How to Sell on Consignment
A Step by Step Guide to Consignment Selling in Your Small Business

By BizMove Management Training Institute

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1. Introduction

Sellers seeking new and expanded wholesale and retail markets for goods can use consignment selling to economic advantage in many cases.

This guide provides a discussion of the advantages/disadvantages of consignment selling and general comments about how to use consignment as an effective selling tool for the small business operation.

What happens to a manufacturer who has developed a new consumer product that is thought to be a best seller, but no retailer or wholesaler is willing to invest enough capital to stock a small number of the items in inventory?

What happens to a manufacturer who is told that the seasonal product he or she is trying to sell is such a capital risk that there is probably no chance that it will make the retail shelves during that Christmas season?

How can manufacturers in these cases and similar cases make the products and terms of sale sufficiently attractive to get the product on retail shelves for exposure to the buying market?

Perhaps through the use of consignment selling.

Selling goods on consignment is described as a situation whereby goods are shipped to a dealer who pays you, the consignor, only for the merchandise which sells.

The dealer, referred to as the consignee, has the right to return to you the merchandise which does not sell and without obligation.

As you can see, this may not be an ideal arrangement. The dealer has no money invested and is not obligated to "push" your merchandise.

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2. Purpose Of Consignment Selling

Even with obvious disadvantages, there may be times when you may decide that consignment selling can serve your purpose. It can be used as a marketing tool which creates no obligation on the part of the dealer in the event they do not sell. As a result, such practice can provide an attractive incentive for the dealer, at least to stock your merchandise. The dealer has no risk and you have your merchandise before the buying public.

Examples of goods which very often are sold on consignment include light bulbs, produce, eggs, poultry, magazines, newspapers, Christmas decorations, garden seeds, batteries for flashlights, and potted plants such as those found in supermarkets.

In the case of perishable merchandise (either in quality or in seasonal appeal) dealers are often more inclined to consider placing it in their stock if they have no great threat of financial loss on investment in the event it does not sell.

In the case of a newly designed and manufactured product for which there is no sales record, dealers might be more enthusiastic about promotion if their investment loss is minimized.

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3. Advantages Of Consignment Selling

Now that you've read some general facts about consignment selling, look at the specific advantages to you as a manufacturer.

It allows a seller (manufacturer) to place merchandise in wholesale and retail outlets for additional exposure to the buying market.

It can provide an incentive for the wholesaler and retailer to stock goods in inventory because no capital of theirs is tied up in inventory.

It can encourage wholesalers and retailers to stock seasonal or otherwise newly introduced merchandise which they might not usually buy because of a lack of demand.

It provides the manufacturer with the opportunity to have the merchandise exposed to the buying market, instead of having it stored and isolated in a warehouse while waiting for an order from a buyer.

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4. Disadvantages Of Consignment Selling

In deciding whether or not to use consignment selling, you need to look at the disadvantages.

While your merchandise is being exposed on the shelves of a wholesaler or retailer, you get no money until they sell.

As the manufacturer you must have enough cash on had to wait extended periods for payment of merchandise sold.

Since the goods are out of your physical control, you cannot control the damage and shopper abuse which inventory merchandise is generally subject to.

You cannot always affect shelving decision which wholesalers and retailer make concerning maximum exposure of the merchandise. Because consignees do not have any capital invested in the inventory, they may be inclined to place their outright-owned inventory in the most advantageous display spots in order to realize a fast return on investment. They are aware that they do not lose any investment if the consigned goods do not sell. They do lose if the inventory they own does not sell.

Where personal selling is important, outright owned merchandise might be promoted over consigned goods because, again, return on investment matters where investment exists.

If the gross margin to the seller is greater than the percentage commission with the sale of consigned goods, then the seller might tend to favor selling the outright owned goods. For this reason, the consignor is introduced to the importance of providing an attractive incentive in the form of a commission for the consignee. In other words, the consignee needs a strong reason to sell the merchandise since the motive to recoup investment is not present.

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5. A Few Words Of Caution

Consignment selling may or may not be attractive to you. It depends on your situation. You might use consignment selling for market testing. It might be a fairly inexpensive way to learn how or if a new product will sell.

Keep in mind, however, that you tie up your funds waiting for merchandise to be sold. Also, the dealer may be a poor credit risk. Moreover, there may be other hazards inherent in a situation where the dealer does not have funds tied up.

In brief, the various factors over which you have less control than in other marketing situations could mean that the risks may be greater than your resources can absorb.

To evaluate whether or not consignment selling can be advantageous to you, consider the following discussion of the consignment relationship, special considerations, and examples of operational aspects.

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6. The Consignment Relationship

The relationship which exists between you, the consignor, and another seller, the consignee, is an agency relationship. That is the consignee never takes title to the merchandise buts acts as the agent of the consignor to pass title to the buyer.

Since title does not pass to the consignee in the absence of an agreement, liability of loss for the merchandise remains with the consignor.

This means that you and the consignee can agree to specific statements for assuming a share of the loss in case of shoplifting or other damage to the merchandise. However in the absence of such an agreement, you, the consignor, are responsible for the loss involved even though the merchandise might have been shoplifted from the premises of the seller while the consignee exercised normal care in the display and handling of the merchandise.

