



## **Returning Profits from Returns: *Leveraging all 5 R's of Effective Returns Management***

by Kate Vitasek, Karl Manrodt and Peter Murphy

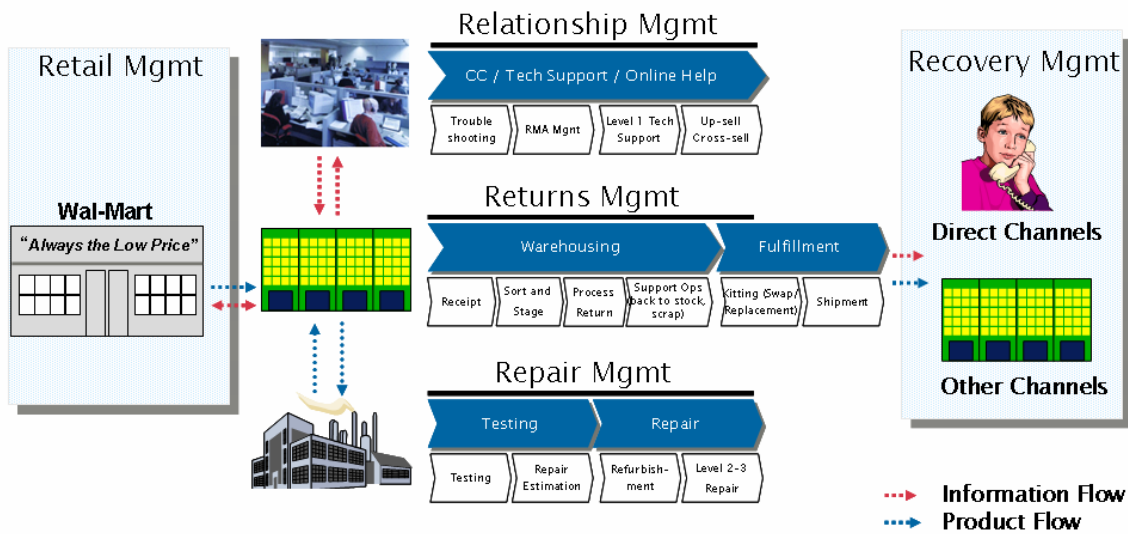
Managing returns is big business. However, for most companies, managing returns is just a big headache that most executives hope would just disappear. Unfortunately for logistics professionals the returns headache is migraine size. According to the chairman of the Returns Logistics Executive Council (RLEC), the top 30 non-grocery retailers in the United States handle around \$53 billion in returns per year.<sup>i</sup> Other recent estimates range as high as \$100 billion – which is more than the GDP of two-thirds of the world's countries.<sup>ii</sup>

Managing returns can be a virtual "Catch-22" for most supply chain managers. Retailers must satisfy the customer to develop loyalty; even if it means accepting product that has passed the manufacturer's warranty period and then manufacturers must satisfy the retailers in order to maintain a strong customer base. This entire process revolves around the issue of cost. In the end, someone has to absorb the expense, with very little visible or measurable return in sight.<sup>iii</sup>

Costs are only part of the picture. While returns are, in fact, a significant source of costs, progressive companies are looking beyond costs in viewing returns as a strategic area within their organization. While most companies feel they must accept returns for competitive or legislative reasons, more and more companies recognize this as an opportunity to broaden their view of returns management as a strategic area for recapturing value and recovering assets. These progressive companies are viewing effective returns management not as a "must do because the competitors do" but as a way to convert returns into a revenue generating source via post sales opportunities and improved customer loyalty. The key is better upfront relationship management during the customer's returns process.

Reverse logistics represents one of the largest and most overlooked opportunities to help return profits to a company. However, very few companies are doing a good job in addressing this issue. Analysts warn that unless companies put systems and processes in place to recoup a significant portion of that cost, returns will have a dramatic impact on profitability.<sup>iv</sup> Leading experts advocate that most companies are overlooking their reverse logistics supply chain and are missing opportunities to improve margins as well as customer satisfaction and loyalty. This may be due to the fact that companies are missing the big picture when it comes to managing returns.

