

Returns Management Inc.

MANAGING RETURNS ART TO SCIENCE

**A White Paper on the Challenges and
Solutions to Managing Product Returns**

(Finding a Pony in that Pile)

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Evolution – Intelligent Design or Natural Selection for Returns

There was a time when customers rarely returned a product purchase unless it didn't work. All manufacturers had to do was tighten quality control and they reduced returns. Today, however, the returns are made for more subjective reasons:

- because it isn't backward compatible with what the customer already owns, or
- "my kids want a different model," or
- "the footprint is too big", or
- the color "looked different on the Web page," or
- it simply "doesn't feel right in my hand."

In the US, we are in the age of the "empowered consumer" and it is adding cost to the entire supply chain for manufacturers, distributors, and retailers.

The reasons are many and varies, and industry analysts agree that returns have become endemic in many markets, with rates higher than 20% in some sectors. It's also suggested that return rates will probably continue to rise due to factors that include increases in low cost, and low contact distribution channels like the Web, customer uncertainty that emerges from a dramatic expansion of product choices, and shorter product cycles. Many manufacturers anticipate a significant impact on corporate bottom lines is inevitable.

Developing a comprehensive and cost effective approach to handling returns is a daunting challenge that reaches well beyond the operational level. A well-conceived and implemented returns management plan can be a vital strategic asset. It is no longer just a necessary burden factored into the cost of quality (COQ), but can be a source of competitive differentiation, customer-retention advantage, and improved profits.

Example Returns Numbers

According to a Consumer Electronics Industry survey by the Reverse Logistics Executive Council, the average returns rate is 8.46%. Across the entire manufacturing value chain, we can find return rates as high as 20% or more – so how do you optimize profits if you have increased overhead for the extra shipping, handling, repackaging, reimbursements, and customer care for your products?

In 2004, the value of some selected returned goods is expected to be around US\$105 billion, with the cost of managing their return running about US\$8.5 billion.

PRODUCTS	RETURN RATES (%) (Indicated)	SALES – 2004 (US \$ Billions)	VALUE OF RETURNED GOODS (US\$ Billions)
Computers	15%	\$282	\$42.3
Office equipment	6%	\$58	\$3.5
Home A/V equipment	10%	\$25	\$2.5
Semiconductor products	15%	\$217	\$32.6
CD's	20%	\$31	\$6.2
Auto electronics	5%	\$16	\$0.8
Software	20%	\$85	\$17.0
Total	Ave. 14.8%	\$704	\$104.9

Source: Reverse Logistics Executive Council

Figure 1: Sample returns rates from consumer electronics

Looking beyond these numbers reveals two important trends that may contribute to a more dismal return rate picture.

1. **Low-cost/low-contact channels of self-service distribution** – the increased traffic through such low-cost channels as the Web, catalogs and other direct-to-consumer mechanisms generally is a positive development, however as products become more complex, mainstream buyers are put at a disadvantage. Without the benefit of specific answers to their questions and a hands-on demonstration, they are more likely to make a less informed purchase, (covered in another Consumer Electronics Association study in October 2004) leading to lower satisfaction, more likely returns, and potentially reduced customer loyalty. Unlike returns in the brick and mortar store channel, the transport of the return in these channels is typically an additional seller's cost.
2. **Build-to-Order business models** – this is counter-intuitive: one would expect that the greater specificity of the ordering process would lead to lower returns. The reality is that customer expectations are extremely high so that the slightest discrepancy in fulfillment, particularly when the order is placed through a low contact channel like the Web, can lead to a product return. Additionally, sometimes the customer does not really understand what is actually needed and this mistaken order is now a return.

Indirect and Hidden Costs

The conventional returns management model takes into account only those costs related to bringing the returns back into the system, along with the cost of warehousing and returns request management. But the cost impact of returns extends far beyond that to such areas as:

- Customer retention efforts
- Product reworking
- Product resale
- Redistribution
- Inventory management
- Overheads allocated to other departments
- Cost of disposal

Returns management is a more formidable challenge than it appears on the surface.

