Bringing it back

Retailers need a synchronized reverse logistics strategy

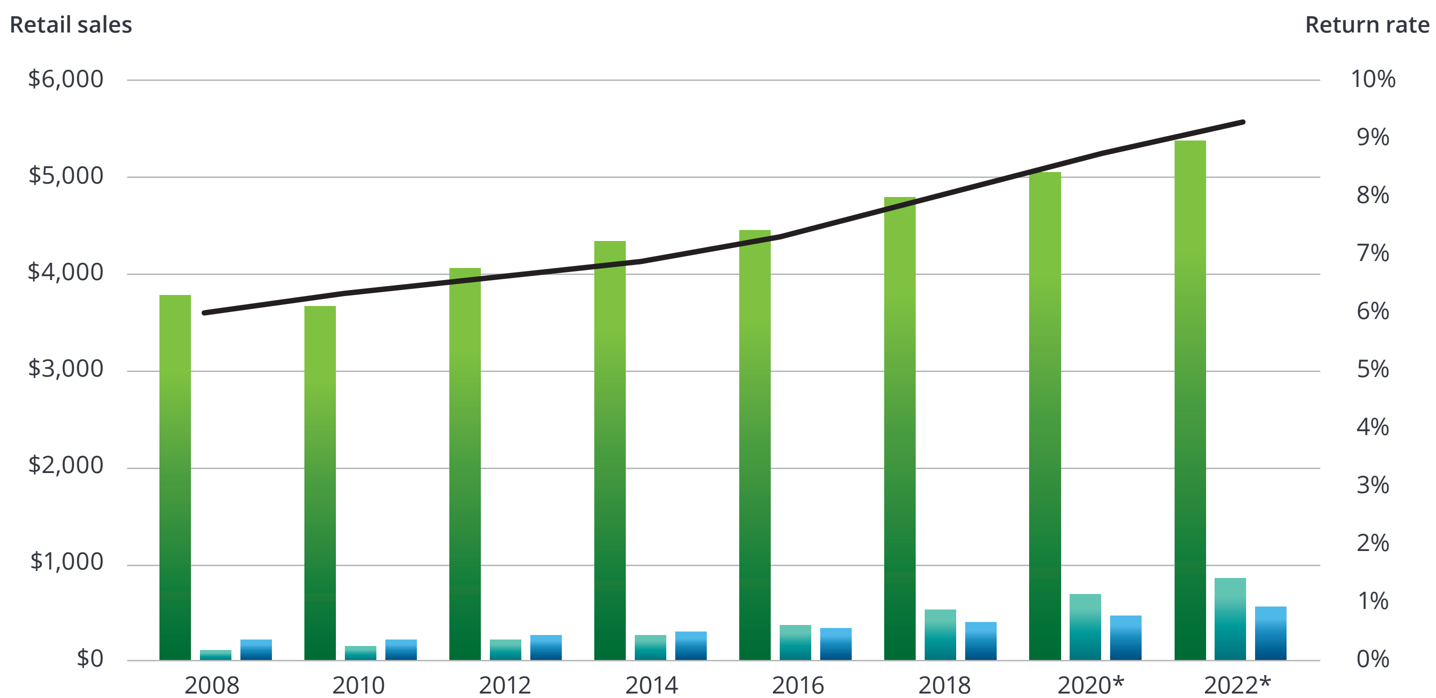
Introduction

In our continuing series of white papers around the vast impacts to the supply chain of the evolving retail industry, this white paper will follow our previous two editions, which focused on leveraging urban fulfillment centers and the pressure retailers face to establish a customer-driven supply chain. This edition will focus on the need for a synchronized reverse logistics strategy to proactively manage the challenges e-commerce growth brings to outdated reverse logistics processes and methodologies.

Bringing it all back

What's behind the surge of returns? Simply stated: E-commerce.

The rise of e-commerce over the past decade has driven a 33 percent increase in the return rate of overall retail sales.[1] Digital challenges, consumer behaviors, as well as emerging business models that are unique to e-commerce, result in an online purchase being returned three times more often than a purchase made in a brick-and-mortar store.



