



The 5 R's of Returns Management

By Kate Vitasek & Karl Manrodt

Note: This is the first in a series of six articles discussing returns in the retail industry.

Managing returns is a big business. For most companies, however, 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 Reverse Logistics Executive Council (RLEC), the top 30 non-grocery retailers in the United States handle around \$53 billion in returns per year.¹ Other recent estimates range as high as \$100 billion – which is more than the GDP of two-thirds of the world's countries.²

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.³

Such costs are only part of the picture. 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.

Leading experts advise 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.

The purpose of this six part series is to shed light on effective returns management and how it 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 (See Table 1 on page 35).

This will require a fundamental shift in mind-set and a focus on all five of the “R” elements of effective returns management process. We will explore each element in more detail in upcoming articles.

- Introduction: Introduction to the 5R framework
- One: Retail Management
- Two: Relationship Management
- Three: Returns Management
- Four: Repair Management
- Five: Recovery Management

Introduction to the 5R framework – Making the case for returns

Across the board returns are increasing. While return rates have grown, so too have the costs associated with managing them. Industry experts suggest the annual costs of reverse logistics, including those from e-commerce, total \$40 billion annually – or as much as 4-4.5 percent of the entire logistics budget.⁴ In fact, studies estimate it costs about three to four times more to process a returned order than an outbound order.⁵ As the sheer numbers of returns increase, companies have begun to take interest in how to conquer (or at least help alleviate) the seemingly never-ending headache that has been sparked by several factors, including the following four issues:

- 1 **The Changing Supply Chain.** One of the primary drivers has been the morphing of the retail channel with more and more non-traditional companies turning to a “direct” channel model. The rapid growth of Internet-based sales has only increased the incidence of returns in recent years. While catalogers have always felt the pain of high levels of returns, mainstream companies are now starting to also see the impact of their decisions to sell direct. High tech companies have been particularly hard hit, leading the polls with the highest percentage of returns. On average, 15 to 20 percent of all goods sold are returned.
- 2 **Shortened Product Life Cycles.** Today customers want choices, new and improved products with more options, new styles, and better features. In many industries product life cycles are measured in seasons or in months, no longer in years. Because of this, product that is in the returns flow lose value as the product runs through its life cycle.
- 3 **Customer Expectations.** To say that customers are becoming more demanding would be to state the obvious; this factor is seen most fully when it comes to returns from the customer.

A product has to not only live up to word-of-mouth recommendations (reviews by consumer groups) and the warranty, it has to exceed them.⁶ Loyalty – especially to providers of services and products – are words used by a forgotten generation.

4 Customer Service Policies. In the past 10 years, most retailers and manufacturers have adopted a more loosely defined and universal returns policy in an effort to remain competitive.⁷ Retailers and customers want quick credit for their returned items and manufacturers want their items returned in a re-usable or resalable manner.⁸ As a result, a need has developed among retailers, manufacturers and customers for timely, efficient and accurate reconciliation of return claims. More and more companies are turning to a longer term view of customer retention – with an emphasis on customer satisfaction during the entire transaction. This approach includes placing an emphasis on customer satisfaction all the way through the returns process.

The Hidden Costs of Returns

One of the major challenges to building an effective reverse logistics operation is not knowing the true costs involved. Tompkins Associates estimates the average cost of handling a return to be \$16.25 per item.⁹ However, this does not include the loss of the original consumer revenue and the costs associated with the original order as well as many of the soft costs associated with managing returns, so the true cost is far greater. See Table 1 for examples.

Although a company will rarely be able to recoup the full value of products returned, the use of effective returns management systems

can ensure that anywhere between 10 and 80 percent of the goods' value is recouped, according to a Retail Week report.¹⁰ In addition, companies can greatly reduce the costs associated with managing returns. Wincanton estimates that less than 5 percent of retailers are operating efficient returns systems and that effective handling of returns can add between 1-3 percent to the bottom line.¹¹

Reverse supply chains are for the most part treated much differently than traditional forward logistics processes. There are several contributing factors to bad returns management practices – with many starting at the top of the organization in how a company organizes itself and prioritizes investments.

Returns usually span multiple departments and no one department has responsibility. In addition, returns don't typically generate revenue, and as such in many cases returns are considered a cost center rather than a revenue stream - with nobody wanting to focus on it or own it. To make matters worse, the total cost of returns is rarely exposed to the product owners or even identified collectively for the company. As such, costs are simply scattered around in various places and the true magnitude of returns inefficiencies are not brought to light.

Furthermore, most companies have designed and optimized their processes around forward logistics of getting product out the door – not getting it back. Recent research from the Warehouse Education and Research Council (WERC) found that more than 90 percent of firms process product returns in the same warehouse/DC that handles forward logistics, and on average employ 10 people or fewer in the product returns/reverse logistics area.¹² In addition, most

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Warehouse Management Systems are geared primarily for returning product to stock; unfortunately, most returns are not returned to stock.

The Aberdeen Group estimates that it takes the average company between 30 and 70 days to get returned goods back into the market, including return transportation, repair or refurbishing, and redistribution to the customer or market.¹³ Or, in other words, the average firm turns these goods only five to 12 times per year, well below the median number of turns for finished goods. One reason is that at most companies returns are primarily managed through a series of disconnected and paper-intensive processes.

And when it comes to returns, uncertainty prevails. Most companies have limited visibility into the returns process and it can be difficult or otherwise impossible to predict which products will be returned

or where they will originate. In fact, a company frequently finds out about a return only after it lands on the receiving dock. WERC's research found that approximately two-thirds of all returns are unplanned. This unpredictability is a major problem in the product returns process because of the numerous impacts it has on operations, including significantly increasing the time to process the return.¹⁴

The Bottom Line on Returns

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.

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Table 1: Return Costs

Hard Costs	Soft Costs
Retail Management	
Increased Retailer management costs	Lowered consumer confidence
Costs to re-sell	Loss of customer satisfaction, repeat purchase
Relationship Management	
Cost of contact center	Negative effect on brand and market value with returns issues
Customer service calls/emails	Impact on competitive advantage
Returns Management	
Original consumer revenue	Increased costs of sales, pricing issues
Original procurement, inventory, shipping, warehousing costs	Increased costs for outbound facilities having to handle returns
Packaging & materials, if not charged to consumer (less likely in competitive e-tail)	Lost bargaining power with suppliers
Repair Management	
Cost of test and repair	Loss of product value
Cost of logistics and handling	Impact on supplier warranties
Recovery Management	
Loss of value through selling in secondary market	Brand dilution and risk of gray market sales
Cost to sell in secondary market	Management of secondary market

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