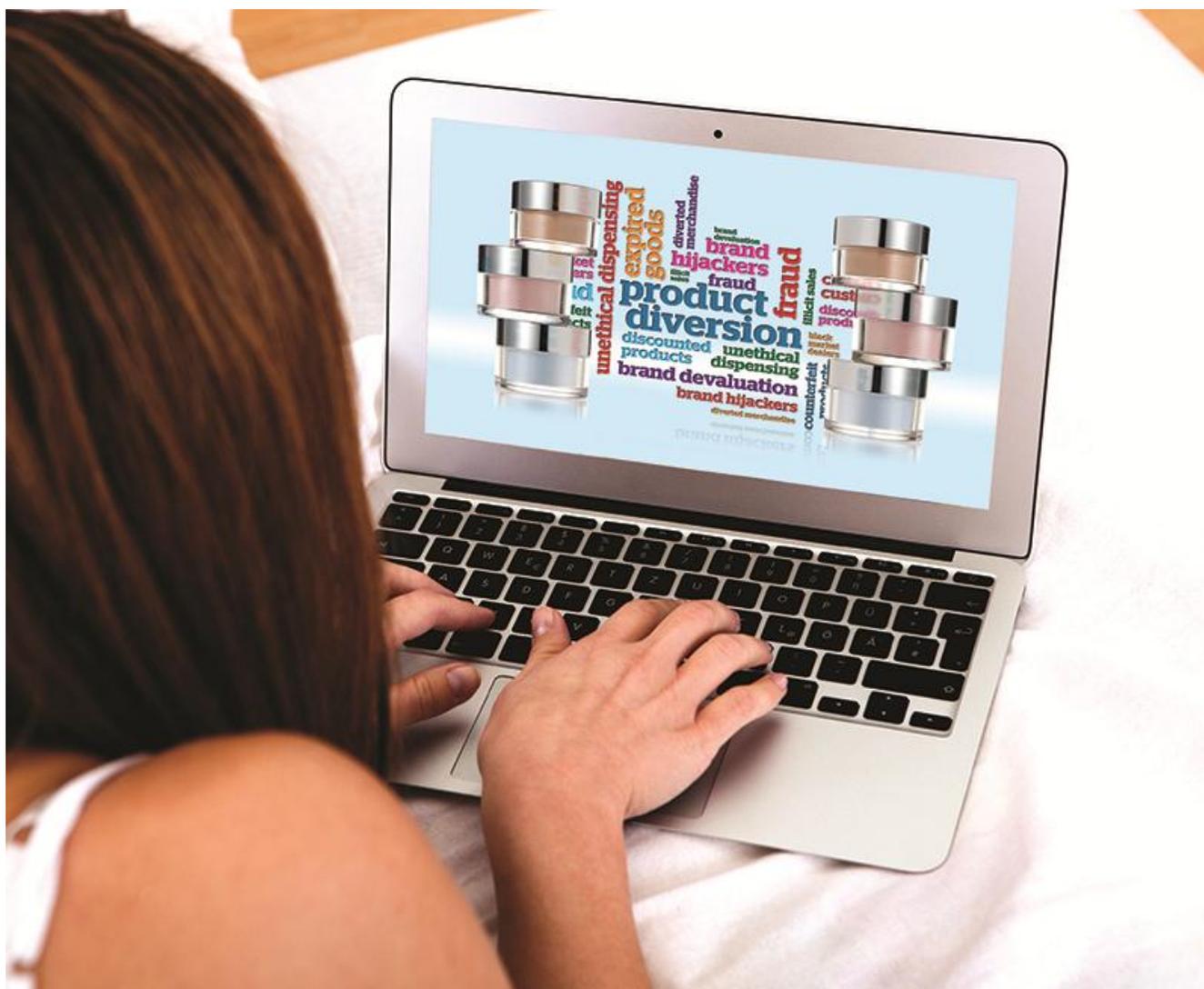


# The inconvenient truth about product diversion

Posted in Topical Treatments on January 30, 2014

Wendy Lewis explains how and why industry leaders are cracking down on product hijackers, and the penalties you may face if you take part in such practices



**Be honest; when was the last time you bought something new on eBay or Amazon at an amazing bargain price? If you did, there is a good chance that the product you bought was diverted merchandise. Diversion is big business today, with annual sales in the US alone reaching into the tens of billions of dollars, and it has become an industry-wide dilemma for professional skincare sellers for a number of years. It has not become an issue for mass-market brands largely because their products are intended to be sold in discounters, drugstores and warehouse chains. However, for professional products, haircare as well as skincare and beauty, it presents a huge issue.**

Diversion refers to merchandise that has somehow shifted away from the intended distribution channel. One of the ways it works is when a seller orders discounted products, fails to sell them all, and then sells off the surplus to a third party without the manufacturer's consent. This practice is illegal when it involves fraud. For example, a diverter orders merchandise ostensibly for sale in a foreign country and loads it onto a cargo ship. The ship sets sail, then turns around and docks in the US, where the goods are then resold.