US Retail Sales excluding food services (billions)

* estimated

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With e-commerce revenues growing 15 percent annually and a product return rate near 30 percent of sales, we can expect 4 billion incremental units to be added to the annual reverse logistics pipeline by 2022.

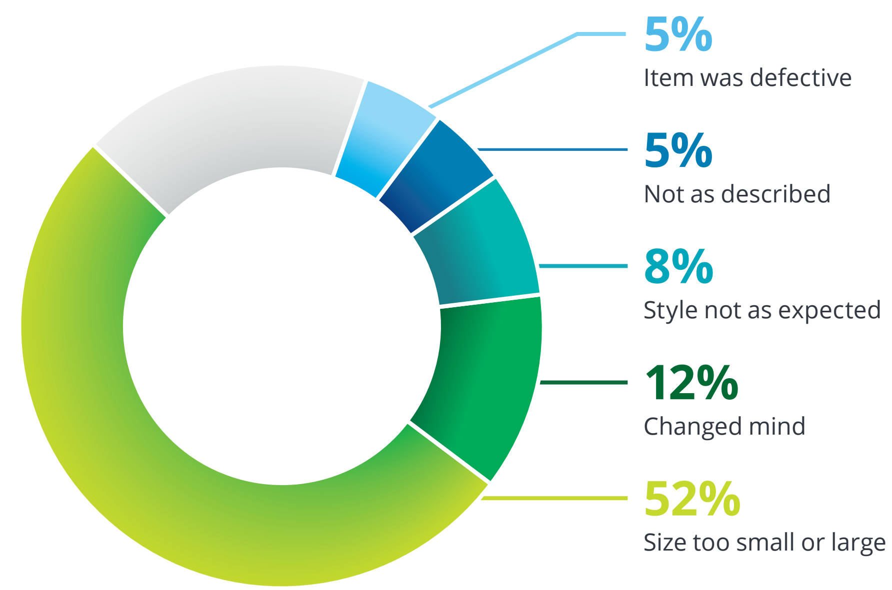
And returns are expected to grow. If current industry forecasts hold steady, by 2022, retailers can expect 13 billion units worth $573 billion[2] to be returned annually. That's four times the total e-commerce sales in 2008!

Why should retailers be thinking about returns?

First, **returns are becoming one of the greatest supply chain challenges** companies face today, with reverse logistics strategy critical to maintaining healthy inventory turn and operating expenses.

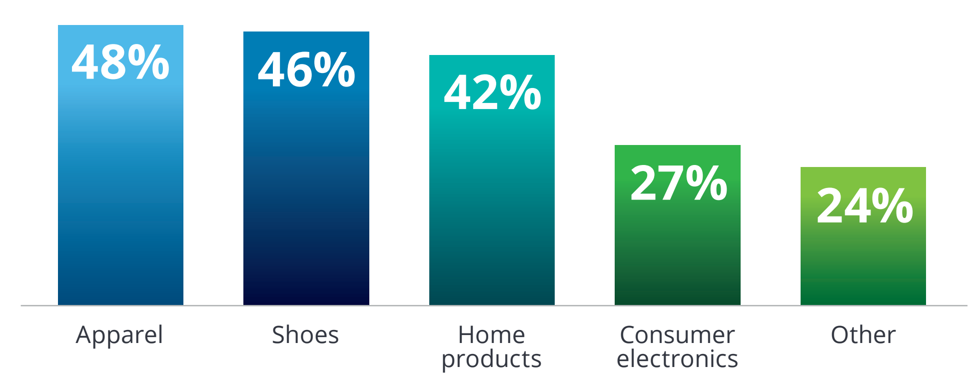
Secondly, **understanding the dynamics behind how, when, and why customers return items is critical to understanding their purchasing behavior and improving their overall experience.** Every product return is a chance to learn more about the customer, drive the next sale, and make it stick.

