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SMARTER PERSPECTIVE: RETAIL INDUSTRY

Nuanced Understanding of Amazon's Liquidation Environment Drives New Appraisal Approach

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In this article we discuss how the increasing relevance of Amazon sellers in the retail space has created the need for an approach to field exams, appraisals and liquidations that incorporates a deep understanding of the unique nuances associated with conducting business within the world's largest online marketplace.

As Amazon has grown to become the world's largest online marketplace, the need to offer a financing solutions, and, consequently, a field exam and appraisal product has grown with it. For all existing and prospective Amazon sellers, securing financing has traditionally posed challenges, given the industry norm of ascribing zero value to inventory housed in Amazon's network. This was largely due to the lack of control associated with Amazon and the many rules it imposes upon its sellers. Together, the lack of control and many rules, present a number of variables that create significant underwriting challenges for asset-based lenders and inexperienced liquidators. However, despite these challenges, the increased prevalence of Amazon sellers requires a different perspective that has been formed and consistently refined to keep pace with Amazon's changes.

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Amazon accounts for nearly 40% of all US retail e-commerce sales, a larger share of the pie than Walmart, eBay, and Wayfair combined, and it adds, nearly 4,000 new sellers to its platform daily. Approximately 22% of Amazon's total revenue is attributed its more than 2 million third party sellers. Of those, sellers can leverage three different methods of selling: Fulfilled by Amazon (FBA), Fulfilled by Merchant (FBM), and Seller Fulfilled Prime (SFP). Under FBA, sellers send their inventory to Amazon operated fulfillment centers, where Amazon then manages all picking, packing, shipping, customer service, refunds, and returns on behalf of the seller. All FBA sellers have the Prime badge. In contrast, FBM sellers list their products on the same Amazon marketplace, but manages all storage, shipping, and customer support independently of Amazon and are ineligible for Prime. SFP is more similar to FBM, though it allows sellers to deliver directly to domestic Prime members, so long as these sellers are able to adhere to the Prime standard, which includes free two-day delivery among other things. Across all three selling programs, the seller retains title to the inventory, even when the inventory is physically sent to Amazon, the seller still owns it until sold. Importantly, these three programs are not mutually exclusive, and it's not uncommon for Amazon sellers to leverage multiple, adding an additional consideration to the appraisal, field exam, and liquidation consideration.

AMAZON HOLDS THE CARDS IN A LIQUIDATION

While Amazon allows liquidation of inventory through its website and even provides a variety of tools to assist in the sale of excess and underperforming inventory, the nature of the activity permitted on the marketplace is much different and more restrictive than how traditional Going Out of Business (GOB) events are typically conducted. During a traditional brick-and-mortar or e-commerce GOB event, for example, the ability to drive sales is greatly aided by the use of highly promotional language and messaging such as "EVERYTHING MUST GO" or "STORE CLOSING." Not only does Amazon prohibit this kind of language, buts since it requires its sellers to adhere to their 30 day return and refund policy, for example, an "ALL SALES FINAL" strategy cannot be implemented as matter of procedure. This is in stark contrast to a typical retail liquidation, where 100% sell-through of inventory is often guaranteed.

The inability to fully control the messaging and sales strategy on Amazon means that inventory net orderly liquidation values (NOLVs) and liquidation recoveries are likely to come in lower than their traditional brick-and-mortar or eCommerce counterparts. Additionally, unlike these other, more familiar liquidation channels, Amazon has a comprehensive and relatively complex set of rules and policies that require careful attention and must be followed. One mistake or issue, whether it's intentional or not, can cause a retailer to breach compliance and, ultimately, lose the ability to sell through Amazon until the violation is resolved. Some examples of these violations include pricing a product unfairly, providing an inaccurate product description, and aggressively discounting the same product on another website or marketplace, but not Amazon.

