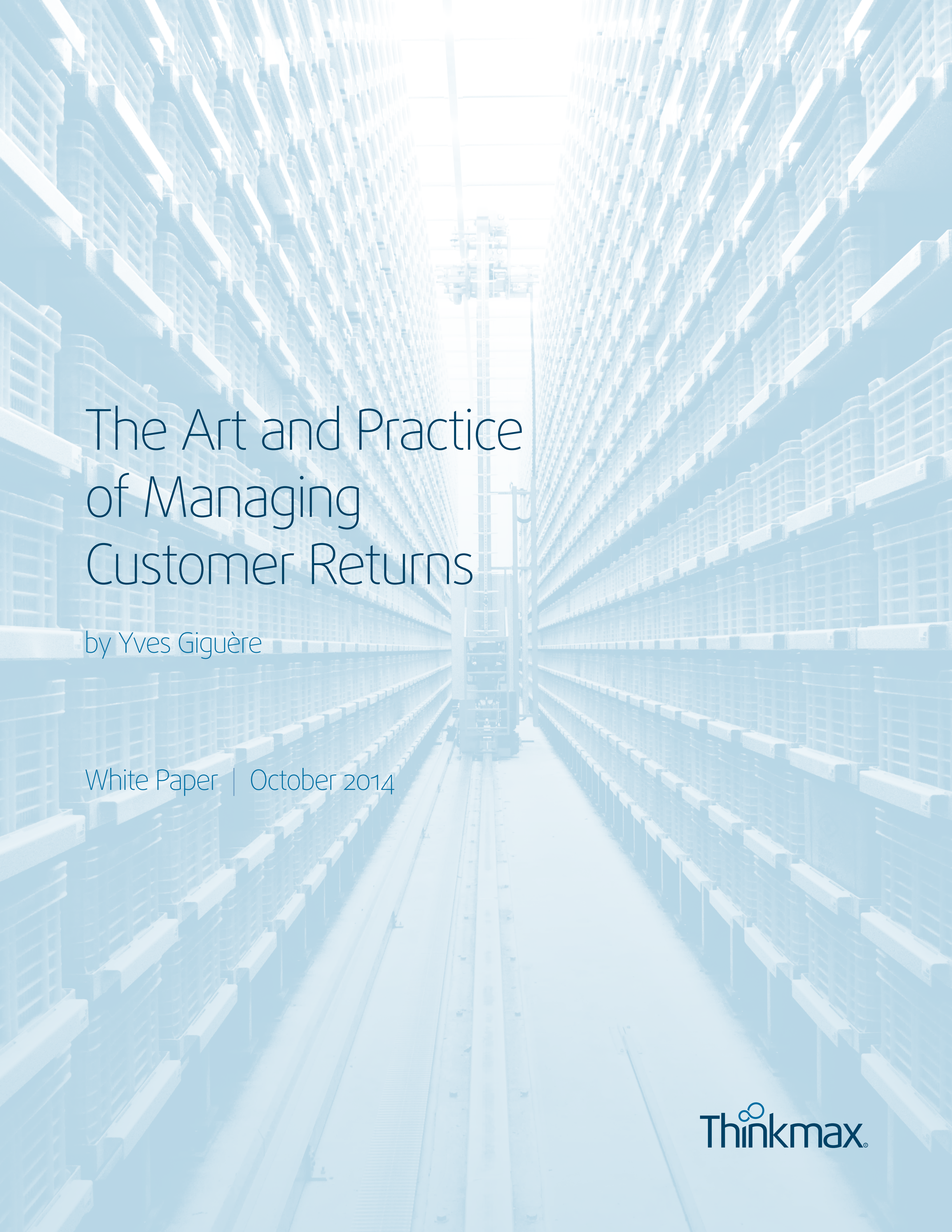

The Art and Practice of Managing Customer Returns

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Thinkmax

Introduction

The goal of reducing customer returns seems ambitious and even impossible to reach. After all aren't customer returns a necessary evil to keep customers happy and retain their loyalty in the long run?

That is what many manufacturers and distributors have believed for a long time. However the harsh economic realities and the growing phenomenon of customer returns have led them to reconsider this position.

