

“Give Me Five, Now Ten...Years
Into the Future”



National Auctioneers Association
Council on Future Practices
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Introduction

It started with some questions... What do you think the auction business will look like in five to ten years? What do you think the live auction event will look like? How do you think online auctions will interact with the live auction event? How do you think the Internet will continue to change the auction industry? Do you think you will still be in the auction industry in five to ten years?

We may ponder these questions privately, or discuss them at a State Auctioneer's convention, but we invariably retreat to what we know: live auctions and the way we have always conducted them. We get caught up doing our day-to-day auction business without taking the time to reflect on what is changing in the world around us and what is changing our business in the future.

We all want to improve our businesses, whether it is by increasing sales, lowering expenses, increasing profits, upgrading our software systems, or hiring new employees. But what happens when external forces in the marketplace change our business? What happens when those external forces change our industry? What if one day we wake up and the world is just not the same?

To survive in this business, we have to see change coming and get ready for it. We, the NAA Council on Future Practices¹, developed this report to address the changes that are currently here, future changes, and how we can improve our business to adapt to these changes. We don't know all the answers that are right for your business, but we do have compelling questions and powerful insights. We cannot tell you how your business will change, but we can make you aware of the external market forces that are occurring and the potential impact on your auction business. For example, in January 2011, CoreLogic[®], a publicly traded real estate information company, acquired RealtyBid[™].com, an online residential auction company. For those in the residential real estate foreclosure business, this was an industry changing event. RealtyBid[™].com went from being a privately funded company to becoming acquired by an international real estate information services company that has deep relationships with nearly every

¹ The Council On Future Practices is an 11-member group appointed by President B. Mark Rogers, CAI, AARE to study the effects of societal trends on the current and future Auction Industry. A complete list of the Council members and a short biography can be found in Addendum A.

government agency and bank in the country. The newest competitor in that space is now a publicly traded company, and all of this happened while you were doing what you do every day. The game changed overnight. Entities from outside the auction industry entered the auction industry and instantly increased the level of sophistication needed to compete, while bringing with them deep client relationships. This is just one example of what is happening to our industry.

We encourage you to take the time to reflect on the issues and concerns addressed in this report and think about how they affect you, your business, and your clients. You owe it to yourself and your employees to do all you can to make sure that you survive in these uncertain times.

Macro Level Factors Affecting the Auction Industry

As business owners, it is important that we manage both the micro- and macro-level facets of our business. At the micro level, we have more control over what happens within our business. This includes such management issues as: controlling our finances, hiring and firing employees, managing clients, engaging in new business development activities, and performing our auction-related activities.

But the macro level is much less certain because we can't control it. We have no influence over national tax policy, housing policy, social media companies, or government agency policies. One of the reasons is that we can't control or influence what is happening at the macro level because the issues are too big to influence.

This paper addresses the four major macro level trends that we believe will have a significant impact on our businesses over the next five to ten years. First, we will analyze and outline what the effect of each of these issues will have on our businesses. Next, we will explore the concept we developed called "Opportunity Agility," and how auction professionals need to be in a constant state of preparedness through continuing education programs. Finally, we will make specific recommendations to the National Auctioneers Association Board of Directors on actions they can take that will help every NAA member best meet these challenges.

Macro Level Trend One:

Economic uncertainty and ‘Opportunity Agility’

Predicting economic conditions is a near impossible task that is best left to the pundits on talk radio. Nobody knows when the economy will improve, how many jobs will be created, or when the deficit will get under control. In our businesses, we are most concerned with the short term horizon but still need to keep an eye on the long term. Many of our businesses are nimble enough that we can adapt to changes in the economy.

Nearly all auction companies have the ability to move their resources to take advantage of near term opportunities. If a certain vertical market is experiencing a hardship, then we can enter that market to offer liquidation services or expand our existing service level within that marketplace. This is contrary to what CEOs of national and international corporations have to think about. They have to make strategic decisions that take years to implement, analogous to turning a tanker in the rough seas. It just does not happen that easily. But auction professionals can adapt to and take advantage of sales opportunities. We call this “Opportunity Agility.” In other words, it is having business intuition and flexibility; it is being alert to trends that may develop into new verticals in the auction industry.

The auction companies that build the mega infrastructures to capitalize on specific vertical markets, such as multi-location equipment auctions, prestigious antique auction houses, and high volume residential Real Estate Owned (REO) platforms have much more economic risk since they are “all in” with one type of marketplace without much income diversity. Typically, those companies do well when the economy is one way - either good or bad - but rarely do they do well in both types of economies.

We believe that the Opportunity Agility concept, utilized by smaller and mid-size auction companies, is what will keep them competitive and profitable during all economic cycles. What those business owners need to study are the major economic trends that will create profitable opportunities to their company in 12 to 36-month cycles. They should then make improvements or structural changes to their businesses to capitalize on the near term sale opportunities.

The economic factors that create opportunity for auction professionals include:

Unemployment. One of the biggest drivers of our national economic engine is jobs. Unfortunately, our country is experiencing an increased amount of people out of work for an extended period of time. The Federal Reserve predicts the unemployment rate will stay near 9% until 2015. Without jobs, consumers don't have the income to spend.

Home Sales. The existing inventory of homes for the entire United States is approximately nine to 12 months. According to an article published in early 2011, lenders have foreclosed on one out of every 45 homes in the United States². The number of homes available for sale is staggering, especially given the "shadow inventory" estimated to be in the neighborhood of 42 months. If this inventory is added to the existing level of listed properties, some estimate we could have as long as five years of product inventory to sell.

Further adding to the problem is the statement that up to 50% of the foreclosed properties held by banks, insurance, and GSE's are not yet listed. Before we can return to a stabilized housing market, the distressed real estate needs to be sold.

Further complicating matters is the downward valuation of residential real estate. As the banks liquidate REO and consent to short sales, they are creating lower comparable sales. When the non-distressed home owner wants to sell their home, they have trouble doing so because the value of their home has dropped significantly. They may have even been responsible home owners and borrowers but the 20-40% drop in value in some markets means that any equity they thought they had has evaporated. This lower equity position means that less people have the mobility to sell their home and relocate, and less money to roll over into their new home purchase, thus slowing home sales.

