The Risks Of Using Third-Party Sales Platforms

Tolstoy famously wrote, "Happy families are all alike; every unhappy family is unhappy in its own way." The same wisdom holds true for successful and unsuccessful businesses. Behind every business failure lies some combination of personality issues, errors of judgment, some avoidable, some not, unexpected market shifts, and plain bad luck. Which brings us to Unique Squared, the formerly high-flying retailer that is now, according to a pronouncement on its website, "worm food." There are no doubt a multitude of reasons for this downfall and we don't have the inside information necessary to provide a thorough case study. However, the rapid rise and fall of what was once a $40 million operation offers useful insights into some current retail practices.

Founded by three tech-savvy Georgia Tech graduates in 2007, Unique Squared was perhaps the first m.i. retailer to tap into third-party platforms like eBay and Amazon to generate large sales volumes. The company also pioneered creative product descriptions such as "new in unsealed container," or "like new" to artfully skirt MAP pricing regulations and offer the lowest price. This focus on price was captured with the company slogan, "We Dare You To Find A Lower Price, Game On!" Low prices consistently put Unique Squared listings near the top of Amazon and eBay searches and fueled meteoric sales growth. When revenues passed the $40 million mark on its fifth anniversary in 2012, we described the company as one of the "fastest growing retailers in industry history."

Unfortunately, their demise points to the limitations of overreliance on third-party platforms, as well as the risk of using aggressive pricing to drive sales. As the fourth and 11th most visited websites ,respectively, Amazon and eBay have a proven ability to rapidly raise any retailer's profile. However, these services come at a steep cost: 15% of revenues for the Amazon marketplace and pushing 10% for eBay. These costs raise the question: "Can you build a sustainable m.i. retail business using them?"

Two decades ago, no one we knew of in the music industry fully anticipated the contraction in retail margins that has since occurred. Unforeseen advances in administrative and inventory management efficiency may make it possible for retailers to operate on even thinner gross profits in the future. However, given the industry dynamics, these gains will have to be enormous to make it profitable to sell conventional products on a third-party marketplace like Amazon. Just do the math. Start with the 40% gross profit allowed by the more generous MAP policies, subtract Amazon's 15% cut, shave off another 8% for inbound and outbound shipping costs, and you're left with just 17%. Include the added costs that periodically arise from obsolete inventory markdowns, shipping damage, customer fraud, and the occasional return, not to mention the well-documented cases of struggling to coax payments from Amazon's bureaucracy, and you can easily knock another two points off the margin.

Walmart needs a 25% gross profit, Dicks Sporting Goods needs 28%, and Best Buy needs 23%. Can an m.i. retailer, with far fewer economies of scale and slower-turning inventory, expect to thrive with a 15% gross profit? Count us as skeptics. The rapid influx of orders that comes with listings on Amazon or eBay is no doubt exciting, but as the closure of Unique Squared suggests, the bottom line contribution is negligible at best. This is not to entirely discount the value of these marketplaces. They may be useful vehicles for generating incremental business or selling hard-to-move inventory, but not as a primary sales channel.

Like Amazon today, back in the late '60s, regional shopping malls attracted hundreds of music retailers with the promise of dramatically raising their visibility and revenues. Mall rents were often three or four times higher than a free-standing store, but higher occupancy costs were supposedly justified by the increased foot traffic that reduced the need for other promotional expenses. After a brief honeymoon, mall-based music stores quickly lost their luster. The throng of consumers walking by each day did result in additional impulse buys, but ultimately not enough to cover the high rent and labor costs that came with staffing a store 12 hours a day, seven days a week. These unforgiving realities prompted music stores to exit malls long before the shopping mall began its current well-publicized decline. Today, there are only a handful of mall-based music stores left, and few are clamoring to sign new leases.

We're not suggesting that the eBay and Amazon marketplaces are the equivalent of the enclosed shopping mall. For one thing, they have a greater ability to adapt. It's easier to revise pricing policies and update search algorithms than it is to repurpose a few million square feet of building space. But profitless transactions are the very definition of unsustainable. Too many of them, and you could easily end up like Unique Squared.

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