Because of the details and legal implications involved in consignment selling you, as a consignor, should give careful attention and planning to selling products on consignment.

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7. Give Special Consideration To...

Contractually speaking, you and your consignee can agree to a variety of mutually-advantageous measures. That is, you might agree in writing that the merchandise will be placed in the wholesale or retail business where it is exposed to an estimated 50 percent of foot traffic that enters the store.

Also, you should agree as to the exact commission to be awarded to the consignee upon sale of the merchandise. The length of time (days, weeks, etc.) which the consignee will agree to keep the merchandise will probably be specified. Also, the intervals at which the consignee will make payments for goods sold should be considered.

Agreement concerning delivery and pick up of the merchandise might be included, as well as conditions of storage of any merchandise that is not on display, particularly perishable merchandise. Your contractual agreement might specify that you will be paid for "inventory sold," when

Inventory Delivered Less Inventory Collected Equals Inventory Sold

Yet, the formula for payment noted above assumes that all merchandise will be either sold or claimed by the consignor and completely rules out the possibility of disappearance of the merchandise from the sales floor. Since shopper damage and shoplifting are sobering realities of doing business, it is wise to consider them and to plan for their occurrence beforehand.

The merchandise legally belongs to the consignor in a consignment sale and liability for any loss is still the consignor's problem. Some consignees may be willing to share the responsibility involved in loss due to shoplifting if the issue is handled tactfully.

In some cases, the consignee will assume responsibility for damaged goods. When this is the case, you, the manufacturer, will suffer no loss. However, such cases are rare. At best, you can expect a sharing of the loss with the consignee.

When you assume part or all of the loss, ask for and keep the damaged goods for your own records. A consignee could claim that some of your merchandise was damaged when in fact the consignee sold it and pocketed the money.

Also consider damage caused by sun rays that fade colors and make some merchandise unfit for sale.

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8. Examples Of Consignment Selling

Consider the wholesaler of artificial floral merchandise who sell to numerous small and medium retail floral establishments. Such a wholesaler often stocks mostly staple merchandise with a limited assortment of infrequently sold items.

A manufacturer who has developed a novel item for that industry and has no sales history to use as a basis for showing the wholesaler that the item will sell, probably will have a difficult time getting the item into the wholesaler's inventory.

If a potential consignee such as the wholesaler in this example, is comfortable with current sales levels and gross margin, the manufacturer will find it difficult to convince the wholesaler to carry this item in inventory.

Yet, in a consignment sale, the manufacturer can always ask, "What do you have to lose?" The answer is, of course, "Nothing."

If the manufacturer makes it easy enough for the wholesaler to stock the item and the wholesaler is aware of a possible commission for exerting very little effort, the merchandise usually has a very good chance of being placed in stock. As a result, the merchandise has wide exposure in the market and the wholesaler feels no risk associated with trying the merchandise. If it sells well, chances are good that it will be placed again. Even if the wholesaler had bought the items outright the first time around, and they did not sell, they would not be reordered. Thus, the marketability of the merchandise is at stake in either situation and the positive aspect in consignment selling is that the wholesaler is assured that he or she has no investment to lose.

In another example, consider a manufacturer of a seasonal item such as Easter baskets, Christmas ornaments, Halloween items, or beach toys. Often wholesalers and retailers order these items far in advance and make a strong effort not to overorder because the market is defined in terms of days or weeks.

Manufacturers can promote their products in these industries by assuring the wholesaler and retailer that whatever is not sold will be taken back by the manufacturer.

In such cases as these, shopper density is usually heavy during a short period of time. That is, there are several peak shopping days during which crowds of shoppers are likely, by their number alone, to cause significant sales and damage to at least some of the merchandise on the shelves.

An agreement concerning shoplifting and damage becomes particularly important in such cases.

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9. Consignor's Liability

A serious issue to consider in consignment selling is that of liability for merchandise. Since the consignor remains owner and title does not pass to the consignee, legally the liability rests with the consignor, in the absence of any other agreement.

This means that whenever merchandise is destroyed by water, fire, or smoke while in the inventory of the consignee, the loss is that of the consignor.

The importance of the issue calls for special attention at this point because there is a sales situation which has been viewed by some as similar to consignment selling and can become a legal problem for the consignor.

"Sale or return" as its is called, is a situation in which the risk of loss passes to the consignee when the goods are in his or her possession.

"True Consignment"

From court decisions over the years, certain points have surfaced that are important in the determination of "true consignment." They are:

The consignor is authorized to demand return of the goods at any time.

The title rests with the consignor until the goods are sold, at which point, title moves directly to the buyer and never passes through the consignee.

The consignee is authorized to sell the goods only at a specified price or not less than the invoice amount.

The consignee is required to meet certain standards in keeping of the goods, such as their segregation from goods wholly owned or held under a claim of ownership or interest.

The consignee is required to forward proceeds of sale immediately to the consignor or to deposit them in a special account.

The title issue becomes critical because creditors of the consignee will have claim to the merchandise if the title has passed to the consignee in a "sale or return" situation. In a true consignment sale, the title always remains with the consignor.

If you plan to sell on consignment, your attorney can provide guidance on the legal aspects and your accountant can advise on the recordkeeping and accounting aspects of this type of selling.

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