Returns Management Solutions - Flawed but Fixable

The old approaches to returns management are simply not adequate to address an issue of such immense and growing scale. RMI has reviewed and used multiple returns management solutions for the manufacturing industry and its customers. What RMI has experienced is that most of the issues in returns management relate to process inadequacies, coupled with the lack of sufficiently supportive infrastructure:

• Process Inadequacies

1. **Poorly defined returns processes** – while reverse supply chains have expanded, returns processes are not appropriately structured to accommodate the greater complexity in the supply chain. This can lead to inconsistencies in process management, which has an additive impact on costs.
2. **Lack of a feedback loop** – returns management processes often lack the needed feedback loop that can provide improvements in front end processes such as new product/market development or quality assurance.
3. **Customer Relations disconnect** – Customer relationship management (CRM) has become a very popular mechanism for enhancing revenues with reduced effort and cost. Most CRM initiatives are focused largely on the forward selling process. A returns inclusive CRM program recognizes that your returns processes can have an unusually large impact on maintaining and building customer loyalty.

• Infrastructure Inadequacies

1. **Insufficient investment in returns management processes and systems** – The two most expensive assets a company can deploy are people and technology, however most

organizations live with labor-intensive, manual, semi-efficient, and often undisciplined returns management processes. The primary reason is that the bulk of their Supply Chain Management (SCM) investment is on forward or outbound projects (e.g., order management and fulfillment).

2. **Low reliability among standard system solutions** – most enterprise planning (ERP) and SCM systems provide partial or limited returns management capability (e.g., credit orders, limited return material authorization support). They also lack end-to-end capabilities in such areas as returns forecasting and customer return collaboration (i.e., customer self-service such as that offered by Newgistics), and fail to provide robust decision support for returns authorization and disposition. In the area of point solutions, insufficient maturity of the offerings from single tool solution vendors makes it risky to implement their systems. As with all system integration issues, it is a continuing challenge to automate and link distributed and often unrelated processes.
3. **Limited data visibility** – this covers a variety of deficiencies – from unreliable and inaccurate data capture, to lack of monitoring for customer satisfaction levels that may drop due to frustrating returns processes. Many organizations suffer from the inability to stay current with the identity, location, status and condition of returned goods going backwards through the supply chain. They aren't equipped to follow returned products, which is exacerbated by long cycle times. Then there is the ripple effect from poor data visibility that impacts other areas like: new product development and product life cycle management that are hurt by the lack of pertinent feedback and a skewed analysis of consumer trends, as is demand forecasting and production.
4. **High management and direct costs** – inefficiencies in the system are always costly, from slower response times to poorly handled product recalls. Then there are the direct costs of charge backs for returned products. Other structural efficiencies can also be realized by using appropriate material handling systems that improve product processing and warehouse utilization.

Returns Failures Stem From Limited Perspectives – What You Don't Know Will Hurt You.

Before you can productively address your returns management challenges, it is critical to understand *why* these existing solutions fall short. In an era when the marketplace is undergoing rapid and dramatic change, the thinking behind the typical approach to returns management remains embedded in the past.

The first solutions grew out of a simpler time when:

- customers had a TV, not a complete home entertainment system;
- consumers had a home computer, sometimes with a dial-up connection to the internet, but now have multiple computers connected by a wireless router and integrated with the home entertainment system;
- customers returned a product because it didn't work for them, not as part of a strategy for buying it back later at a discounted "open-box" price.

Products were simpler and buying decisions were simpler. The reasons for returns were more straight forward.

While some manufacturers have been quick to embrace the Internet and direct-to-consumer merchandising, their existing returns solutions were devised for the brick and mortar retail environment. These standard approaches don't address the complications that typically arise from remote purchasing in the face of the rapid expansion and sophistication of product options, nor recognize how a poorly managed returns process can undercut customer retention and satisfaction programs.

RMI believes that the development of effective solutions must be built on forward thinking

perspectives. That is one of the primary differentiators in the RMI approach to returns management.

