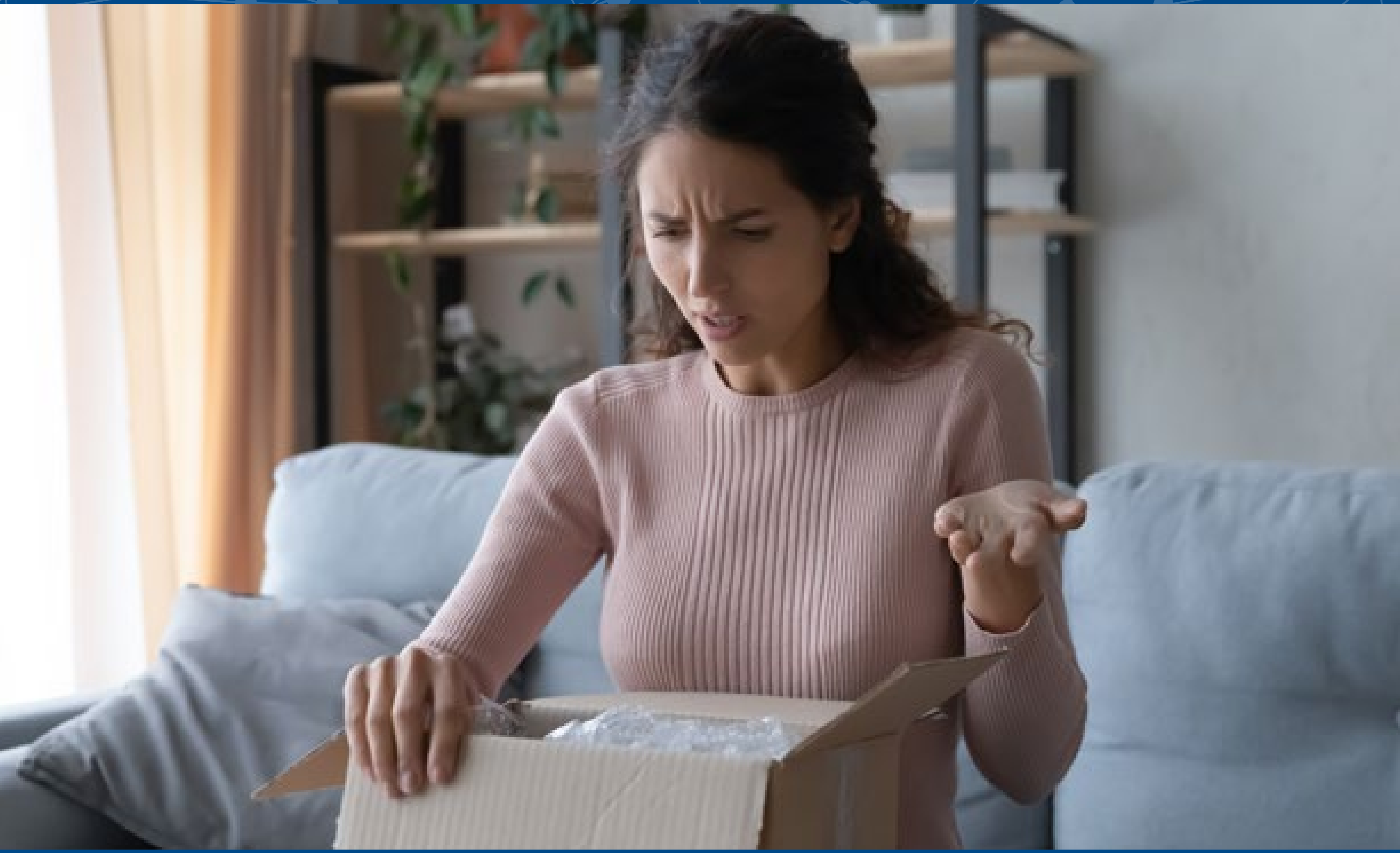
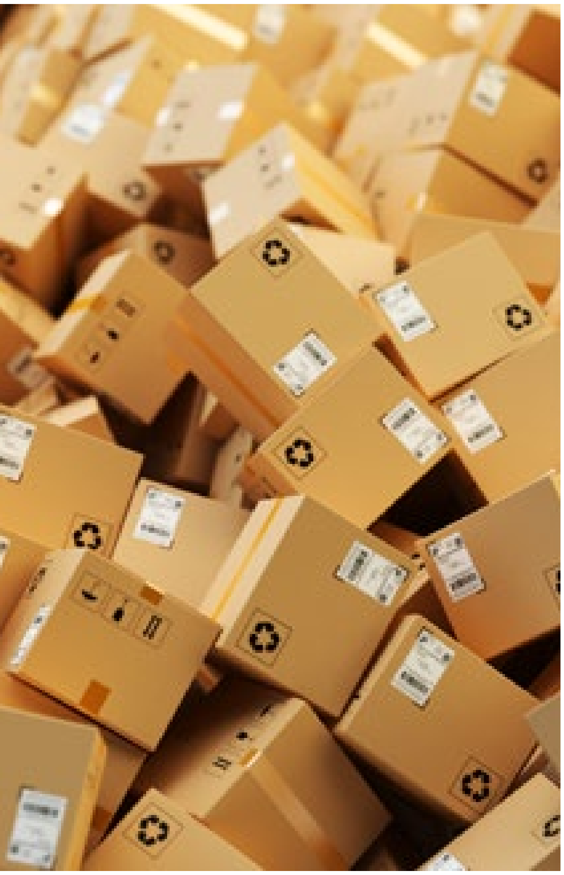
THE DISTRIBUTION EXPERTS™
Fortna Thought Leadership Series