The problems associated with homes sales will continue to be exacerbated by government policy and lending policy. Many of the government policies intended to "ease the pain" of the Great Recession have only delayed the pain, instead of making it

² <http://www.realtytrac.com/content/press-releases/record-29-million-us-properties-receive-foreclosure-filings-in-2010-despite-30-month-low-in-december-6309>

disappear. For example, the Loan Modification Program seemed like a good idea to help struggling homeowners get back on track and keep their homes, but the “re-default rate” is well over 50%. Some wonder why modify a loan if the borrower is perpetually unemployed. Auction professionals have always believed that “ripping off the Band-Aid” is the best approach, not the “slow pull approach” taken by government policy makers.

Auction professionals need to continue to make the case that we are vital to creating liquidity in the marketplace by making transactions happen. When this happens, economic activity happens. The properties get fixed up by contractors, title companies get business, and all of the professionals involved in the transaction earn an income. Our sales create additional sales to help the economy as well as create wealth for others and ourselves.

Small Business Failures. The success of small businesses in America is what gets an economy vibrant. However, many small businesses continue to fail, whether by slow sales, bankruptcy of a major client, or inability to obtain working capital financing. The Federal Government also continues to add new regulations on to companies - large and small - making it harder to earn a profit. This results in many bankrupt businesses with the Trustee engaging an auction professional to liquidate the assets.

While we all wish small businesses could grow and prosper, their failures result in opportunities for aspiring auction entrepreneurs. We should take pride in how we help create those opportunities for growth by redeploying assets to create wealth and value.

Tight Lending Standards. Lenders remain very conservative with their lending standards. Outside of their concern that they have losses on legacy loans to cover, they also know that values of real estate and equipment will continue to decline for the next few years. They don't want to make loans today that they know will have no equity in just a few years. Coupled with the extended high unemployment rate and the weak economy, banks are resisting new lending unless it is a very safe loan.

High Personal Debt. A vast majority of Americans have excessive credit card debt and other debts that are consuming most of their discretionary income. This over-leveraging of America is at the heart of the problem that brought on the Great Recession.

The National Debt. This is the one economic issue that should keep us up at night. Our country has experienced all of the issues listed above before - high unemployment, slow home sales, small business failures, etc...but we have never had a national debt approaching \$15 trillion dollars before. Just ponder that figure. It is a big number - \$15,000,000,000,000 - that is beyond comprehension.

To put it into context, think about a credit card statement and the new disclosures that state how long it would take to pay off a credit card if only the minimum monthly payments were made. For those that have a high credit card balance, it could take five, six, or even seven years to pay off the debt, plus all of the interest that was accrued. Now think of the national debt. Let's suppose we could make a \$20 billion/month payment on our national debt. That's right - \$20 billion per month. It would take 750 months, or more than 62 years to pay off the debt, and that does not even take into account the interest! Now just think about how much money \$20 billion per month is, and then think about where the government is getting that money - the taxpayer.

Since we are in proverbial "uncharted waters," there is no way to predict what our economy will look like in five or ten years. At some point, the government cannot keep spending. All they are doing is transferring the debt of businesses and consumers to the debt of the national government, which becomes the debt of businesses and consumers through tax funded liabilities. It's like paying off one credit card with another credit card. We really aren't paying off anything but we think we are making progress.

The other impending government debt problem is at the state level. Many states, such as California and New York, have large looming budget deficits that are going to force major changes in the way those states function. Because the states with high budget deficits also have a strong union presence and high cost pension plans, we will see states break their promises to retirees and cut back benefits to make their budgets balance.

Once that line is crossed, some economists are predicting riots and violence in the streets, creating instability in some cities. States will have to raise income taxes and real estate taxes, further impeding the business and job growth.

By no means is this a complete list of economic issues we confront as auction professionals. There are even more issues, ranging from tax rates, health care regulations, retirement plan changes, farm subsidy policies, and interest rates. We encourage every auction professional to position their business for “opportunity agility” so as times change, we will be ready.

For auction professionals, this means:

1. The loss of retail businesses creates an opportunity for more business liquidation auctions, including the sale of commercial properties.
2. Struggling business owners may wish to sell surplus commercial equipment, which creates a demand for more commercial equipment appraisals and auctions.
3. There is a potential for more liquidations of household effects.
4. Banks may need to increase the number of auctions to dispose of the residential foreclosures on their books.
5. Auction companies need to be prepared to work with both sellers and banks in short sale situations, and be aware of the extra time, and logistics of completing a short sale transaction.
6. Sale of residential property for banks and individual owners will continue for those sellers that have to sell.
7. There will be fewer bidders for residential auctions because of the lack of mobility for buyers to “move up” or “downsize.” This is due to the bidders’ inability to sell their current residence and their inability to obtain mortgage financing to buy a new home. However, this makes the “all cash” buyer more attractive to the distressed seller since they don’t have to worry about the buyer getting bank financing.
8. There will be lower demand for new homes and new home auctions because of the high inventory of quality, vacant, built homes on the market.

9. Buyers will be more conservative with their discretionary spending as they try to improve their own financial position.
10. Auction items may attract lower prices because buyers have to pay cash or have lower spending limits on their credit cards.
11. There will be continued opportunities to liquidate all types of assets to generate cash for clients, including governments.
12. There will be a need to have access to foreign buyers since they perceive that America is “for sale” and they will invest their money into our real estate and acquire our equipment.

For the NAA, this means:

1. We need to tell the auction story to local banks, bankruptcy trustees, etc. of how Auction professionals can help address their need to liquidate assets. We need to be clear that the options we bring to the table are unique, and different from other options currently being utilized by local banks, bankruptcy trustees, etc.
2. We need to be realistic as an association that due to the size of the problem the solutions to this problem will in all likelihood be solved by policy makers outside of the control of the association.
3. We need to tell the story of the importance of flushing out the housing system of vacant homes so value and jobs can be created.
4. We must educate the members of the association on how to identify sources of assets, and how to effectively work with these sources.
5. We must educate the members of the association about the overlying problems impacting the sources, and their limitations on the liquidity of their assets.
6. We should create an enhanced speaker’s bureau of highly qualified speakers and make the bureau available to outside organizations (private and governmental).
7. It is critical that ALL of NAA’s education programs be reviewed so that the content is topical and up-to-date with current economic trends.

