6 Things You Can Do To Make Returns a Competitive Advantage

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Customer Expectations for a Seamless Experience Includes Returns

Retailers encourage online purchasing with free shipping and lenient returns policies because that is what encourages online customers to shop with confidence. At this point, free and easy returns have become an expectation that retailers must meet to keep customers happy. A recent Comscore survey revealed 85% of customers would not return to a company with a difficult returns process. Online shoppers indicate a significant leeriness of purchasing without the ability to try-on, touch and experience the product the way in-store shoppers would. In exchange for their patronage, they have expectations for easy, no cost returns. They often purchase multiples (size, color, brands, and/or products) for comparison knowing they can return the one that doesn't fit or doesn't fit the need. And with the exponential growth of online sales, comes a rise in returns. Nearly 62% of consumers returned or exchanged items in 2013, a 20% increase from the previous year. And for omni-channel retailers, returns are complex and unpredictable – causing logistics nightmares and potential service failures. Compounding matters, returns often peak as the season peaks. How do you balance customer expectations with the cost of providing a seamless experience that includes easy returns?

Returns as a Competitive Advantage

For some companies, returns are a critical element of their brand promise. Zappos considers its one-year, free-return shipping policy key to building customer loyalty. L.L.Bean considers reverse logistics to be a core competency – and an integral part of its brand marketing. The company's returns facility rivals many distribution centers in size. Unfortunately, for many companies returns are a necessary evil and dealt with only when they start to impede the business. Returns can tie up costly resources across multiple functions of the company – from customer service to warehousing to accounting.

Case Study: Zappos Uses Reverse Logistics to Gain Competitive Advantage

Zappos, an online retailer of shoes and apparel, built its success on the promise of free and easy returns. The company actually encourages customers to order two sizes of shoes to make sure they end up with one pair that fits. Zappos' use of logistics as a competitive service advantage is one reason 75% of the retailer's shoppers are repeat customers. While this policy drives up return volumes and shipping costs, it reduces customers' hesitancy to place an order and results in more sales overall.

Case Study: Amazon Makes Returns Easy for Customers

Amazon centralizes returns in a single facility for efficiency. The Lexington, KY facility is designed to handle both inbound returns and outbound disposition of returned inventory. Amazon makes it easy for customers by providing a pre-paid shipping label so packages can be dropped off or scheduled for pick-up by UPS. For Prime-eligible items, the company credits the customer's account within 24-48 hours of initiating the return; in many cases before the customer has even shipped it, to encourage the order of replacement or additional items.

Returns Add Complexity to Distribution

Receiving, evaluating and re-packaging are labor-intensive functions when performed in quantities of one and two, which are typical quantities for eCommerce returns. Systems have to be able to track the merchandise (receipts, inventory, value, etc.) and support the issuing of credits and intake of inventory. Does the item retain the same SKU number as before or is it assigned a new SKU number? Should the item be transferred to a different DC or channel due to demand patterns? Will the item be returned to the vendor or scrapped based on its condition? These decisions are complex in nature and can have a material impact on an organization's bottom line and cash flow.

Brick and mortar retailers have the option to accept returns in store, but then what? Do you put them on the sales floor at full price, mark them down or perform additional handling tasks to ship them back to the DC? What if the store doesn't carry that SKU? Some companies encourage returns to the store because it brings shoppers back into a sales environment where they are likely to make additional purchases. Other brand owners choose instead to destroy all returned merchandise because the cost of all that handling and re-packaging is too high or out of fear that the brand image might be tainted by discounting.

Whatever you do, you can't ignore them. Sarbannes Oxley (SOX) requires tighter control of the returns process. All movements of inventory must be recorded in a timely fashion given their financial impact. That aside, it's important to note that the returns inventory awaiting receipt, inspection and disposition, is likely current season merchandise which has a shelf life. The sooner you can make it available for sale, the greater the opportunity to sell it at full margin.

So, how do you turn handling returns into an opportunity for competitive advantage?

1. **Decide whether or not you want to deal with returns.** There are logistics providers who specialize in returns. If you outsource this function, you don't have headaches to deal with, but you also recoup far less of your investment and have less control over the process. These 3PLs have developed processes and standards for disposition that rival the discipline of most outbound distribution operations. Their procedures and training are often much better than those of in-house returns operations. Some have even invested in automation to reduce cycle time and labor cost.