For instance, typical returns management solutions take a generic approach:

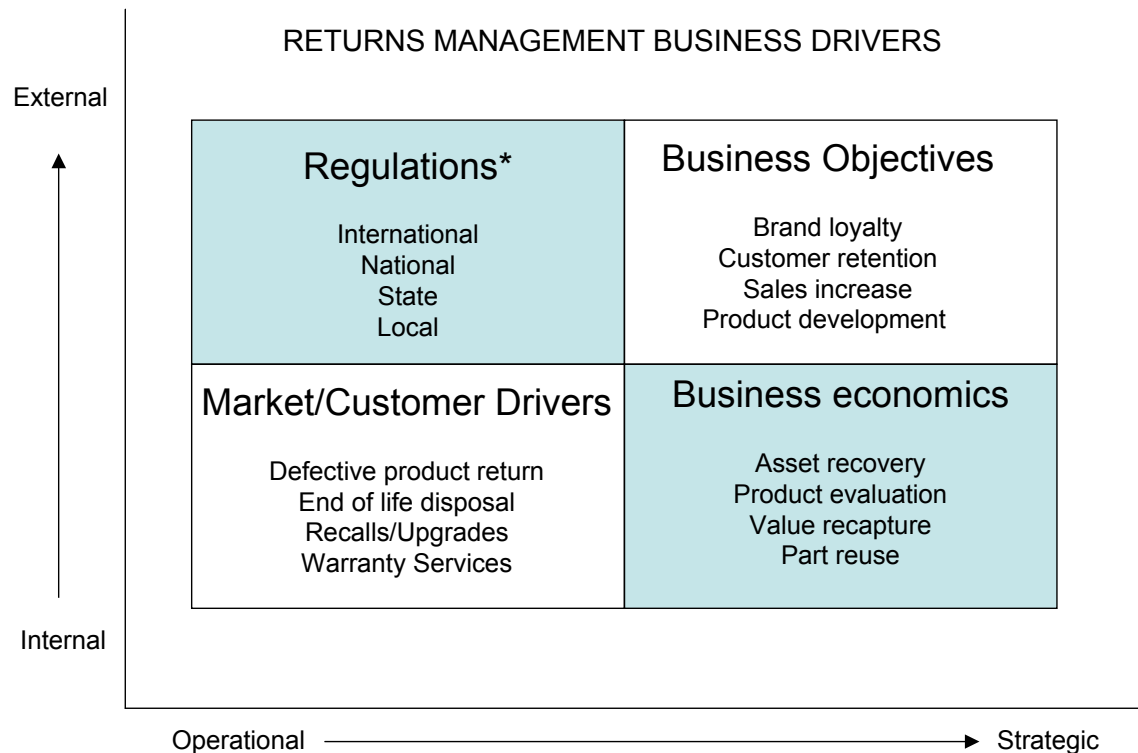
- **Digitize** – employ enabling technologies to the enterprise
- **Streamline** – reduce the number of touch points and transfer key activities to vendors
- **Partner** – collaborate with supply-chain partners
- **Outsource** – centralize and contract out returns processing to a 3rd party

While use of any or all of these solutions may improve many existing processes, they don't go far enough. There is extraordinary diversity and complexity among today's companies and products. Thus, there can be no generic solution to managing returns. The returns characteristics for Dell are very different from those of HP due to the differences in their business models. Likewise, the returns characteristics for Lowes and Home Depot differ because of the services they offer, and they differ between Ford and GM due to the differences in their product lines.

It is imperative that every organization takes into account its unique combination of operating characteristics as it designs its reverse supply chain. Thus, the most effective returns management solutions are built from the ground up: **customized, comprehensive, and integrated across functional company departments.**

RMI's Perspective – Strategic and Operational

Such a customization approach will fall short if it only addresses operational factors. Virtually every business has come to realize in recent years, operational tactics must be driven by business objectives. After years of experience in the returns-management field, RMI has developed the following matrix for better understanding the business drivers of returns management.