Macro Level Trend Two:

Developing technology increases visibility into auction results, auction business practices, and entry into the auction business

With the rise of social networking and mobile devices, individuals may distribute information from any location or point in time. It is also possible to perform relatively good research with a minimal effort, again from any location or point in time. These possibilities impact every business because they are so incredibly useful and pervasive; they may impact the auction business more than most.

Auction results used to be difficult to obtain without attending the auction in person. Now, more auction professionals are publishing auction results and more attendees are documenting these results and making them available for review online (i.e. www.machinerypete.com and others). In addition, attendees are “tweeting” about auction results as well as posting results on Facebook. In the future, auction professionals with inferior results and unsuccessful sales will have difficulty contracting with informed sellers because they won’t be able to defend their poor results or poor online reviews.

Auction failures were not as visible to sellers as they are now. Today, higher profile sales may be documented online by an attendee, a casual blogger, or by a professional, whether the auction professional likes it or not. This documentation remains visible in perpetuity.

In the future, auction professionals must consider the impact a high profile failure will have on their ability to contract future sales. Theoretically, the quality of auctions will increase due to the pressure that failures will be visible. In order to be successful, auction professionals must be more selective and patient with price-sensitive sellers.

Auction professionals must also remember that from the moment they arrive at an auction location, to the moment they leave, they and their staff are “on” and they should assume that somebody could be recording their auction. In addition to these factors, recent television shows are changing public perceptions of the auction industry, and creating both good and bad perceptions of the industry.

In the past, real estate records could only be accessed by visiting the county register of deeds (in most areas). Real estate records are now electronically accessible via multiple services (i.e. Courthouse Retrieval System). Real estate auction companies in particular must be conscious that their track records are available to the general public with relative ease, and may be aggregated by a competitor. Again, theoretically, the quality of auctions should increase due to the increased visibility.

Internet Auctions: the barriers to entry in the auction business. We know that Internet-based auctions are becoming (or have become) a key part of our auction industry due to their efficiency. Most auction professionals use the Internet to market their auctions. Yet there are many reasons to hold a live auction. It is important that we always cherish the live auction tradition, but we also need to embrace the online auction business. When it comes to Internet auctions, as the saying goes, “That ship has sailed and there is no turning back.” We have no choice but to become a key part in the promotion and education of online auctions and auction professionals.

Auction professionals face more competitors than ever, as evidenced by the fact that today it is easier to sell items online. There are very few regulatory issues with starting an online auction company. When an Internet company in California can start selling real estate online in Florida without a real estate license or an auctioneer’s license, then real estate auction companies in Florida should take notice. If regulatory barriers to entry for Internet auction companies aren't already less stringent than they used to be, they are likely to be in the near future. Internet auctions are now exempt from regulation in many states due to extensive lobbying efforts by eBay[®]. We do not believe that there is any potential in the regulatory environment moving towards regulation of online auction companies. Beyond the lobbying efforts of the large online auction companies that are very well funded, many states are also facing budget shortfalls and those states with minimal license requirements which generate no revenue for the state may even cease regulating auction professionals in the future.

There are already real estate, asset management, and trade publication companies beginning to conduct Internet auctions of real estate without an auctioneer's license and without membership in any professional organization of auctioneers. Literally, anyone

with a computer and a consignor can conduct an online auction. The net effect of this is that they don't know the professional Code of Ethics that we follow and have the potential of damaging the reputation of the industry. We believe that over the long-term, professionals will outperform the unprofessional companies but in the short-term, the unprofessional firms can severely damage our industry and its reputation by blurring the distinction between an auction professional and someone running an auction.

Why does a trained auction professional need to be the auction company of choice, regardless of whether or not the auction is live, online, or any variation thereof? That is the argument we need to make as an industry. The public needs to know that all auctions should be managed by auction professionals and that just because anybody can do an auction, it does not mean they really know how to conduct an auction.

Online auction platforms and innovative marketing companies offering auction-like services will continue to proliferate creating competition to licensed auction professionals and putting downward pressure on fees and commissions. While these companies may enter the marketplace with a big splash and promise sellers a magic bullet, building a sustainable business with traction in the marketplace will require continuous equity investment.

A number of companies attempting to create the perfect solution are already hard at work with investment capital in hand. Their low success rate so far has not discouraged them from continuing to invest large scale resources towards finding the perfect online solution. This final solution will have to include the elements that have always made great auction companies successful: it will have to create and execute a custom marketing plan for each individual asset, provide an outstanding customer service experience for buyers and deliver consistent price results for satisfied sellers – all at no or little cost to the seller and with little to no fees to the buyer. It is possible. Some of the best marketing and software companies in the world seem to think so and are investing time and money towards this goal. If these efforts are successful, they could completely redefine our auction industry.

Rather than wait for outside elements to redefine our industry, we must take steps to convey the following consistent and strong messages to the public:

1. Successful auctions are driven by licensed and trained professional auction companies and auction professionals.
2. Professional auction companies are marketing experts who make dozens of key decisions throughout a marketing campaign and keep abreast of technology and best

practices in creating and executing marketing campaigns that attract ready, willing and able buyers.

3. We offer buyers an excellent customer service experience and make bidding at auction easy and accessible to them.
4. We deliver consistent price results for our clients.

We believe that most start-up online auction companies regulated or not, will not last long enough to establish a large web presence, mailing list, or email list to engage their target marketplace.

Generally most new auction companies, trained or not, live or online, fail because:

1. They are under-capitalized. There are very few auction companies that are funded with private equity capital. Our estimate is that less than 2% of all NAA auction companies have capital behind them in excess of \$1,000,000.
2. Because they are under-capitalized they are impatient when seeking assets to sell.
3. Because they are impatient, they are less selective about what sellers and which assets to represent and on what terms and conditions the auctions will take place.
4. Because they sacrifice selectivity, their auctions fail.
5. Because their auctions fail, their companies also fail.