8 Steps to Optimize Returns

Best Practices for Profitable and Efficient Reverse Logistics



With the precipitous increase in online sales — and the disproportionate frequency of order returns — it's clear that new returns processing approaches are needed. To maintain profits, retailers must apply the same level of focus to the reverse logistics process as they do to outbound operations. The problem — and the opportunities — justify a closer look.



A TSUNAMI OF RETURNS

Retailers have an increasingly large return problem. American consumers returned a whopping $761 billion of goods[1] in 2021, compared to $428 billion in 2020. More concerning, the average return rate rose from 10.6% to 16.6%. And since e-commerce purchases are returned at a much higher rate than in-store purchases[2], as e-commerce grows, so will this return rate.

The e-commerce returns process is time-consuming, chaotic, unpredictable and costly. Like outbound logistics, most returns are "each" or individual items that are being returned across multiple channels. They may need to be consolidated, sorted and redistributed to different locations based on demand. And in this fast-paced environment, time is money.

The longer returns processing takes, the more likely that an item will become obsolete, out-of-season, out-of-style or require a significant price reduction to re-sell it. In addition, items may require inspection, re-packaging and labeling — and each step may have supporting systems, processes and communications associated with it.

According to a report by CBRE and Optoro, the cost of an average return in 2021 was two-thirds of the original sale price — factoring in labor, transportation and warehousing costs. It's no wonder that many companies outsource the entire returns process or send returned merchandise directly to liquidation. But with proper processes that quickly recirculate products back into sellable inventory, returns can be good for the bottom line and the environment.

1 https://nrf.com/media-center/press-releases/retail-returns-increased-761-billion-2021-result-overall-sales-growth
2 https://www.imrg.org/blog/3-e-commerce-return-trends-for-2022-to-attract-more-customers-and-keeping-them-loyal

If you're among those retailers who think implementing efficient processing returns is not a good use of internal resources, it's time to rethink that assumption. Consider the following eight steps toward optimizing returns for improved profitability.