Effective returns management is about more than getting product back and possibly reselling it to recoup losses. It is about effectively managing all five of the critical elements of returns – or the 5 "R's": Retail Management, Relationship Management, Returns Management, Repair Management and Recovery Management.



### ***The 5R Returns Management Framework***

#### **Leveraging 5R for Effective Returns Management**

Reverse logistics includes a number of processes that aren't typically included in a traditional forward logistics supply chain. The 5R framework can help companies think about each of the key elements of a successful return as well as the best practices necessary to help companies bring profitability to their returns management process.

#### ***Retail Management***

Retail management is the starting point in the returns and reverse logistics process, and consists of two distinct parts: communicating the warranty / returns process and proactively solving problems.

A good beginning to preventing returns is to be upfront and clear with regards to retail policies – with both direct customers and with channel customers. Companies need to ensure they are clearly communicating their returns policies at the “point of sale” to their customers.

The primary reason is that consumers tend to have fewer problems with return policies when those return policies are communicated clearly. Research further shows that when consumers don't understand the returns policy, they tend to get angry.<sup>v</sup> Angry customers will likely not be repeat customers – a clearly communicated returns policy should help prevent future lost sales.

A positive customer experience and interface is also critical. Research by the University of Nevada's Returns Logistics Education Center indicates that companies with identical return policies can be viewed quite differently by consumers, indicating that what matters more is the interface between the consumer and the retailer, not the actual return policy.<sup>vi</sup>

Companies are beginning to explore post sale options that help prevent customers from returning product back through the channel altogether. As a result, supply chain partners are working together to minimize the number of returns at the retail level.

Few returns are due to defective parts; focus group research reveals that more than 75 percent of consumers admitted knowing their returned products were not defective.<sup>vii</sup> Making sure that these products are diverted from the complete returns process can help save resources.

arvato services (a global outsourced supply chain management company) has worked with some of its customers to put in place “intelligent gatekeeping” processes that catch false returns upfront. They have begun training in-store employees to assist in the diagnosis of problems customers were having with their mobile phones. Instead of sending the phone off for repairs, a local technician – trained by arvato – will run a few quick diagnostic tests first; in many cases this solves the problem. When it does not, the phone is sent in to arvato for repair. One might suggest that such a strategy would negatively impact arvato, who is paid to repair products for the channel partners. Most firms are looking for ways to increase their revenue stream, not reduce it. While the cost of repairs by the provider may increase, this is primarily due to working on the products that have a serious problem. The reality is that total supply chain costs should decrease, as less complex repairs are done on site. This cost avoidance strategy optimizes total supply chain efficiencies and increases customer satisfaction at the same time..

What does all this mean for today’s companies? Simply put – companies can leverage an efficient returns process into the ability to convert a customer with a problem into a loyal customer.

### ***Relationship Management***

Many companies view returns as something that shows up at the dock door unexpectedly which must be dealt with. However, more and more companies are starting to view the “front-end” part of returns as a critical part of an effective returns management process. This upfront part is the relationship management element of the returns process which includes troubleshooting, returns management authorization (RMA) management, technical support and cross/up selling.

One good way to prevent returns altogether is to engage in proactive troubleshooting and upfront customer care in the returns process. Studies show product return rates with “no defect found” (NDF) averaging more than 70 percent for consumer electronics, more than 85 percent for PC products, and over 90 percent for some small appliances.<sup>viii</sup> Companies are spending millions of dollars on returns that are not defective!

One example of troubleshooting is the use of “stop sheets” in the box with their product. These sheets are emblazoned with a stop sign and direct the consumer to contact the manufacturer first before taking the product back to the retail store. This not only decreases returns – it solves the problem and keeps customers satisfied.

Proper packaging and paperwork are important components of an efficient returns program. A robust RMA process is an important element for helping to drive returns efficiencies. A major benefit of using RMAs is that it gives companies a better forecast of when and how many product returns will be received by their returns processing facilities.

Return authorization labels can be preprinted by the company and sent to customers with the original shipment or after the customer has notified the company that an item will be returned. Having the return label color coded or address specified can help employees easily recognize returns and keep it separated from other product being received. Some firms have even allowed the customer to print the RMA on their printer, and send it back to the company with the product.