We know that successful auction companies fill a crucial role by simultaneously managing sellers' expectations and attracting buyers who believe the auction will be fair. Because it is so easy to post an online auction, online “auction companies” are more likely to just list the auction and see what happens. We know those auctions tend to fail more often due to the lack of marketing skills and expertise as well as other competencies needed by auction professional. This happens to the new, licensed and unlicensed auction companies as well.

The Internet may make it possible for potential sellers to find top-quality auction companies in the future (and know for sure when they have found them). However, the Internet will not help an auctioneer say “no” to a seller with unreasonable expectations. For those reasons, there may be some consolidation in the auction business as successful auction professionals build larger and more efficient markets.

Consumers are Shifting Their Buying Habits Online. Take, for example, the declining newspaper industry. As of March 31, 2010, the only newspaper that grew in terms of readership was the Wall Street Journal - the number one readership paper - which was up 0.5% from the previous year. The USA Today, at number two in readership, was down 13.8% from the previous year, and the New York Times, third in readership, was down 8.47% from the previous year. A Fall 2010 Audit Bureau of Circulations report detailed a circulation decline of 5 percent compared with the same six months last year. In fact, only 40% of Americans report reading a newspaper in any form, down from 46% in 2008 and 52% in 2006.

In addition, the demise (and online reinvention) of the traditional newspaper industry has made it nearly impossible to rely on print advertising to ensure participation in an auction. This demise has made the web traffic, mailing lists, and email lists of established auction companies much more valuable than they would have otherwise been.

Consumer usage of the Internet to make purchases is growing at double-digit rates. comScore, Inc. released its 4th Quarter 2010 U.S. retail e-commerce sales estimates, which showed that online retail spending reached a record \$43.4 billion for the quarter, up 11 percent versus one year ago. This growth rate represented the fifth consecutive quarter of positive year-over-year growth and second quarter of double-digit growth rates in the past year.

Eighty-four percent of U.S. Internet users conducted an online transaction in Q4 2010, up from 78 percent last year. The average buyer spent about the same amount online during the most recent quarter as they did last year.

As the newspaper becomes less important and digital and social media become the norm, it's important that auction companies embrace this technology. A recent study by King Fish Media reports that nearly 75% of all companies have a social media presence. LinkedIn, Facebook, and Twitter are the most common-used social media sites, and two-thirds of companies maintain corporate blogs. In the future, YouTube and news aggregation sites are likely to be added. In order to compete in today's market, auction companies should look to create a social media presence. Consumers that cross over from the non-auction world to the auction world will expect similar experiences to what they already encounter. In the same study, more than 30% of surveyed businesses have

conducted online social media ad campaigns, and of those, more than 50% say the campaigns performed as expected or better.

However, just being online doesn't equate to success. Content is king when using social media. More than 75% of the companies state that original content is very important or extremely important to the success of the social media campaign. As such, auction professionals will need to differentiate themselves from other companies with original content in their campaigns. The 'when and where' model of marketing, while still significant, is less important when using social media, whereas the 'who, what and why' is most important in social media campaigns. For example, when marketing a personal property estate, one may focus on the notoriety of the seller, or the uniqueness of a particular item or items to create original content about the item or items. This will serve to raise the product to the forefront of the consumer's mind.

One could make a strong case that the main effect of the Internet on the auction business will be to strengthen already-strong auction firms – not to make it easier to run a successful auction start-up or a new auction division of an existing real estate firm.

For auction professionals, this means:

1. We have to treat every public auction and public activity as if we were going to end up on YouTube.
2. We have to be selective in the types of the auctions we take on because our failures can always be available on the Internet for prospective clients to see.
3. Trained auction professionals need to distinguish themselves in the marketplace from the new, self-anointed online "auction companies."
4. The capital requirements to be in the auction business will continue to rise as new companies enter the industry and offer services with a more competitive pricing model. The rise and fall of many of the new online auction companies will damage the credibility of the traditional auction professional.
5. Auction professionals need to explore online avenues to market and sell both their services and their client's assets.

6. Auction professionals need to understand consumer habits online, and that they are product driven - the method used to sell the product is of little importance to today's consumer.

For the NAA, this means:

1. The association must offer cutting edge educational opportunities on available technology and how to use it most effectively.
2. The Trustees of the Education Institute must review designations and update association members annually through required course attendance on information relating to these designations.
3. The association should partner with a group or groups to obtain auction results and provide those results to association members so that we can promote the positive results and not just have negative postings on the web.
4. Association members must be educated on how to use social media and other online technologies to obtain stronger consumer profiles that will lead to successful auction buyers.
5. The association must consider ways to educate the public that all auctions should be managed by auction professionals.

Macro-Level Trend Three:

“Freemium” - a new business model

“Freemium” is a business model that is quickly changing how entire industries compete for customers by offering basic services for free, while charging a premium for advanced or special features. The word “freemium” combines the two aspects of the business model: “free” and “premium.” The freemium business model was articulated by venture capitalist Fred Wilson in March 2006, “Give your service away for free, possibly ad supported but maybe not, acquire a lot of customers very efficiently through word of mouth, referral networks, organic search marketing, etc., then offer premium priced value added services or an enhanced version of your service to your customer base.” In 2009,

blogger and freemium guru, Chris Anderson published the book *Free: The Future of a Radical Price* which examines the increasing popularity of this business model.

Freemium is now considered the best practice for rolling out new products and ideas. Since this has already been proven as an effective, successful, and relatively quick process for developing brand recognition and customer loyalty, many venture capital firms now require that entrepreneurs base their start ups on the freemium model. Examples of freemium business models abound: Craigslist – a free classified ad network; Skype – free telephone services; Facebook – a free communication platform; LinkedIn – professional networking site; Google – free email accounts and free software that emulates Microsoft Office; Wordpress/Red Hat – free, open source software. Each of these companies has discovered that building a strong consumer base using the freemium business model is a successful springboard for up-selling customers to a premium product.