1. Define clear ownership and metrics.

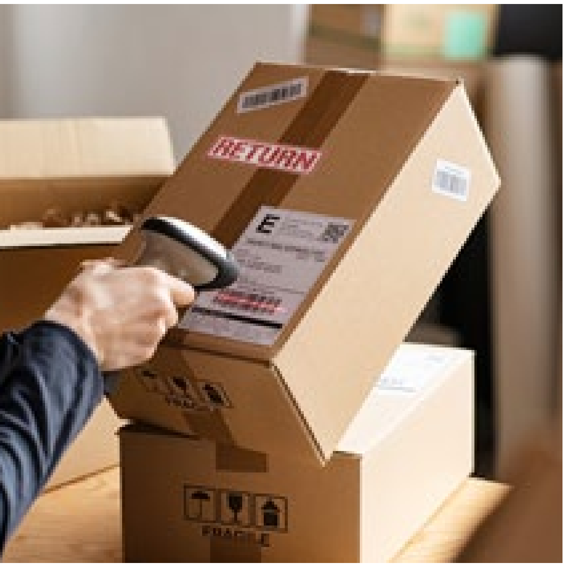
Returns management is inherently a cross-functional discipline that impacts multiple departments, including finance, manufacturing, sourcing, merchandising, marketing and distribution. According to McKinsey, rather than designating a single owner, half of all retailers assign four or more functions with responsibility for some aspect of returns[3]. That can lead to a misalignment of performance metrics and result in declining efficiencies. For example, while Sales is incented to sell and may not be penalized for frequent returns, Warehousing is rewarded for processing returns quickly but may not be focused on an item's profitability. And who is responsible for reducing the volume of returns?

Appointing a single person to oversee company-wide returns process is key. That person's focus should be on streamlining the overall process — from collaborating with suppliers to share ownership for returns to the liquidation of inventory. S/he should develop cross-functional metrics that encourage the desired behaviors. For example, all commissioned sales associates should be measured on net returns, and product profitability should include the cost of processing returned items. Finally, they should develop an executive dashboard that gives everyone a high-level view of returns, including the following metrics:

- What is the cost per unit to process a return for each return channel?
- Are returns routing decisions optimized for efficiency?
- Are you incentivizing customers to the most profitable returns behaviors?
- What is your returns rate for each product and product group?
- What percent of returns do you salvage?
- What percent of returns are resold at full price? At a discount?

"Appointing a single person to oversee company-wide returns process is key."

3 https://www.mckinsey.com/industries/retail/our-insights/returning-to-order-improving-returns-management-for-apparel-companies



2. Focus on speed.

Companies tend to think more about the cost of processing returns than they do about product profitability. But a slow returns process can mean much lower profit if the product misses the selling season or depreciates in value. Fashion apparel is well-known for losing value quickly. Electronics lose 4 to 8% of their value each month[4]. Returns are especially tough for wholesalers who must often wait until the end of a season to receive returns from retailers, forgoing any chance of recovering a profit.

The sooner you make a return available for resale, the greater your odds of selling it again for full price. If possible, you should try to make an item available for resale within 24 hours from the time you receive the return. This means that the disposition of the returned product must be determined in the location where it is returned and, if possible, put back into sellable inventory at that same node.

3. Improve your systems.

To ensure the highest returns recovery rates, you'll need good systems. At a minimum, a system should support a single view of inventory that tracks returned items and issues credit. As soon as a return is received, it should be immediately recorded in the system and assessed as fit for resale, easily repairable or damaged. Bar codes and radio-frequency identification (RFID) tags can help to identify items, and new artificial intelligence (AI) solutions use cameras to help assess the condition of returns quickly.

To maximize the profitability of returns, your system will need to use insights from inventory and sales data to intelligently route each return to the ideal channel or location based on:

- How quickly the item is likely to be resold at each node
- Minimizing the cost of transportation
- Reducing touches and processing costs
- Factoring in re-packing and re-labeling costs

The system should also be equipped with machine-learning (ML) algorithms that analyze market demand and historical data to determine the best resale price and incentivize customers to return the item via the most cost-effective channel. These data-driven decisions are complex, but they can have a big financial impact when well executed.