The propensity for violations is, understandably, greater during the course of a liquidation. It's not uncommon for sellers to experience capacity limitations related to shipping and packing, and ensuring inventory arrives to Amazon warehouses or customers on time. This is especially true during a bankruptcy, after a company has experienced financial difficulties and during a liquidation when the goal is to sell through as much inventory as possible at the highest value possible. As inventory selection dwindles, and discounting increases, albeit in much smaller increments on Amazon than other sales channels, it can be challenging to meet the shipping speeds and customer service requirements demanded by Amazon, especially for SFP Sellers. In the event of slippage, results can be negatively impacted. For example, if a seller's rating drops too low, sellers may have to discount further to win the "Buy Box," also known as the "Featured Offer." Simply put, winning the Buy Box means the customer is buying your product when they click "Add to Cart" or "Buy Now." Given these risks, it is imperative to monitor several key metrics before and during an Amazon liquidation, including, but not limited to Inventory Performance Index, buy box eligibility, inventory heath (age, unit counts, etc.), sales history, product conditions, seller rating, inactive SKU counts, and more. And, lenders need partners who have experience with the variables impacting these metrics – positively and negatively.

THE GOOD NEWS

Despite the many nuances, differences, and complex challenges associated with Amazon, lending to an Amazon seller and utilizing Amazon as a sales channel during liquidations are each viable options when a proper understanding of risk and appropriate monitoring are both present.

Field Exams

Diligence unique to Amazon sellers would include analyzing key performance metrics, including return rates, and how the seller exploits Amazon metrics to optimize their sell through. Inventory reporting accuracy and timeliness can also be evaluated as well as compliance with Amazon's many requirements. These and other Amazon seller specific procedures should be performed.

Appraisals

As mentioned previously, when Amazon is one channel through which a retailer sells its inventory, this inventory has historically been treated as ineligible, and Amazon excluded as a recognized sales channel for underwriting purposes. Clearly, this approach to lending disadvantages Amazon-centric sellers. From our perspective, the many unique factors that impact NOLVs in the Amazon environment – including imposed fees, ratings, the restriction against aggressively marketing the urgency or finality of sales, the requirement to offer returns, and the potential of losing the right to sell at any point in time during or outside the course of a liquidation – demand a new way of approaching asset appraisals for these sellers that includes, among other things, a commitment to more frequent field exams and collateral updates. A specialized appraisal report that incorporates key metrics that have a positive or negative impact on NOLVs as well as variables to monitor is critical for any lender.

Liquidations

Similarly, conducting liquidations that involve Amazon as a channel requires highly specialized knowledge and expertise that is not widely accessible. From optimizing the timing of efforts around Amazon's seasonally-adjusted fee structure and navigating policies to minimize the chance of suspension, to protecting buy box eligibility and proactively developing a complementary disposition strategy to address the likelihood of less than 100% sell through... such effort must be well planned and coordinated at every step.

At Hilco, we have more than 35 years of retail inventory field exam, appraisal and liquidation experience across retail and consumer goods businesses. Our Hilco Retail Group also has hard to find, real-world experience in successfully assisting third-party sellers and aggregators, and conducting the largest Amazon related seller liquidations. This breadth and depth of expertise has led to our development of an innovative new appraisal product and field exam approach, which are now being used by lending and retail clients, and from which many are already benefiting.

THE BOTTOM LINE

As with any other borrower, in order to make an asset based loan to an Amazon seller, a lender must have confidence that its collateral – the inventory – can be effectively liquidated if necessary. Some traditional liquidators will be quick to tell you that this can be done "easily" for Amazon sellers. Others will tell you that it "can't" be done at all. At Hilco, we are actively engaged on both sides of this complicated equation on a regular basis. And we are here to tell you that it can, in fact, be done but that a successful liquidation must be planned and executed with a high degree of precision and expertise.

Hilco's Retail Group offers broad and deep expertise in all retail sectors. Our seasoned professionals deliver a wide range of analytical, advisory, asset monetization, and capital investment solutions to help define and execute client strategic initiatives. We encourage both asset-based lenders and Amazon sellers to contact us and learn more about our team's experience and offerings in this highly specialized area, including how we may be able to assist with either a current or anticipated field exam, appraisal or liquidation need.

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