The Questions. Does the freemium model currently apply to auctions? Existing auction companies have long found ways to create added value to their specialized services including free evaluations and consultations. However, no traditional auction company has yet been built on the freemium business model. Companies coming closest to this model are online auction providers who charge a fixed fee for an auction listing. Will the auction business eventually move to a freemium model? According to Chris Anderson, this is inevitable; it's just a matter of who will step up to the plate and figure out the correct freemium model first. What will happen when someone figures out a way for consumers to purchase at auction without paying additional buyer premiums, fees, or commissions, particularly with large assets?

What will force this change? The desire to change industries over to the freemium model is being driven by consumers and technology. Entire industries will have to figure out how to successfully move into the freemium business model or they risk becoming irrelevant to a marketplace they might have once dominated.

How can auction professionals compete? The main way to compete with a freemium business model is to offer superior added value and customer service. But that's no guarantee of survival. Travel agencies renowned for their customer service and

competitive pricing were still driven out of business by technology and freemium competitors.

For auction professionals, this means:

1. Emerging new business models can change the way we charge for our services.
2. Well-funded start up auction companies can seize market share without near-term profitability concerns.

For the NAA, this means:

1. How does this model impact the association and its offerings of education, information, and community?
2. Could a new association emerge based on the freemium model?

Macro-Level Trend Four: Governmental regulations

Beyond the economic policies that have far reaching effects on our industry, there are changes happening in other parts of the government that will affect our business as well.

Small Businesses Need Not Apply. The FDIC, Fannie Mae, and Freddie Mac hire multiple auction companies and prepares RFP's and contracts for auction services, giving an opportunity to all size firms. However, these government agencies and government-controlled organizations have historically only wanted to work with the largest auction companies. Smaller auction firms will be excluded from obtaining government contracts, making that source of business only available to the largest auction companies with the cash and employee capacities to manage and execute that business.

The USDA, which used to employ auction companies on a regular basis, has stopped using auction companies because of a class action lawsuit by a group of borrowers that are protesting their liquidation policies.

The Small Business Administration (SBA) has employed auction companies and will continue to do so, but the capital requirements to service their business continue to

increase, making it difficult for the individual or small auction company to compete for their business.

Licensing Trends - State and Professional. We believe that online auctions will continue to be an unlicensed activity in most states due mostly to the “eBay[®] effect” and their lobbying efforts to prevent licensing of online auctions. We also think that the government’s lack of interest in regulating the Internet will further support this trend. Only Pennsylvania and New Hampshire have promulgated an online auction license law.

We believe that existing state boards responsible for the regulation of auction professionals and auction firms will come under pressure in two ways. First, some states will attempt to cut costs by eliminating the cost of regulation of the auction industry altogether. Second, due to sizable budget shortfalls, governmental authorities will push the regulatory boards to generate additional revenue. Fees for licenses are likely to increase. Some states may even pursue license law and rule violations as a source of additional funds.

At the professional level, some certification programs are making it more difficult to get a designation. The most notable example of this is The Appraisal Foundation. Authorized by Congress, the Appraisal Foundation is in charge of the Uniform Standards Principles of Appraisal Practice (USPAP) and sets the educational qualification requirements of member organizations through the Appraiser Qualifications Board.

In late 2010 and early 2011, the Appraiser Qualifications Board has been reviewing significant changes to get a personal property appraisal designation. We have already seen the Appraisal Institute investigate a policy to double the number of hours required to get an appraisal license. The recommended changes could include the likely expansion of educational hours of continuing education, which may result in the increase of time and curriculum expense.

Tax Trends. The government has traditionally created laws that were favorable to small businesses since they are responsible for 70% of all new jobs. Nearly all auction companies have less than 200 employees, classifying them as small businesses, with most companies being 20 or less employees and/or independent contractors. From 2008 to

2010, the Obama administration established significant changes to government policies that have a negative effect on small businesses. The NAA and its members need to pay close attention to changes in government policy and its effect on how they manage their businesses, ranging from tax laws to health care policy requirements at the Federal level, to new taxes at the State level.

Tax policy for the past ten years has leaned towards lower capital gain taxes and lower estate taxes. As already described, the Federal government is accumulating a huge deficit. To raise money to pay for its spending, the government may increase capital gain taxes, personal income taxes, and estate taxes. Changes in tax policy will affect how our sellers and buyers act. Property owners may need to sell to avoid tax increases and buyers may have less cash to invest if taxes are raised.

We can expect to see more State governments aggressively enforcing sales tax laws against auction companies. There may be auction companies that do not fully understand all aspects of their city, state, and local sales tax laws as well as the sales tax laws for their neighboring states. For example, beginning in early 2008, Minnesota initiated a thorough audit of a large number of auction companies located in Minnesota claiming that they were not collecting appropriate sales tax. The State completed audits of sales records for up to the past ten years. It resulted in many Minnesota auction companies having to pay past-due sales tax in amounts of \$5,000 to \$10,000, with one auction company owing in excess of \$80,000. The auction companies were not trying to avoid paying sales tax. However, the State government's aggressive enforcement of sales tax laws shed new light on the potential revenues produced by the industry.

In the spring of 2011, South Dakota began to initiate requests for sales information from auction companies located in Minnesota. This request is being made to discover additional tax revenues from individuals who purchase items at auction in Minnesota and transport the items across state lines for use in South Dakota. It would come as no surprise if additional states began to explore such measures to ensure sufficient revenues.

There is also discussion in some states to charge sales tax on service income. This would mean that our commissions would be subject to the state sales tax. There have

been some studies done that conclude if the states did this, it would solve their deficit problems.

We also believe that there is the potential for a national sales tax to be implemented. With the mounting debt problems the country is facing, we cannot completely discount the idea of a national sales tax. While this will be another tax to collect, it could also have an impact on how we structure our auctions. For example, if a personal property auction company charges a 10% to 18% buyer's premium at their auctions. In addition to the buyer's premium, non-tax exempt buyers have to pay a state sales tax that can range from 4% to 9%. If there is a national sales tax on all sales, we will have to ask ourselves the question, "At what point are the added fees paid by the buyer at an auction just too much?" If a national sales tax is instituted, could it result in auction companies having to reduce or eliminate the buyer's premium amount they charge?