The purpose of this white paper is to provide practical ideas that will help manufacturers and distributors reduce the costs associated with returns, while showing them how to use this trend to their advantage.

A growing phenomenon

Every year the National Retail Federation (NRF) tries to quantify customer returns in the retail industry, in both Canada and the United States. In 2013 it estimated that returns as a percent of total sales corresponded to 8.60% or $270 billion in the United States and $26 billion in Canada[1]. In comparison this number only reached 7.26% in 2007[2]. Furthermore other studies have shown that in 2005 only 4% to 6% of purchased items were returned[3]. The upward trend can hardly be denied.

The NRF statistics are only compiled for the retail industry, but customer returns can have even greater consequences for manufacturers and distributors who see their margins shrink whenever returns increase. Thus it is not unusual for a manufacturer or distributor to spend as much as 5% or 6% of its revenue on processing, evaluating, returning, repairing or reselling returned items.

Naturally, these costs—when they can be quantified—vary from one sector to the next, and from one company to another. However there are also real costs that are very hard to estimate, such as the impact on customer loyalty or the consequences on the manufacturer's reputation, especially with the growing popularity of social media.

But the most worrying aspect is that many studies indicate that customer returns are very likely to continue to increase over the next few years.

This phenomenon is partly due to the sustained growth of internet sales, where return policies are often largely permissive for the simple reason that there is no better way to gain the trust of customers who cannot touch the items they buy before they are delivered. In this context, a "no questions asked" return policy is often perceived as a "standard" guarantee of quality, and companies can hardly not offer it when it is so easy for the online visitor to compare sales conditions with other online merchants.

Also there is no question nowadays that customers are better informed and more demanding. Even the smallest defect, such as a tiny dent in the back of a microwave that does not alter its use in any way, becomes a justifiable reason to return merchandise.

In the same vein, returns are often the inevitable consequence of a new way to shop. For example, Zappos is proud to offer to its clients free shipping both ways. Under these circumstances, why not order five different pairs of shoes to try them on at home even though you only plan to keep one? While these kinds of returns are not considered “fraudulent” by the NRF, they are considered of “abusive nature”.

Also the Federation worries about the progression of fraudulent returns, which in its view are encouraged by the possibility to return in-store the items supposedly bought online. Omnichannel retailing and the increasing complexity of channel distribution make it easier for thieves, and retailers and distributors must be extra vigilant.

That said, customers are not the only ones to blame. Over the past few years many manufacturers have relocated their operations to countries with low labour costs. On occasion this has caused quality problems, which impact the entire supply chain.

Sometimes the distributor is the one to blame, especially when it doesn’t have the “right” inventory of seasonal items. Late deliveries are then more likely to be returned.

Nevertheless the vast majority of returned items are not defective at all. In some sectors, such as electronics, the proportion of such items has plummeted. Upon verification it appears that about 70% of returned electronic items had no defect at all!

No longer considered a necessary evil

For a long time companies considered customer returns a normal cost of business, but many organizations are now calling into question this assumption for many reasons.

First, manufacturers and distributors are fully aware that returns are more and more expensive. To maintain their margins, they can no longer neglect any opportunity.

Moreover, some innovative companies have managed to turn customer returns to their advantage. Looking at these success stories, companies are now more hopeful that they can turn this cost centre into a profit centre. This can be done through reverse logistics or when organizations manage to reuse, refurbish or resell for a profit the returned items.

Also, when customer returns are handled effectively, it can greatly contribute to strengthening relationships with clients and supply chain partners[4]. As a result an increasing number of distributors offer this value-added service as a way to differentiate themselves from their competitors.

Ample room for improvement

Companies that successfully tackle the problem of customer returns use a two-pronged approach: preventing returns and optimizing the return process, all while ensuring that corrective measures do not affect customer satisfaction.

But first they have to quantify the problem. Can they estimate how many items are returned? What are the broad cost categories to process returns? Some of them may include staff costs for customer service, order entry and the processing of returns, as well as handling charges, and warehousing and transportation costs.

Then and only then will they be able to compare their cost of returns to industry benchmarks and establish objectives. For example, what would happen if the organization could reduce customer returns by 2%? Would that save $500K? Conversely what is the cost of status quo? Could a $500K problem become a $1-million problem a few years from now?