In some cases, manufacturers may be complicit in the process when they knowingly sell merchandise to diverters in order to hit sales targets, or to unload outdated products that will become obsolete when the new formulation is launched.

# Zero tolerance policy

While selling professional skincare brands online appears to have exploded over the past decade, we are seeing a backlash from leading companies who are committed to controlling how and where their products are dispensed.

ZO® Skin Health is one company that takes the issue of diversion very seriously. As a developer of medical grade skincare available exclusively through contracted physicians, they have adapted a zero tolerance policy on unauthorised sales.

‘We are taking a very hard line against these opportunistic diverters and third party Internet pirates in their veiled criminal activities, no matter who they are,’ says Jim Headley, CEO and President of ZO Skin Health, Inc. ‘Our top concern is the huge risk this illegal conduct poses to consumers and to our physician customers.’ Headley has made this position clear by filing suits against online retailers on unauthorised Internet sales. ‘We are fiercely committed to protecting our reputation for high quality products. We will take legal action against these ‘brand jackers’ to protect the consumer, the physician, and the brand,’ he says.

However, tracking black market dealers is an expensive, time-consuming and often difficult process that not every brand or marketer has the bandwidth for. ‘ZO Skin Health, Inc. has put many mechanisms into place to control diversion of its products, and will relentlessly pursue violators of this policy,’ Headley explains.

The growing worldwide problem of product diversion has heightened the need for skincare marketers to protect their brand philosophy and positioning to ensure that their customers and patients are getting the highest level of quality and safety from their products.

## Ethical dispensing

According to Curtis Cluff, CEO of Envy Medical, ‘Because each of our executives have seen this issue in many forms in the past, we are very tuned-in to the potential for problems. Much of the issue of diversion is fueled by the temptation to save a couple of dollars, or make a couple of extra dollars at the risk of quality or reputation. We simply won’t do that, and we won’t deal with any individual or partners who will. We recognise that it starts right here with us and then is extended by identifying international distribution partners with the highest ethical values.’

Staying on top of where products are sold takes a concerted effort on the part of the manufacturer to be actively involved in the process. ‘We keep a very close watch on the flow of our product by the use of lot-code tracking, and subtle label differences by region to identify when products may be being diverted from one country or region to another, or if a fake product is being made and sold as if it were ours. For example, we recently discovered a facial device copy manufacturer operating in Asia, and worked with our IP litigation firm to quickly serve notice to the offending company, who promptly complied with our cease and desist. The quality of the devices they were making were very poor, but that was not readily apparent to a buyer at first,’ says Cluff.

The same holds true for skincare products, whether cosmetic, over-the-counter, or prescription. Cluff adds, ‘If you are being offered a deal from someone other than the actual manufacturing company, and it seems too good to be true, it should be a big red flag. Those who buy without checking with the company that is supposed to stand behind the product, do so at their own peril. If someone tells you they have a product for sale at deep discounts, or a product that is exactly the same as a branded product, the best advice for the sake of your customers and your reputation is to walk away.’

## Chain of custody

According to Cluff, ‘We have developed superior products at an attractive price and we support that pricing structure globally, which substantially limits the opportunities for arbitrage dealings in the grey markets. One of the ways the manufacturers unwittingly contribute to the issue is by supporting significantly different pricing in different countries. Individuals and even entire companies will materialise to buy the product lower in one country, and then sell it higher in another country. This practice is one of the major factors for seeing a product that is made in the US or the EU, and sold into another country, then flowing back into the US or the EU. The retailer or medical practice buying it may not see the risks, but they are real.’

For example, what assurances does the buyer really have that the product is genuine and undamaged? Cluff says that the products may have travelled half way across the world and the buyer and end-user would have no way of tracing the chain of custody. It may have been left out in the blazing sun or freezing cold on a dock somewhere for long periods of time, which can compromise the quality of the product or the efficacy of the actives. 'The product may also be past its expiration date, and it may have been returned, opened, or rejected by the originally intended customer for unknown reasons. The risks to the buyer are real, and simply not worth it,' he adds.

Horror stories of what really goes on in many corners of the world are rampant. Yet even in the US, these tales are all too common. As Headley explains, 'The sale of products through an unauthorised, unofficial or unintended channel has the potential to damage brand integrity, erode distributor loyalty, reduce clinic profitability, and can put end-user customers at great risk. It is widely known that products containing high levels of actives have a finite shelf-life, and any exposure to light, air, dust, heat, or cold can alter the formulation, breed bacteria and contaminate the product.'