An alternative to a national sales tax is the value added tax (VAT). The value added tax is similar to the national sales tax, however, instead of implementing one tax of a certain percentage at the time of retail sale, there is a smaller tax added each time the product is resold or when value has been added. For example, a tax is added when a manufacturer's "part" is sold to another manufacturer for assembly into an additional "part," and taxed yet again when sold to the wholesaler. Most products would be priced higher than they are today because the cost of goods would include this built-in tax, along with the buyer's premium, and state sales tax from the auction company.

As our industry continues to grow, the states will be focusing their efforts on tax enforcement of auction companies. State governments will stop looking at us as auctioneers but instead as retailers. This trend will require a more diligent accounting management process for auction companies. Calculating, collecting, and paying taxes will become an even bigger part of our regular accounting practices.

For auction professionals, this means:

1. Governmental regulations can affect the motives of our clients and customers.
The change in their motives will change the way they buy and sell.

2. The lack of auction licensing regulations in many states has made it easier for long-time auctioneers to stay in business without the concerns of meeting regulations, but it has also made it easier for people that want to call themselves auctioneers to get into our business. Because auctioneers have fought new auction regulations for so many years, they are now realizing the negative consequences of making it easier for others to get into the business.
3. Increased sales tax enforcement will require auctioneers to improve their accounting systems and their understanding of the sales tax laws.

For the NAA, this means:

1. NAA should help state auctioneer associations understand the need to have a concerted lobbying effort to manage any governmental regulations that change our industry. This is one area of government regulation that we can have a significant influence over.
2. The NAA must continue to monitor and lobby to represent the interests of auction companies nationwide.

Applying ‘Opportunity Agility’

Taking into account the four macro level issues we addressed, we concluded that the most viable auction businesses over the next five to ten years are those that can adapt to change quickly and be able to manage growth. The most successful auction businesses will be those that can change to take advantage of new opportunities that emerge as a result of uncontrollable macro level influences. The auction business that operates one way, and only one way, will eventually be replaced by the auction companies that can adapt, improve, and change based on what has happened to them, to their clients, and to their customers. The successful businesses will have Opportunity Agility.

By way of example, imagine an auction company that has a quarterly farm equipment auction at the local fairgrounds. For the past 20 years, this company has always had this auction. You begin to notice the crowds are thinning out and your competitors are using online auctions. As the company owner, you must ask yourself these questions:

- At what point will people stop coming to the fairgrounds to buy farm equipment? Do I realistically believe more people will want to come to the fairgrounds in the future to buy from our auction company than to buy online?
- When do we change the way the auction at the fairgrounds is conducted to allow for online auctions along with the live auctions?
- The toughest question of all is...when do we break from the traditional auction our company has always done because it no longer makes sense to do it?

The fairgrounds farm equipment auction is only an illustration of the trap that auction companies can fall into. It's the trap known simply as "we have always done it this way." This conflict of tradition vs. necessary future practices applies to all types of personal property auctions, real estate auctions, car auctions, estate auctions, and livestock auctions. The fundamental issue is whether or not it makes sense to change business practices because of what is happening to our business.

We also must keep in mind that there are people entering our industry that do not have any appreciation or respect for the history of the auction industry. Instead, they see the significant income opportunity the industry offers and they want to be a part of it.

We are going to see a continuation of new auction company owners that are more interested in growing an auction company and shaking up the industry than conforming to the way auctions have always been done.

A company with Opportunity Agility will look beyond the tradition of what has always been done and in addition, will look forward to what the company should be doing. The business owners will evaluate what processes they have in place now and the talents of their employees and then redeploy them in a way that is consistent with what is happening in the industry.

For instance, when evaluating social media, one of the major macro level trends we identified was the use of mobile phones to video our auctions and our auction staff and then to upload the video in real time. This is an issue that can't be ignored because the younger generation of buyers is heavy users of their mobile phones. A business owner should evaluate the impact of that trend on their business and make changes to adapt to the threat of being videotaped without their consent. Those changes could

include: improving how the staff acts at the auctions, how the staff dresses (do they look like a team? clean? professional?), or even implementing a written and posted policy about videotaping to try to control it (but can we do that?). What we don't want to do is wait for the unfortunate moment of having an unsuccessful auction occur and for it to end up on YouTube...forever. If we use Opportunity Agility, we will see this potentially harmful trend as a positive that we can capitalize on if we can make our business adapt to it and prevent the issue from becoming a real problem.

Opportunity Agility is not just the ability to adapt our marketing and operations to changes in the marketplace, but also to recognize new sale opportunities because of macro level changes that create the opportunity. The business owner needs to be in tune to industry-specific changes, communicate those changes to their sales team, and pursue new auction opportunities based on which industries are next to experience a downturn or a liquidity crisis. An example of this could be the consequences of health care reform.

When the legislation was being debated, many older doctors threatened to retire because the cost to operate was going to be too high and the enjoyment of being in the business had vanished. If there is a mass exodus by older generation doctors, then there is a new opportunity for auction companies to appraise and sell medical equipment. As auction professionals we have expertise in appraisals and equipment auctions and can help this group dispose of their assets. A business with Opportunity Agility would quickly figure out how to get into the medical equipment sales business, develop a service focused on that specific vertical market, and then market to get that business. And they would do this without sacrificing their core business that is well-adapted to the current environment. If your business does not have Opportunity Agility, you will watch another auction company seize on the opportunity as you sit on the sidelines.

In order to be an auction business with Opportunity Agility, we need to have several inherent characteristics called "seeing it" or Capital, Ideas, and Technology (aka CiT):

Capital. Without cash, we cannot pursue new opportunities since many have a learning curve, may require new marketing materials, an investment in education and training for our sales and marketing team, and trial and error as we explore ways to capture the

business. But if our business lacks capital or access to capital, those opportunities will pass us by. We may be in a low cost business now but there is no guarantee that we will be in a low cost auction business five to ten years from now.

Ideas. Instead of thinking outside of the proverbial “box,” we need to own the box. We need to think in creative ways that apply our auction transaction experience to new opportunities while also taking into consideration all of the macro level factors that are happening to our business. If something has never been done before, it does not mean it should not be considered.