"These data-driven decisions are complex, but they can have a big financial impact when well executed."

4 https://www.supplychaindive.com/news/reverse-logistics-flood-returns-warehouse/580304

4. Leverage automation technologies.

Investments in automation may be more easily justified when considering the sheer volume of returns, the need to handle returns quickly, and the struggle to hire warehouse workers. As a good rule of thumb, if you process more than 4,000 units/hour, it's probably time to consider automation[5].

Several automated order-picking solutions can work in reverse to restock returns. For example, pouch systems, mobile robots and goods-to-person (GTP) solutions are designed to pick items from inventory to create an order. The same process can be reversed to return items back into inventory. This can be especially efficient in a high-density storage system like AutoStore that can take advantage of your existing facility footprint and leverage odd-shaped storage spaces.

5. Take advantage of brick-and-mortar stores.

When it comes to returns processing, your brick-and-mortar stores can be transformed into a strategic advantage. Even items that are purchased online can be returned and resold in physical stores. In addition to eliminating the cost of shipping the item back to a distribution center (DC), you have an opportunity to cross-sell additional items when they come into the store. Reducing the need for transporting returns throughout the DC network also lessens your carbon footprint and has a positive impact on the environment.

Be aware that buy online, return to store (BORTS) processing can introduce its own set of challenges — especially if an item is out of season, damaged or not a store SKU. In these cases, you may face the decision of selling the item at a discounted rate in the store or shipping it back to the DC or supplier. Many retailers are implementing ship-from-store fulfillment models that are enabling items returned to a store to be used to fulfill online orders — which can also result in transportation cost savings.

6. Refresh your returns policy.

Two-thirds of consumers review returns policies before making a purchase, and 54% of buyers are unlikely to buy from a retailer with a poor or unclear returns policy[6]. Because it is an important part of your overall customer service capabilities, having a pro-customer returns policy is now a competitive advantage.

"As a good rule of thumb, if you process more than 4,000 units/hour, it's probably time to consider automation."

5 https://www.mmh.com/article/reverse_logistics_meets_automation
6 https://chainstoreage.com/survey-return-policy-influences-purchase-decisions

A key aspect of your returns policy is the decision whether to offer free returns. Consider the following consumer data:

- Customers spend three times more at online stores with free returns[7].
- Buyers say that free returns make them more loyal and likely to buy again[8].
- 66% of U.S. shoppers say they are more likely to purchase an item online when it can be returned at a local store[9].

If offering free returns to everyone is not an option, consider free returns for loyalty members, items over a certain value or returns to a store. Another option is to charge for returns but make exchanges free. To keep the sale, consider offering store credits instead of a cash refund.

Returns policies are so critical that they should be reviewed regularly and consider the following: the competitive landscape, the cost of processing returns and the likelihood of resale.

"Returns policies are so critical that they should be reviewed regularly."

7. Mine customer feedback for process improvements.

Instead of thinking of returns as a lost revenue, many retailers leverage them as a feedback loop and/or gold mine of information that can lead to company-wide improvements and higher sales. Insights include:

- Products returned frequently due to damage or low quality should trigger an alert to the buying or merchandising team.
- Products returned due to damage, late deliveries or mis-picks indicate a problem in fulfillment processing.
- Products returned due to color or fit may indicate a misleading website description.
- A vendor with a large volume of returns should be re-assessed, as should a customer with a large percentage of returns

A cross-functional returns owner can make an immediate impact by improving this feedback loop for the good of the entire company.

7 https://www.imrg.org/blog/3-e-commerce-return-trends-for-2022-to-attract-more-customers-and-keeping-them-loyal
8 https://www.imrg.org/blog/3-e-commerce-return-trends-for-2022-to-attract-more-customers-and-keeping-them-loyal
9 https://www.morningbrew.com/retail/issues/run-it-back?email=%7B%7Bprofile.email%7D%7D&utm_campaign=rtb&utm_medium=newsletter&utm_source=header_signup

8. Rethink outsourcing and liquidation.

Many companies outsource returns processing or send returns directly to factory outlets, discount stores or salvage companies. Some reverse logistics companies utilize sophisticated software and technologies that speed up returns and cut labor costs. In addition, they have existing relationships with liquidators, recyclers and others.