* Regulations include governmental, industry groups, standards organizations and others

Figure 2: Drivers that influence returns management process design

As you can see, the left-hand quadrants of customer service initiatives and regulations represent conventional operational drivers. But the drivers in the right-hand column all have major bottom line, brand and loyalty building elements that transform returns management from an operational chore into a strategic asset.

Take customer retention and loyalty, for instance. If the company has launched a customer relationship management (CRM) initiative that doesn't encompass returns, they risk undercutting their customer-retention efforts. Customer loyalty erodes when customers are unhappy with poor returns handling. On the other hand, when the business has a comprehensive, horizontally integrated returns management program in place, it can dovetail with their CRM program.

To consider another example, look at what can be done if companies cross-index data on product lifecycles and customer replacement/purchase patterns for fast depreciating products like PCs and consumer electronics, and link it to their reverse logistics processes. This would allow an offer for customized promotions to individual customers, up selling a replacement product with another offer to provide "trade-in" value on the product they currently own, and handle its recycling for them.

These are examples of strategically driven opportunities that a well designed, fully integrated, returns management program can provide. The most significant business drivers are largely strategic.

RMI believes that returns management demands executive level focus and attention on how to optimize its impact on diverse areas like customer retention, regulatory compliance, gate keeping to reduce return rates, quality management, and new product design.

The RMI Approach For Success

It is holistic. The questions we ask are not “How do you handle returns?” They are “How do you create a comprehensive returns management plan that

- help you reduce the number of returns that must be dealt with from your customers,
- transform inherently negative customer experiences into a valuable strategic asset,
- generate profits from returns that were previously a loss?

Viewed from that perspective, the RMI approach to returns management involves multiple parties, processes and applications.

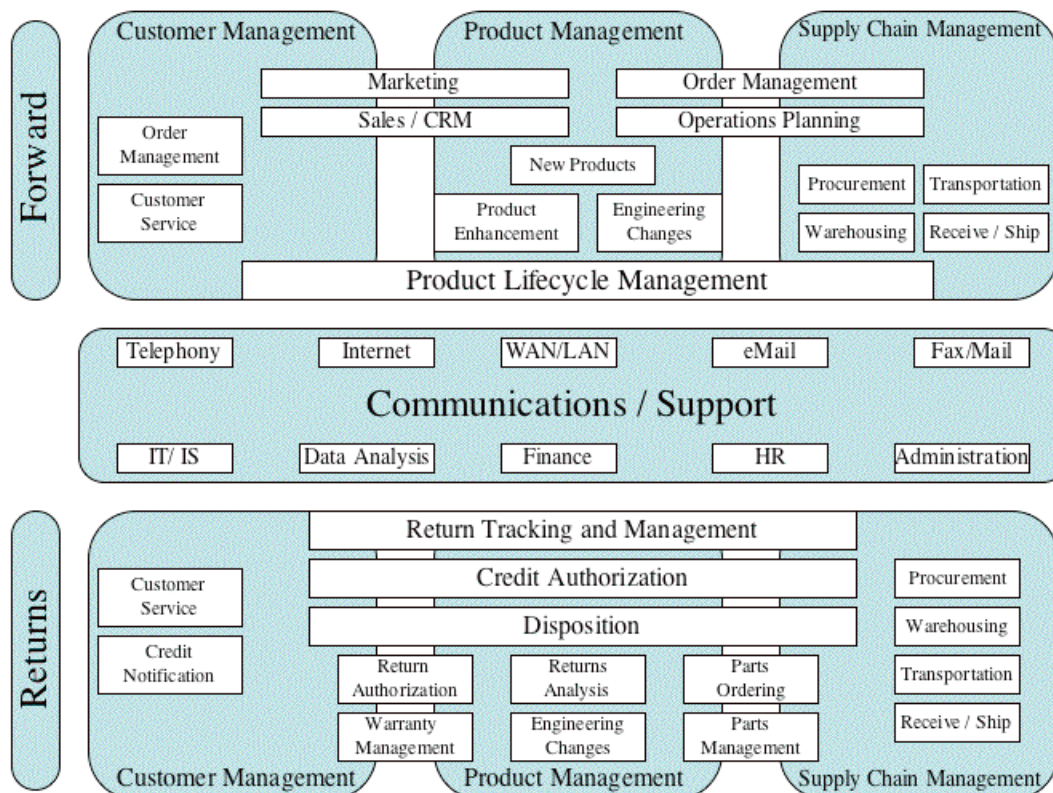


Figure 3: Organizational environment for product returns

When you look at the entirety of an organization from the perspective of returns management opportunities, the complexity of the challenge and the promise of competitive advantage increase. For instance, return requests are initiated through several different communications channels and typically routed to order management. A comprehensive solution to a return request requires:

- coordination with supply chain management in order to provide a replacement product or update inventory if replaced in the distribution channel.
- interaction with product lifecycle management if the return request has revealed a product flaw that needs design, engineering or production adjustments.

Discovering a flaw could also alert the new-product development process. Customer feedback on the product could be valuable input to the marketing department as well as a customer-retention opportunity if your returns-response provides a positive customer experience.

The proper utilization of this information and effective integration into business processes enables the creation of an adaptive enterprise, capable of accurately anticipating its customer's needs.

With such a high order of complexity, the first step RMI takes is to conduct a reverse supply chain process study and consider all the pieces that might play a part in the ultimate solution.

This study addresses a broad range of questions such as:

- How do we integrate returns management and inventory management so that both are more cost-effective?
- How do we coordinate the elements of the reverse-supply-chain in order to reduce the touch points, thus streamlining the returns process and making it more cost-efficient?
- How do we build quicker responsiveness into the customer-facing aspects of the return process in order to build customer loyalty?
- How do we link pertinent feedback for new-product development and product management so that timely changes can be implemented before manufacturing and marketing processes are engaged?
- How do we need to revise our order-fulfillment processes so that late deliveries (leading to purchase returns) won't occur even at the peak of the holiday-shopping season?
- How do we better identify the target market for a particular product so that customers aren't enticed to buy something that does not fulfill their needs?

By looking at the full range of departments and applications in this manner, and asking uncommon questions that go beyond the typical conception of returns management, you can bring the full power of your organization to a solution that enhances returns management by improving a broad spectrum of business operations and processes.

The RMI Roadmap - Insights For Returns Management

It is important to recognize that returns management is a dynamic process that must be able to scale and adapt to changing circumstances in the marketplace and in the business model of a company. If you look at the following "roadmap," drawn from the work RMI did with several clients, you get a broad-brush picture of how RMI applies its holistic approach to returns management solution development, and the benefits that can accrue to clients.

In RMI's experience, designing a return friendly business process is essential to the success of a returns management program. RMI sees process design breaking out into four central areas:

1. Pre-purchase considerations to ensure appropriate purchase decisions – One of the best ways to reduce returns is to lower the number of ill-conceived purchases. This is a notable point when products of increasing complexity and converged functions are coupled with remote purchasing.

- *Simplify product design* – because when design complexity interferes with a product's ability to deliver on its promise, customers return the product rather than take the trouble to figure it out.
- *Simplify user-driven feature specification and product configuration* – with the increase in remote, self-directed purchasing, it is vital that the customer is easily able to make clear and appropriate decisions about product features and configuration.
- *Post clear and highly visible returns policy* – customers often assume that they can go ahead and make the purchase, and then return it later if it doesn't work out. Don't let them make that assumption.

2. Post-purchase processes that help reduce returns – There are still several processes that can be implemented to minimize returns after a purchase.

- *Utilize on-line interactive product support services* – many products are returned because the consumer cannot determine how to operate the equipment, software or processes that they have purchased. Effective support for frustrated purchasers can be supplied that enhances the user experience and improves the type and amount of information from purchasers that can be used for other purposes within the supplier organization.
- *SLA with 3rd-party logistics provider* – many product returns, particularly when purchases are meant to be date-specific gifts, are due to late shipments. An SLA between the retailer/distributor and the 3rd-party logistics service provider may help reduce delivery errors.
- *Effective gate keeping* – many companies accept the return of products whose value

can't be recovered. Proper gate keeping is required, therefore, to prevent useless products from entering the returns logistics chain and incurring costs as they move through it to the rework center.