2. **Determine what returns are worth to you.** All returns are not created equal. What is the value of the merchandise and how much margin do you have to work with to try to re-sell it? This will guide investments in labor, equipment, training, etc., as well as the disposition strategy for returns (re-stock, discount, return to supplier or scrap). Shipping cost will also influence how much you can invest and whether or not to centralize operations in a multi-site network. You must balance economies of scale against transportation cost.

Case Study: Hermes Automates Returns Process

Hermes Fulfillment is the largest fully-automated reverse logistics warehouse in the world. Rather than continue to manually sort returns in its picking warehouse, Hermes looked to automation technology to increase efficiency and accuracy.

The automatic returns management system has a storage capacity of 1 million items in approximately 176,000 storage locations. Most products remain in the system for only a few hours. Utilizing up to 30 workstations on two levels, up to 15,000 items per hour are processed during peak times.

The use of automation at Hermes has enabled the company to process returns faster with greater flexibility. They've also been able to improve quality with greater accuracy and make better use of the space in the facility.

3. **Measure and manage returns as closely as you do the rest of your inventory.** Metrics and management are key. With most returns operations, there's opportunity to improve how you measure and manage the cost structure for returns. Focus on processes and institute the same management and control over returns as you do over other inventory. Consider:

   - How long does it take to cycle through returns?
   - What percent of returns can you salvage?
   - What is the cost per unit handled in the returns process?
   - What is the margin impact (salvage/disposition value divided by cost)?
   - What categories, vendors, customers, etc. have the largest volume and dollar impact on returns?
   - What can you learn from returns to help make better purchasing and inventory deployment decisions in the future?

Case Study: Returns Place Constant Pressure on Automotive Aftermarket

For an example of how to handle returns more efficiently, you might look to automotive aftermarket distribution, which has one of the highest rates of product returns of any industry. Returns as a percent of revenue consistently run in the mid- to high 20's. It's a constant pressure on automotive parts distributors as both professional installers and do-it-yourselfers often order multiple parts to ensure they have the part that fits and then return the unused parts when the repair is complete. While most large aftermarket distribution operations have the benefit of a closed loop transportation system, which represents a significant savings in shipping cost, there are other lessons to be learned from an industry that has both a complex and consistently high returns rate. At one automotive aftermarket distributor:

- Returns are systemically-driven. Systems enable visibility into what is coming into the DC for disposition, enabling the returns team to plan for and manage returns better.
- Rules for disposition of product are clearly defined and metrics are put in place to support the return-to-stock goals.
- Returns are processed in a dedicated area in the DC with a returns team that is trained and staffed as part of operation, including a management team dedicated to carefully managing this critical area of the business.

4. Work toward a **single view of inventory**. Visibility to inventory is critical in an omni-channel returns environment. Having visibility to a single real-time view of inventory, including returns, allows you to make better decisions about order fulfillment and replenishment. Can you fulfill orders directly from returns? Can you confidently ship orders from the store knowing that you have the inventory in returns to replenish that stock? Data from product returns can also be used to improve planning for new products or inform future purchasing, design and manufacturing decisions by identifying products with high-rates of failure. When you take a broader view of supply/demand, you can make better decisions to optimize the recovery value and inventory productivity of returns.

5. **Mitigate the need for returns.** Many companies are investing in fitting technology and enhanced fit guides online to help shoppers find the right fit and minimize the need for customers to return as many products. With the proper fit information, the customer is less likely to order two different sizes only to return the one that doesn't fit. Providing more product attribute information and product reviews can diminish returns as shoppers make better informed decisions.

6. **Consider return policies.** Return policies may have to change to incentivize the lowest cost return option or de-incentivize returns for consumers who are on the fence about whether to keep an item. Encouraging store returns where possible has the added advantage of providing another sales opportunity. Can you offer free shipping and charge for returns? You train your customers with your policies.

6 Things You Can Do to Make Returns a Competitive Advantage

1. Decide whether to outsource or handle returns in-house.
2. Determine the true cost of returns.
3. Implement metrics and management controls for returns.
4. Work toward a single view of inventory.
5. Mitigate the need for returns.
6. Align return policies to incentivize the lowest cost return option or de-incentivize returns.

Summary

Expect returns to increase as online sales grow. Companies that take a strategic approach to handling returns efficiently will continue to delight customers without negative impact to profitability. Those who fail to apply discipline to this aspect of their business will see reverse logistics costs rise. Balancing cost and customer expectations is challenging, but while returns are often resource intensive, they can have value in increasing sales and competitive advantage as part of a brand promise.

How Can We Help?

Fortna helps companies improve their distribution operations, build a business case for investment, and implement solutions that drive business results. To learn more, ask to speak with one of our Associates.

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