However, using third parties and liquidators pushes returns efforts downstream, and that can result in "out of sight, out of mind" inefficiencies. With less control over the process, online retailers may not be as motivated to reduce returns. In addition, using third parties may delay or discourage the reselling of returned merchandise. With 72% of returned merchandise in resalable condition, this translates into a squandered opportunity for profit[10].

"...using third parties and liquidators pushes returns efforts downstream, and that can result in 'out of sight, out of mind' inefficiencies."

10 https://www.shopify.com/enterprise/ecommerce-returns

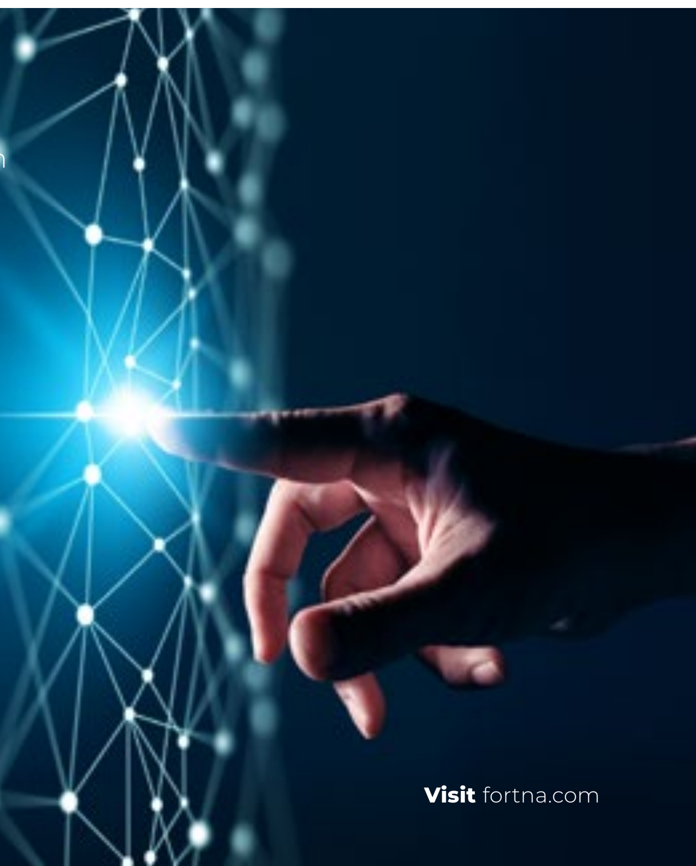
FORTNA CAN HELP

As e-commerce volume growth continues, companies must take a strategic approach to handling returns efficiently to continue to delight customers and drive competitive advantage. Failure to apply discipline to this aspect of the business can result in further cost increases and escalating challenges as reverse logistics costs spiral out of control. The returns experience is as important as the purchase experience in earning and maintaining brand loyalty. Although balancing cost and customer expectations can be challenging, Fortna can help. Fortna enables companies to improve their distribution operations performance with designs and solutions that optimize seamless omnichannel fulfillment and returns.

For help with a more efficient returns handling operation, contact the Distribution Experts™ at info@fortna.com.

THE DISTRIBUTION EXPERTS™

Fortna partners with the world's leading brands to transform their distribution operations to keep pace with digital disruption and growth objectives. Known worldwide as the Distribution Experts, we design and deliver intelligent solutions, powered by FortnaWES™ software, to optimize fast, accurate and cost-effective order fulfillment. Our people, innovative approach and proprietary algorithms and tools ensure optimal operations design and material and information flow. We deliver exceptional value every day to our clients with comprehensive services, including network strategy, distribution center operations, material handling automation, supply chain systems, and warehouse software design and implementation.



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