Technology. Without applying new technologies to our current business and possible new opportunities, our business won’t transform with all that is happening around us. Technology integration into our business should happen strategically so the technology augments the results we desire as opposed to being in the way of achieving what we want. Technological integration can be as low-tech as switching from white boards to LCD screens at our auctions, or as high-tech as having our own “app” for smart phones.

If we see change coming, it is up to us to get ahead of it by using technology to make us a market leader.

With CiT, we can adapt our business to seize new opportunities within the auction industry. We can identify a new client need, be the first to solve it, and be the market leader to keep it.

We believe that a paradigm shift is happening in the auction industry. We believe that the world around us is changing in ways that we cannot control and that perhaps we may become victims of our own success. More and more people are embracing auctions as a method of sale. The effect is now catching up to us and auction firms are becoming more professional, increasingly corporate, and much larger. To compete in the burgeoning auction industry, auctioneers need to be able to leverage the CiT with exceptional business management skills.

To compete in our changing industry, auction professionals are going to have to adopt sound management and business growth skills to simply stay in business. Some of the business management challenges that we face are:

1. Reduction of commission rates. As more companies get into our business, there will be pressure put on commission rates. This is especially the case in the residential REO marketplace where there are several very large companies chasing a marketplace that has 5+ million homes to be sold. We have already seen RealtyBid™.com acquired by CoreLogic®, a publicly traded company. It is entirely possible that they could dramatically reduce commission rates because they (a) can do it - they are publicly traded, (b) have a significant relationship advantage with all of the lenders so they can get more volume at a lower rate, and (c) can sell other services from their related companies, like First American Title Insurance, to capture revenue from other parts of the transaction that auction companies cannot get. We saw the lowering of commission rates at the end of the Resolution Trust Corporation (RTC) days as well. One of the last deals completed for the RTC had a commission rate that was measured in basis points.
2. Lower revenue per transaction. If equipment values and real estate values continue to decline, we will have to sell more assets to realize the same income. Unfortunately, the numbers don't allow us to just sell a little bit more to make the additional money. Instead, we have to take more time and hire more people to realize the same volume. For example, if we had an annual commission volume of \$150,000 from six auctions. That is \$25,000 per auction. With the market values dropping by 20% to 40%, we could do the same six auctions but only realize an annual commission volume of \$90,000 to \$120,000. We do the same amount of work but make less money. To get back up to the \$150,000 commission volume, we would have to do eight to 10 auctions. By doing those auctions, we could get to the \$150,000 commission volume, but we would also raise our operating costs. Therefore we must conduct 11 to 13 auctions to compensate for the increased expenses. The alternative is to charge more, do fewer sales, and operate very efficiently. Unfortunately, that strategy works for the short term but does not result in building a larger, sustainable business.
3. Human resource problems will continue. If we decide to expand our business, we will need to have adequate human resource skills to manage other people. Many of us can handle managing two to four people, but once our business grows to 10,

- 20, or even 50 people, then a whole new set of management services and skills are required.
4. Data and analytics will become a greater part of businesses. As we compete against companies outside of the traditional auction industry, we must provide the same or comparable level of data about our businesses, our results, and our valuation estimates. Clients consistently ask us “what will this item bring?” Historically we have responded with “whatever the market will bear.” This answer is no longer acceptable to our clients. Actual historical data is available and NAA needs to be the source of it. In addition, we must educate members how to use this data. We have to have the ability to provide analysis of assets that go well behind our “gut feeling” of what something is worth.
 5. Industry consolidation will continue. We will see smaller and regional companies coming together to form larger auction companies. We will also see franchises and networks expand so those companies can offer turn-key solutions (including auction services) to their clients. When we draw a comparison of the real estate auction companies to the real estate brokerage companies, it becomes clear that the independent companies are falling short to franchised companies. The ability to earn large fees through volume and gain efficiency through technology, marketing and shared services create huge competitive advantages over smaller, independent companies.

Recommendations to the NAA Board of Directors

In light of the major changes happening to our industry, we recommend that the NAA Board of Directors take the following actions to help NAA members improve their businesses and adapt to the changes happening to them so that all NAA members can operate a successful auction business:

1. Fast track educational program improvements. The single most important service provided by the NAA to its members (today) is education. We need to have systems, processes, and people in place that can make rapid changes to our educational programs as the marketplace evolves. The idea that a designation program has a class that has not been updated for five years must be a thing of the past. In fact, it is simply embarrassing that that is the case with some of our classes. We need to have classes that are current, topical, and even cutting edge. And most importantly, this must happen without any political agenda or political barriers by any of the members or leadership. It needs to be done because it is the right thing to do for the membership.
2. Adopt an online education program. We need to offer specific courses online. There is really no excuse for us to be offering many of our programs in a classroom. Some say it is the networking that is important, but education and profit making through education needs to come first. For instance, the Auction Technology Specialist class should be an online class. It is a paradox that our most technologically-advanced education class is offered through antiquated educational techniques.
3. Develop classes that focus on company staff and not just the business owners. By expanding our classes for everyone in the auction business, we will get more participation. And it is the back office staff, or the new sales person, who cannot afford to travel to Conference & Show but still need the education, so an online educational program would help them grow without the added travel cost.
4. Pursue seller-focused strategic association relationships. Our relationship with the National Association of Realtors (NAR) may look good, but we question whether it is really in our best interest. We think the days of “partnering with

Realtors®” to do auctions has come and gone. Now, Realtors® are seeing how lucrative the auction business can be and are doing it themselves. Alternatively, there are online auction companies, such as AuctionPoint, that give Realtors® the ability to run auctions themselves. We have to question whether all of our education of Realtors® has helped or hurt us. Instead, we should turn our attention to associations that have potential clients for auction companies, such as the National Association of Bankruptcy Trustees (NABT), American Bankruptcy Institute (ABI), Risk Management Association (RMA), the Turnaround Management Association (TMA), Mortgage Bankers Association (MBA), American Society of Certified Public Accountants, and others like that. The NAA already has a relationship with ABI and NABT but we need deeper relationships. We also need to market the value of our designation programs to these associations.

5. Pursue business management strategic association relationships. To help our members learn how to be better business managers and marketers, we need to partner with associations that provide that type of education. Such associations include the American Marketing Association, the Direct Mail Marketing Association, American Management Association, and others. We should also encourage auction professionals to take classes at their local community college to help with management and accounting skills so they can learn how and where they need to grow their business.