In addition, in order to attempt reducing returns, companies should identify their causes. Determining the cause of a return can help you decide whether it could have been avoided and also what you should do with the returned item. This can be remitting to the client a full or partial reimbursement, exchange, coupon, etc. When dealing with distributors or manufacturers, you'll have to decide whether you want to put back into circulation undamaged articles or send defective items to a repair centre.

To do so, you need to collect and analyze data. Some companies are not in a position to do this, either because they have inadequate processes or they use outdated systems.

Sometimes when you review your internal processes, you may find that better training of your staff is all it takes to avoid fraudulent or abusive returns or that there is a way to put the items back into circulation more rapidly.

Similarly, it is not unusual for an organization to realize that its current ERP solution does not allow it to leverage the latest technological advances, such as enhanced demand planning, self-replenishment functionalities or bar codes as well as online self-service options for automating return processing. For example, these technologies can enable a distributor to systematically verify the origin of the returned item or even find out if the item is on backorder for another order and should therefore be put back in the system as soon as possible.

Not to mention that an electronic portal helps distributors and manufacturers better inform their clients about the return process. This enhanced visibility can be perceived as a value-added service and may even represent a competitive advantage. This may also reduce costs, such as the volume of calls to customer service or to the accounting department.

Some ERP solutions also offer advanced capabilities to process returns, such as the ability to process returns differently depending on the type of client or customer channel. Furthermore the system can suggest the best return route, whether that be to another retailer, a repair centre or the manufacturer.

The complexity of customer returns therefore varies greatly depending on the type of organization and its current systems and processes. This is why it is important to work with a team of experts who are well versed in industry best practices and knowledgeable about the technological solutions now available on the market.

Real results

Some companies may be rebuffed by the amount of work to the point where they may ask if it is even worth it or not. There is indeed always an acceptable level of customer returns, beyond which it simply costs more to attempt to diminish returns than to process them.

Every situation is different, which is why it is key to quantify the financial impact during the initial assessment phase.

However distributors and manufacturers that go through the effort of reviewing how they address the problem of customer returns can expect a number of benefits.

Indeed efforts to both prevent and better manage returns may lead to significant cost savings, especially if they reduce fraud and eliminate staff costs for the processing of returns as well as transportation and warehousing costs. In the consumer electronics industry it is estimated that customer returns cost on average 5% to 6% of sales to manufacturers and about 2% to 3% of sales to retailers. Whereas a mere 1% reduction in customer returns usually translates into a 4% reduction for repair and processing costs, equivalent to an annual saving of $21 million for the average manufacturer[5].

Some companies may even be more ambitious and decide to implement a new strategy that translates customer returns into a new source of revenue. That is precisely what happened at Estée Lauder, which decided to invest $1.3 million in a new scanner system and related technologies. Thanks to this reverse logistics solution the company has successfully created a new product line for returned cosmetics to be sold in discounted stores and that is valued at approximately $250 million[6].

Conclusion

There is no doubt that there is an escalating trend in customer returns and that this is likely to get worse with the progression of e-commerce. Manufacturers and distributors can no longer ignore the problem. Evaluating how customer returns impact the profitability of a company is not an easy task. It is nevertheless necessary to determine whether that should be a priority or not, and to determine the resources that need to be allocated to this problem.

A strategy of reducing customer returns requires effort to both prevent returns and to optimize their processing. That is why it is wise to analyze the efficacy of the operational processes in place and to evaluate the current and future capabilities of business management systems, especially ERP.

Some companies may feel intimidated by the scale of the task, but in all likelihood the mid- and long-term benefits are worth it, whether they be cost reductions, improved customer service or strengthened relationships with partners.

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About Thinkmax

Thinkmax is a management and technology consulting firm with offices in Montreal and Toronto.

With years of experience in implementing Microsoft Dynamics AX and Microsoft Business Intelligence Suite, we help manufacturers and distributors improve their operational efficiency at all levels.

Companies that wish to work with a partner determined to find innovative solutions to reduce costs while improving their competitive advantage can visit our website at thinkmax.com or contact us at info@thinkmax.com.

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