For example, one sales manager of a leading physician-dispensed cosmeceutical brand uncovered a doctor who purchased a few hundred dollars worth of her products, and next placed a few thousand dollar order, and then jumped to a \$50000 order. She saw the figures and became curious, and paid the doctor an impromptu visit with his sales rep, asking to see his inventory. To her surprise, after he made a number of lame excuses, there was not one product to be found on the premises. Clearly, this doctor was exporting goods under the radar, and the end result was that his account was shut down and an investigation ensued. The fines ultimately levied on this clinic far exceeded any profits made from siphoning off goods for sale overseas.

'In one instance with one of my previous employers, we uncovered a company in another country that was actually taking the products they had purchased, and squeezing them into new bottles with their labels in an open warehouse, by hand. Besides the obvious legal issues, the conditions were far from good manufacturing practice standards, risking contamination of the product that could cause harm to anyone buying it,' says Cluff.

## Challenges of online retailers

The biggest culprits cited, and perhaps the hardest to control, are eBay and Amazon, but that is just the beginning. There are hundreds if not thousands of smaller players whose primary business is selling skincare and cosmetics products online at steep discounts. They often use aggressive online marketing tactics, including Facebook ads, Google ads, banners, coupons, and more. And it's not just professional skincare that is taking the hit. Luxury beauty products from global players such as Estée Lauder, La Prairie, Sisley, and others have trickled down to discounted sites.

Amazon recently launched its own Luxury Beauty store, a premium beauty e-commerce site that offers editorial content under the Shop by Trend and Editor's Picks links on the home page, as well as a Complete the Look/Regimen feature and a New & Noteworthy section. As part of the mega-retailer's ongoing efforts to showcase luxury beauty brands, unauthorised third-party sellers of brands featured on Luxury Beauty have been identified and removed.

According to Joel Schlessinger, MD, CEO of Lovelyskin.com, 'Product diversion has always been a problem for some companies, but the newest challenge is their emergence on Amazon and eBay and the limited, if not zero, assistance these companies provide to deter this situation. Recent initiatives by Amazon clearly show that they are aware of this issue, but choose not to take stolen or diverted products off their site except if retailers 'play ball' with them by allowing Amazon to sell their products.'

He continues, 'It is an interesting way of holding up retailers and forcing them to market on Amazon. The idea is to join us so we can help you to keep anyone but us from selling your product. Additionally, it remains clear that these shadowy diverters are being aided by not only Amazon, but Google and eBay as well, and no 'provenance' is being insisted on when selling on these sites or advertising with Google. This clearly doesn't pass the 'sniff test' in many retailers' minds who go through appropriate channels to purchase and sell their products, yet are competing against grey market products.'

## Keeping the patient in the practice

A number of global brands have become vigilant about protecting the professional skincare model by initiating new programmes to ensure that their customers maintain their value position with patients.

According to Stuart Mohr, Senior Director of Marketing at Jan Marini Skin Research, 'Product diversion through unauthorised Internet discount sites and the sale of expired or counterfeit products presents a significant challenge to the professional skincare industry. Products on the market vary widely in concentrations and quality, and very few have real clinical validation. For this reason, consumers look to professionals to recommend products that deliver real results. In-office consultations are integral to selecting the best products for individual needs. In most cases, professional products have higher key ingredient concentrations with higher costs to manufacture than mass retail luxury brands, yet cost less to end-consumers. Online diversion and discounting of professional products threatens to erode the value of these brands, creating a condition where lower quality, less concentrated, less proven, higher margin brands thrive. In this scenario, the consumer and the professional lose in the long-run.'

'Along with many of our top-end peers, we take a very active role monitoring and shutting down suppliers of illicit online sales to ensure the long-term success and value offered by professional retail skincare,' says Mohr.

Many professional-product manufacturers have taken steps to stop diversion. They often have contracts with distributors that require the distributors to sell only to health professionals and no other person or business. Some may impose steep penalties for products diverted to other channels, and even damages for any instance of diversion that deviated from the contract.

Other companies are using tracking codes or RFIDs on each unit sold so they can track exactly who bought them. For example, to combat diversion, ZO Skin Health, Inc. uses special undetectable coding in their product packaging. In addition, ZO® does not permit online sales of its products on any website except its own, through the recently launched ZO® Physician Online Store Program. In order to purchase products as a first time user or to replenish products, the customer must select an authorised ZO® physician through their ZO® Physician Online Store. This model is another way of driving consumers and new patients to physicians that they would not normally get on their own.

'Through ZO®'s continued pursuit of diverters of our products, we've figured out how most of it is happening and are using that information to eliminate it,' says Headley.