Online **returns are often the result of digital challenges such as poorly displayed images and incorrect fit.** Items never quite look the same "in person" as they do in pictures: colors and textures tend to appear differently in the flesh. Fit is another thorny issue: variances in manufacturer sizing contribute to over **50 percent of customers returning items due to product size or fit.**[3]



Top reasons that customers return an item purchased online

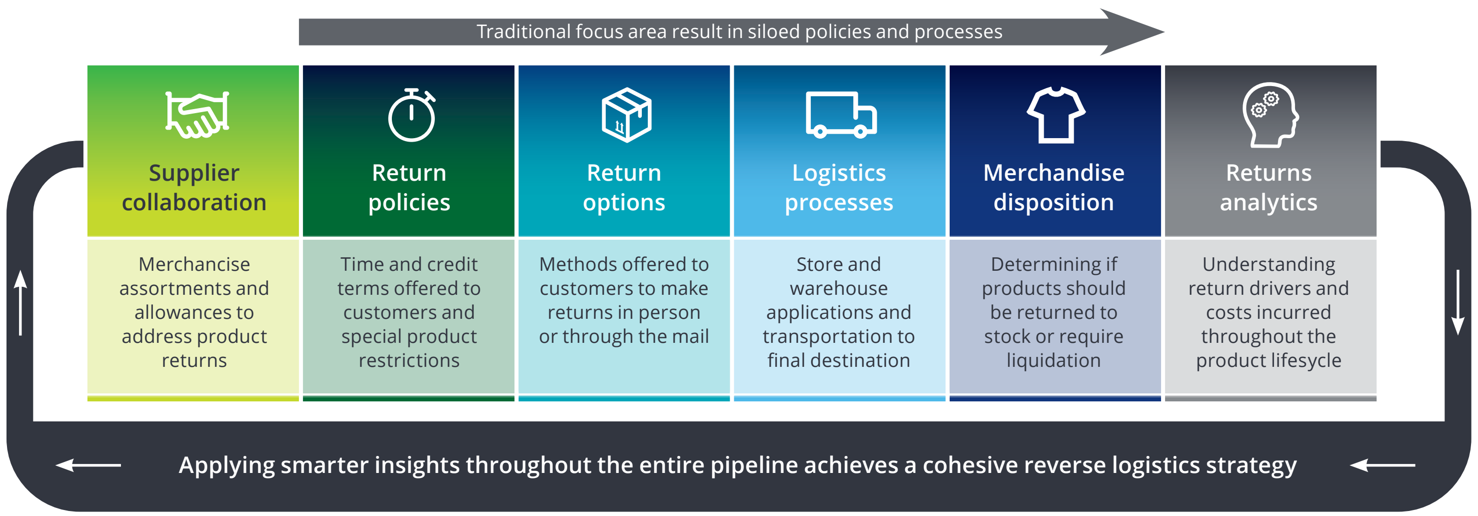
The increase in online shopping has also contributed to a new consumer behavior known as bracketing. Bracketing occurs when the customer orders multiple items online to try on at home in the same way they would bring multiple items into the fitting room if they were in a store. The customer's intent at the point of purchase is to return any items they don't like or that don't fit.



Top merchandise types for bracketing show the customer's intent to try on at-home versus in-store and the prevalence for this phenomenon to occur with fashion items

Additionally, emerging retail models, such as curated shopping, rentals, and try-on services, are compounding e-commerce return volumes. Companies like Stitch Fix, Rent the Runway, and Warby Parker are conditioning the customer to make returns, as each of their models is built on the concept that some, or all of the items ordered, will come back. For many retailers, this concept creates a behavior for which the supply chain is not currently designed.

But to seize these opportunities, retailers must transform siloed return policies and processes into a holistic returns strategy. That transformation means knowing when, how, and why customers make returns and applying smarter insights throughout the reverse logistics supply chain. It also requires taking returns into consideration at the point that merchandise orders are placed, and collaborating with suppliers on product and assortment choices that will drive down return rates.



To better understand what a *returns strategy* should look like, we will look at the reverse logistics value chain and key components that embody a reverse strategy:

A. Supplier collaboration
B. Return policies
C. Return options
D. Logistics processes
E. Merchandise disposition
F. Return analytics

A. It all starts with supplier collaboration

In many siloed returns processes, we find that the buying agreements with suppliers are disconnected from the supply chain, making it very difficult to understand the total cost of that supplier agreement. If there are high returns on an item, the current siloed processes don't usually tie this return rate back to the supplier agreement. In a traditional retail model, it is not uncommon to find that merchandising is aligned under the Brand President and supply chain under the COO, so they are not even in the same organizations, which does not allow for collaboration to understand the total cost of that supplier agreement.