3. **Return channels** – These can vary by business model and company operational structure. However, trends clearly reveal a need for:

- *Centralized Return Centers (CRCs)* – provide scale economies in transportation, better space utilization, more consistent operations, labor cost savings, compressed disposition time, improved customer service, and better inventory control.
- *Multiple channels* – for processing returns face-to-face at a storefront, over the Web, or by phone.
- *Regional Return Centers (RRCs)* – where returns from customers in a given region are consolidated before being shipped to the CRC. The RRCs may also be used for initial screening of returned goods and effective gate keeping.
- *Outsourcing* – by transferring returns management to 3rd-party logistics providers who are developing capabilities that go beyond the usual management of reverse logistics.

4. **An effective IT infrastructure to support returns** – The holistic approach can even be applied to system design and would include:

- *Data analysis capabilities* – for predictive modeling and trends analysis that can be used to determine cause and correct the problems in manufacturing.
- *Gatekeeping capabilities* – that include returns request management, validation checks, online support and troubleshooting etc.
- *Tracking capabilities* – that can follow a return in transit and provide real-time updates of its status
- *Accounting systems* – that accurately charge remediation costs to the returns processes and have the ability to credit/debit trading partners based on return policies.

A Way Forward - Finding the Pony

Returns management has become much more complicated in recent years – which makes the payoff all the greater when you do it right, and do it better, than anyone else in your sector. If we were to reduce the content of this viewpoint to just four critical points, it would be these:

1. Prevent returns from occurring in the first place.
2. Look beyond the immediate challenge: The questions you need to answer are “How do we create a comprehensive returns management plan that transforms inherently negative customer experiences into a valuable strategic asset?” “How can we reduce the number of returns that must be dealt from our customers?”
3. Develop a holistic solution that will address returns from multiple angles and will likely provide benefits that extend far beyond the area of returns management.
4. Returns management solutions must account for a variety of factors, such as business models, product type, and market geography. The most productive solutions are developed from a grounded approach that is based on business needs, comprehensive, and forward looking.

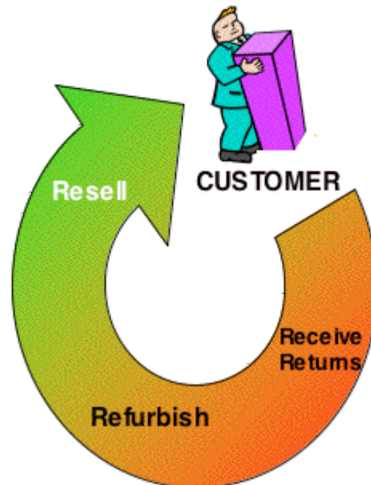
RMI believes that the right blend of technology, process change, and management capability will improve your opportunity for success. By doing this, you can implement solutions with the higher level of predictability needed to convert returns management from an expense to a valuable strategic asset.

About that pony, call us with your pile and we'll show you the pony.

Additional Resources

1. "Going Backwards: Reverse Logistics Trends and Practices". Rogers and Tibben-Lembke. 1999.
2. "Service Providers tackle e-product returns", Internetweek, June 2000.
3. "Reverse Logistics Is the Icing on the Customer Fulfillment Cake", Gerald McNerney, AMR Research, July 29, 2002
4. "Reverse Logistics – A Framework", Marisa P. de Rommert Dekker and Brito, Erasmus Research Institute of Management (ERIM), 30 May 2003.
5. "New Strategies for Transportation Management". Aberdeen Group, September 2004.
6. CEA, Product Returns Special Interest Group, October 2004.

Closing the loop on **Returns** . . . for a **Profit**.



The benefits to our clients are ;
- retention of sales profit
- improved operating costs
- greater customer satisfaction

Our company's focus is to reduce the number of product returns you receive and cost effectively process those products that are returned for our clients.

Returns Management Inc.
"From **Loss** to . . . **Profit**"

<http://www.returnsmanagement.com/>

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