The RMA process also opens up the possibility for companies to proactively handle the returns receipt itself. For example, companies can determine in advance during the RMA process where they want to route the product. If the troubleshooting phase indicates a definite defect or

damage, the product can be routed directly to the repair facility or to the OEM and can by pass distribution center altogether.

Many companies use web-based RMA templates to capture customer information before an item is returned. Return authorization labels can be generated by the customer from the firm's website or using software provided by the company.<sup>ix x</sup>

There is one key benefit of an electronically generated RMA that should not be overlooked– the ability to capture and understand what is going to be returned, why it is being returned, and when it should be received by the company. Knowing in advance what to expect can be used by the appropriate supply chain partners to manage capacity, set customer expectations, and manage service parts inventory levels.

For instance, Level 1 Technical Support involves helping a customer get through the basic challenges they might be having with their product. This can be done via a call center, through the internet, or on site at the retail store. Often it is the complexity of the product versus the product itself that drives a customer to return the product (think about programming your VCR!). The web is a great resource to post Frequently Asked Questions (FAQs) and other self help technical support. When the web doesn't work, good companies don't hesitate to encourage customers to contact them for more help. A good technical support person can help customers get over their initial hurdles with the product and can also set a positive experience for the company.

Best practices companies are also turning to progressive customer service approaches to prevent the return and to improve customer satisfaction. One example of this is a "swap" program where the customer is shipped a new (or refurbished) product as a replacement, often within 24 to 48 hours of when the problem call was received. If a "newer" product is available, the customer service representative can "up sell" the customer to the newest product for perhaps a reduced rate.

### Returns Management

The warehousing and fulfillment activities of managing a return are often the most visible part of a company's returns process. It is no surprise that these core

functions are often the primary focus for improving a company's returns process. The ARC Advisory Group and other leading experts are advocates of having a dedicated and specially designed returns center rather than simply managing returns in a traditional distribution center (DC)<sup>xi</sup> In recent years the trend has centered around creating a dedicated facility or outsourcing the returns altogether to help drive focus around the core activities associated with managing a return.

The primary reason for this trend is that a forward flow DC doesn't work well in bringing returns back. Many forward DC's are being designed to manage cases and pallets as opposed to individual returns.

Using a consolidation center for returns allows a company to define and execute its returns processes efficiently. In addition, having returns centralized helps bring focus, thus companies are better able to determine and analyze the root causes of returns. In addition, by having a single point of return, the problems associated with numerous retailers individually returning items to a single vendor can be bypassed. Research indicates that retailers processing returns in store can be up to 20 times less productive than a central return center.<sup>xii</sup>



Receipt of the returned product is integral to the returns process. While using an effective RMA process and troubleshooting can greatly reduce the number of returns a company gets back, volumes will still probably fluctuate which can challenge staffing levels. Returned product should come back with bar codes that can be scanned to minimize handling. In addition, some companies are turning to innovative transportation methods to help speed the receipt of goods. One method companies are starting to explore is to consolidate repairs coming back into larger shipments. Companies can reduce transportation costs by coordinating returns shipments with larger shipments.

Once companies have a returned product in their possession, the item can spend days, weeks, even months on a shelf waiting to be evaluated because this process is often done on a case-by-case basis. The testing, sorting, and grading of returned products are labor-intensive and time consuming tasks. The process can be streamlined if a company subjects the returns to quality standards and uses sensors, bar codes, and other technologies to automate tracking and testing.<sup>xiii</sup>

Processing a return involves updating companies systems to both check the product back into inventory as well as give credit authorization to the customer. Some companies are starting to integrate this activity within the distribution center to speed up the process.

One of the most effective steps a company can take with regards to supporting the smooth flow of product to its appropriate place is to perform product disposition based on predefined business rules. Demands for faster support – especially for spare parts either that need to be sent to a customer or used in the repair process – are becoming a key priority. A recent study found that nearly 70% of respondents indicated that the typical aftermarket service response times required in service level agreements (SLAs) have shrunk to 48 hours or less. This translates to the need for outstanding logistics processes that can support the various channels and customer needs associated with a returned product – whether doing a simple replacement or managing a complex repair.