From the outset, even before the purchase is made, merchants, suppliers, and sellers need to be discussing how they will share ownership for returned products and building that ownership into the buying agreement. Accountability lies at the heart of returns, and suppliers should be sharing that responsibility with their retail partners.

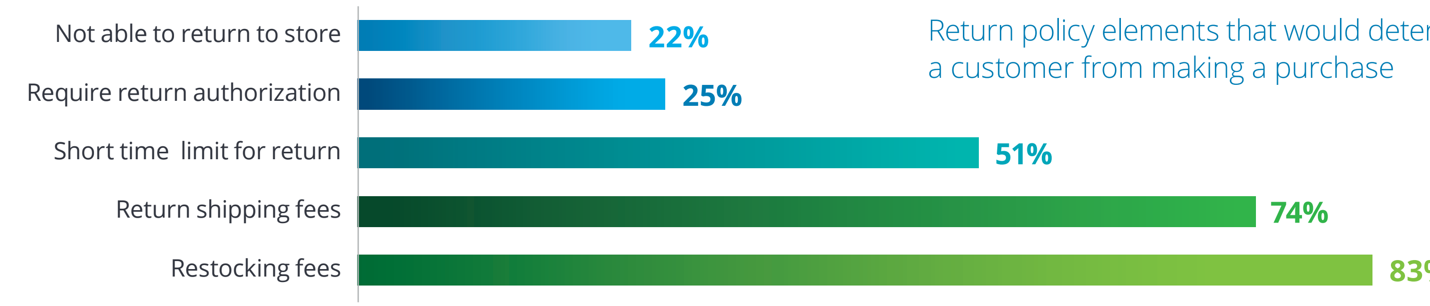
For example, suppliers can customize purchase order assortments to limit product types with high historical return rates, label products accurately, and offer return-to-vendor privileges and/or return allowances based on factual data analysis of historical return rates and trends.

B. Return policies and the customer experience

When is the last time you reevaluated your return policy to make sure it is competitive and aligned with your business strategy? Why?

Returns are increasingly a part of the overall customer experience, and **67 percent of consumers check the return policy before purchasing an item.**[4] **For example, 74 percent of people will be deterred from making a purchase due to returns shipping fees.** Given the emphasis around driving brand loyalty, return policies are key to creating an experience that is sustainable, competitive, and customer-centric.

Extended return periods also impact markdowns. The time allowed for returns varies between retail industry sectors. On average, traditional big box/department Stores allow customers up to 150 days to



return an item from the point of purchase. Fast fashion, off-price, and resale companies with the best inventory turn rates require faster returns—on average, within 25 days of purchase.[5]

Although customers prefer free return delivery, it isn't an industry norm yet. During the 2018 holiday season, more than half of the retailers reviewed by Deloitte required customers to pay to use a return mailing label or required customers to make their own return delivery arrangements.[6]

Free returns are most frequently offered by pure-play e-tailers, but even that model is changing. Online companies with no or limited physical presence can now offer customers a free "walk-in" return option through partnership with brick-and-mortar retailers (Kohl's and Walgreens) or through third-party services (FedEx and UPS Stores).

Such cross-channel partnerships are adding increasing complexity for retailers to not only process their own, but also partners' returns at stores to increase foot traffic. In a 2018 study by Earnest Research, Kohl's has seen Chicago sales and transactions, and customer growth, all outpace the same metrics nationwide for 2018 after the stores began taking Amazon returns. The same study also measured new Chicago-area Kohl's customers (those who hadn't shopped at Kohl's in the previous year), which rose 9 percent in 2018, versus 1 percent for the rest of the United States.