Conclusion

We all see new auction companies gaining market share by offering new ideas, new services, and new solutions to the marketplace. We must ask ourselves, “Why didn’t we do that? Why didn’t we see this coming? If we did see it coming, why didn’t we do something about it? Were we afraid of change? Did we hope the change would go away?”

It is imperative that all auction professionals recognize that their business is being changed. And it’s never going back to the way it used to be. For some segments of the auction industry, the change is slower, while in other segments the changes are happening at rapid speed.

Now the next step is for us to take action in our own companies. Is our business positioned for “Opportunity Agility?” If not, what do we have to do so we can take advantage of the change that is happening to us?

By managing a business with Opportunity Agility, we will be prepared and able to adapt to the change before and after it happens. And if we are really are on top of the curve, we will be leading the change.

Addendum A Council on Future Practices Members

B. Mark Rogers, CAI, AARE, chairman

Mark Rogers is from Mt. Airy, North Carolina and currently serves as the president of the National Auctioneers Association. He has served in several leadership positions since 1996 when he served as president of the Auctioneers Association of North Carolina. In 2003, he was inducted into the Auctioneers Association of North Carolina Hall of Fame. Mark has been active in the auction industry for more than 20 years and works with his family in Rogers Realty & Auction Co.

John Schultz, vice-chairman

John Schultz actively works for his family business Schultz Auctioneers Landmark Realty, Inc. based in Minnesota and also for several regional and national auction firms, and was involved in over 90 different auctions in 2010. He serves the National Auctioneers Association as vice-chair of the Council on Future Practices, member of the Auction Technology Specialist Designation Oversight Committee, member of the Technology Committee, past member of the Futures Panel, a charter webinar instructor; charter NAA Ambassador to Minnesota, and multi-state and national conference seminar presenter.

Kurt Aumann, CAI, ATS

Kurt is a second-generation Auctioneer from Nokomis, Ill. Aumann Auctions Inc., and regularly conducts 100 auctions per year and sells real estate and a variety of specialty niche markets from antique automobiles to collectible toys. A 1982 graduate of Fort Smith Auction School, Kurt has taught college level courses and has been an instructor at the Certified Auctioneers Institute for several year and numerous auction conventions and seminars. He is a Past President of the Illinois Auctioneers Association and served as chair of the Education Institute Trustees in 2009-2010. He is a founding member of the Marknet Alliance auction marketing network.

Hannes Combest, CAE

Hannes Combest was named as Chief Executive Officer for the National Auctioneers Association beginning in June of 2008. Prior to her work at NAA, she served members of the Golf Course Superintendents Association of America for more than 12 years in various capacities. She has a master's degree from Baker University and is a Certified Association Executive. She is past-

president of the Kansas City Society of Association Executives and is active in the American Society of Association Executives (ASAE). She served on ASAE's Research Committee during the development of a project entitled "Designing Your Future."

Jere Daye, CAI, AARE, MPPA

Jere has been active in the industry for over 20 years, and has sold real estate in over 700 cities across the US, many multiple times. Financial institutions and insurance companies have been the predominant source of his auction business. Daye pioneered electronic bidding in the auction business early in the last decade, and is primarily responsible for the creation of the Appraisal Tool now used by GPPA members. He has served Chairman of the AARE Designation Committee, Vice Chairman of the GPPA Designation Committee, former member of the Educational Trustees and as alternate delegate to the Appraisal Foundation for the NAA. Jere works with Rowell Auctions as National Sales Manager.

Stephen Karbelk, CAI, AARE

Stephen started in the real estate auction business in the early 90's. Since that time, he has sold all types of residential and commercial properties at auction for banks, special servicers and bankruptcy courts. Stephen is the founder of National Commercial Auctioneers, a nationwide company that specializes in the sale of commercial real estate at auction. Stephen is also an instructor at the Worldwide College of Auctioneering.

Kurt Kiefer

Kurt is the owner of Kiefer Auction Supply and has been in the auction industry for more than 30 years. He received the Presidential Award of Distinction in 2008 for his work with the NAA finances. He previously served on the NAA Board of Directors from 1990 to 1995, including two years as Treasurer. He was appointed in 2008 to fill a vacant term as Treasurer and then was unanimously reelected to the position in 2009. Kurt specializes in liquidating large inventories.

Christie King, CAI, AARE, BAS

Christie is vice president of the National Auctioneers Association and will become the first female president in the association's 62 year history. She is one of three principals of J. P. King Auction Company and is President of C King Benefit Auctions. Christie has 24 years experience in the auction industry and holds either real estate or auctioneer license in 19 states.

Larry Latham, CAI

Larry founded Larry Latham Auctioneers in 1981, and over the next 28 years, acted as a prime contractor for the FDIC, RTC, HUD, Fannie Mae, Freddie Mac, the VA and many other financial and banking institutions. He established the first Internet-based platform to sell financial instruments, loans and mortgages owned by failed banks and savings and loan institutions. Both the RTC and the FDIC used this platform in the early 90's to facilitate the sale of hundreds of millions of dollars in loan portfolios. Larry was inducted into the NAA Hall of Fame in July 2009 and was appointed by Mark Rogers to serve as the Presidential appointed to the NAA Board of Directors for 2010-2011.

Will McLemore, CAI

In more than a decade as an auctioneer, Will McLemore has sold more than \$50 million of real estate and personal property at auction while working for some of the largest auction firms in the world. In 2006, Will founded McLemore Auction Company, LLC and opened its Nashville headquarters. A native of Nashville, Will holds a BA from Yale University in New Haven, CT. He is currently on the Board of the Tennessee Auctioneers Association and serves as a member of the Technology Committee of the National Auctioneers Association.

Sarah Sonke, CAI, AARE, CES

Sarah is founder and president of AuctionFirst, an accelerated auction marketing firm headquartered in Raleigh, North Carolina. Her business background includes experience in the fields of marketing, publishing and technology. She has extensive business development experience and has been involved in four successful start-ups including two national companies. She holds a B.A. from University of Richmond.