When the re-boxing of product returns is appropriate, the DC should have an inventory of vendor/supplier boxes, tape, shrink wrap, strapping and other vendor-specific materials available to employees/associates at returns processing stations.<sup>xiv</sup>

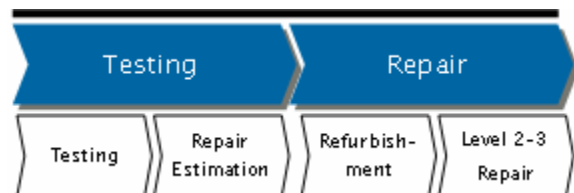
While customers are demanding rapid service for their returns or repairs, many companies have not been able to efficiently manage these expectations. This is especially true with regards to managing spare parts needed to make repairs. A recent study shows an on-time delivery performance of 89%, and first-time fill rates of 82% for spare parts. This performance might seem acceptable –even good. However, such sub-90% performance can negatively impact customer satisfaction and overall profitability, especially when it means a customer needs a critical part for a repair. Research shows, on average, companies experience 272 service parts stock outs each year, a typical company may potentially lose more than 270 customers<sup>xv</sup>

### **Repair Management**

As Dave Vehec, VP of retail service at GENCO points out, “There is value in products”.

Unfortunately, Mr. Vehec also adds, “the longer it sits, the less value you’re going to have in that product”.<sup>xvi</sup> Companies should shift their thinking

from associating returns as a headache and view it as a reselling opportunity for profit. Firms that do product refurbishing can reap significant benefits. Recovery rates (as a percent of the dollar value of the product) for refurbished or remanufactured items can be quite high compared



to products resold as is, sold for scrap/salvage, or donated. One study showed that recovery rates can easily exceeded 50%.<sup>xvii</sup>

While stripping a product to its component parts to reuse or recycle sounds more expensive than purchasing new, this may not always be the case. The ability to efficiently reuse and recycle may emerge as a competitive advantage from a manufacturing / supply chain and marketing perspective. These practices will appeal to an audience that is especially environmentally friendly.

### **Recovery Management**

In the old days, companies might simply just scrap the product, strip it for spares, or sell it to a liquidating firm. Progressive companies are taking a more aggressive approach to managing returns with a focus on recovery speed. Getting product back into the distribution pipeline and onto the sales shelf, especially for short lifecycle or seasonable product, can cut the amount of merchandise that has to be dispositioned.

Kodak remanufactures their single use cameras after the film in the camera has been removed and developed. Over the past decade, the company has recycled more than 310 million cameras in more than 20 countries.<sup>xviii</sup>

Best practice companies are not only getting product back into existing sales channels quicker – they are also turning to multiple channel options as ways to recover their assets. Some of these options include

- Sell as new in existing channel
- Sell at discount in own shop or through another outlet
- Repair and resell as seconds
- Return to supplier for credit
- Sell at bigger discount into secondary market
- Sell through online marketplaces such as eBay or Amazon.com
- Refurbish, inspect, test, remanufacture, recycle, repackage, re-warranty
- Strip for spares
- Donate to charity
- Scrap to a licensed agent
- Develop global networks or partnerships with other companies that repair products and services<sup>xix</sup>

### **The Bottom Line on Returns**

The bottom line of any good returns management program should be to look across each of the five key elements that touch a return. Companies should seek opportunities to broaden their view of returns management as a strategic role for recapturing value, recovering assets, and improving customer loyalty. Companies that bring focus to their returns practices can achieve considerable benefits.

## **About the Authors:**

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Ms. Vitasek, Managing Partner at Supply Chain Visions, is a thought leader in the area of supply chain management and is a well-recognized authority on performance management. Ms. Vitasek currently serves on the Council of Supply Chain Management Professionals (CSCMP) Executive Committee and teaches seminars for the Warehouse Education Research Council (WERC).

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Peter Murphy is Vice President of Operations with arvato services inc. He has responsibility for arvato's reverse logistics/mobile phone repair sites in Melbourne FL and Juarez Mexico as well as West Coast Operations based in Valencia CA. Peter has extensive supply chain management experience having held leadership positions in many high tech, manufacturing and fulfillment companies in Europe and the US over the past 15 years.

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