When evaluating your return policy to align with your defined customer experience, you need to consider some of the following key questions:

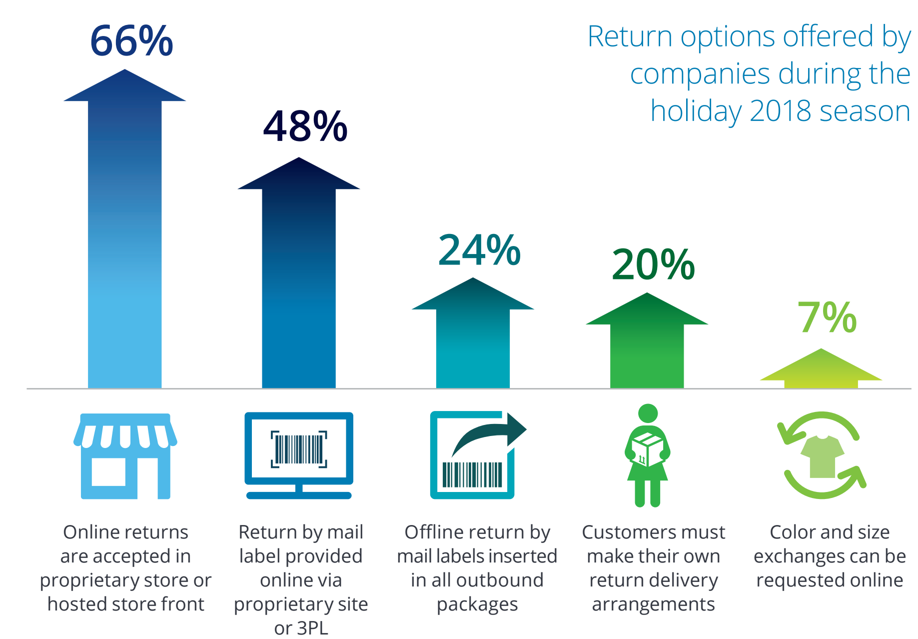
- How much time do you want to let your customers have to make returns?
- Who pays the cost of a return in the case of a mailed return—the consumer or the company?
- Do the cost and time allowed for returns align with customer expectations and the competitive landscape?
- Should return time extensions and free delivery be reserved for best customers?
- What are the best return options to offer based on cost and customer preferences (in-store vs. mailed, refund vs. credit, prepaid labels provided vs. customer arrangements)?

These decisions depend on the company. But to make the right decisions, a better understanding of the underlying data is paramount.

C. Return options can save a sale

Retailers must make sure that they embrace the return and not miss the big picture—that returns represent another opportunity to engage the customer. Rather than representing a failed sale, return options can save the sale and lead to further sales, as evidenced by the fact that **96 percent of consumers would shop again with a retailer based on a good returns experience.**[7] Moreover, every **return can be leveraged as an opportunity for a customer to replace the item or buy additional items.**

Fifty-five percent of 21- to 29-year-olds prefer in-store returns, and 48 percent agree that online returns are a hassle.[8] Our research suggests the main reason they are returning purchases to the store **is they want their credit immediately, rather than waiting 10 to 14 days for a mailed return.**



Buy online and return in store (BORIS) is increasingly the method of choice for consumers and retailers, as it is a win-win. For the customer, it means an immediate credit and ability to make an exchange; for the company, it means logistical expenses are reduced and additional sales can be made while the consumer is in the store.

By giving customers easy and flexible options, retailers can improve the experience, drive new sales, and build brand awareness. Some emerging trends and opportunities include:

- Online return labels enable customers to self-serve and companies to collect critical return information.
- Merchandise credit options in lieu of payment credit can drive the next sale. Offering customers a "conditional credit" as soon as their return package is handed over to a carrier can alleviate much of the customer's pain and processing strain.
- An exchange is the best opportunity to save a sale; few companies, however, are providing this option for online purchases today.

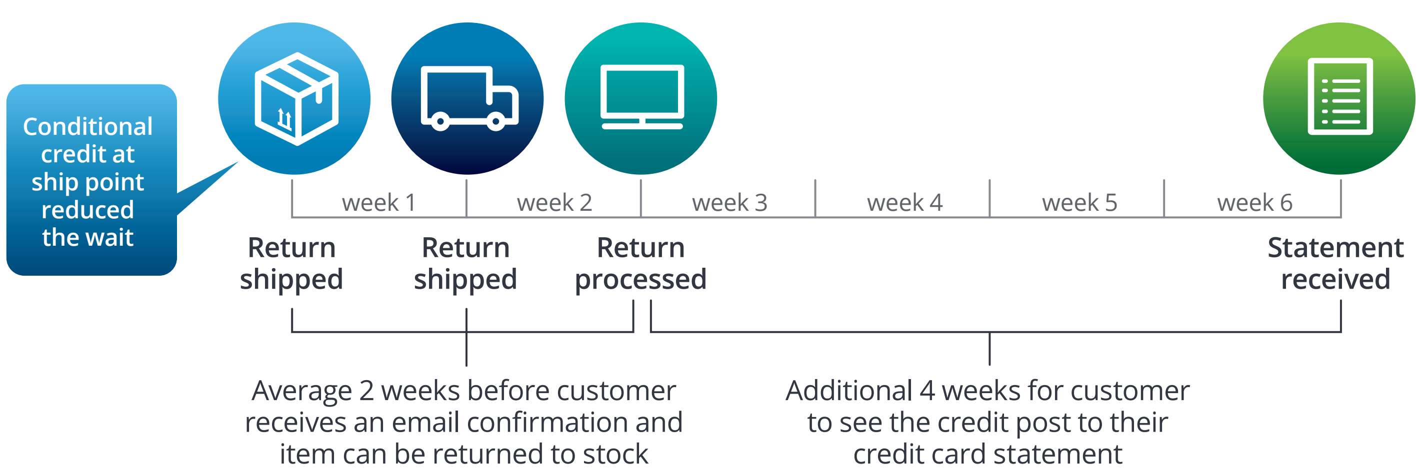
D. Faster operational processing is critical

Returns that are in transit or in process represent lost opportunity to retailers. The longer those items are not available for sale, the less valuable they become. Getting merchandise available for sale as quickly as possible is critical to maximize the recovery.

Nearly half of all companies (44 percent) say returns are a pain point for their supply chain.[9] But addressing the pain requires robust logistics processes, and there are three major areas that retailers are focusing on to save time and money:

- **Technology –** Allowing customers to request a return and print an online return delivery label is a fast and easy customer experience and it also provides multiple benefits for return logistics. Online delivery labels allow retailers to dynamically address returns to their optimum location, eliminating the need to repackage and forward goods somewhere else. Being able to track a return package and its contents enables accurate staffing for inbound volume and facilitates return processing and disposition. Automated handling processes for returns and seamless systems integration need to be leveraged to shorten processing time to a maximum of 24 hours once the return hits the dock through disposition. Visibility into the reverse supply chain is becoming critical to providing customers with fast return credit, as waiting can increase the expense of customer service contacts.
- **Operations & infrastructure –** Many companies attempt to manage reverse logistics through their forward logistics channels, believing that it is most economical to leverage existing warehousing and transportation networks. However, for certain industries, it can increase operational complexity and cause negative ripples across the value chain. Another option is to leverage a third-party service provider to manage your returns to minimize cost and enhance capability in a short time-frame. We will explore the potential benefits that a separate channel for reverse logistics might have for retailers in our next edition.
- **Transportation –** Network consolidations, economy delivery services (small parcel to USPS), and in-store options are tools that are being leveraged to keep the transportation costs down as part of the return's strategy. The Amazon and Kohl's partnership is an example of how stores can be leveraged to keep the costs of returns down and add incremental sales through returning to stores. In addition, recent announcements by UPS to allow returns to be dropped off at a CVS or Advance Auto is another example of retailers leveraging retail storefronts to drive parcel costs down for returned items.[10]

The return life cycle from the customer's perspective…
It can take up to 6 weeks for them to see their credit.



E. Disposition of merchandise

While the first choice of retailers is to resell returns at the full price, the reality is that **less than 50 percent of returns can be sold at the full price.**[11] This reality is due to markdowns occurring while the customer is in possession of the goods or a result of merchandise and/or packaging condition.

Determining whether to reinvest in or dispose of returned merchandise is a critical decision point in reverse logistics. Although many returned items can be repackaged to be made to look new again, refurbishing them will add cost and time that also must align with the cost of the goods.

Additionally, the preference of consumers to buying online and returning in-store **often results in stores having noncongruent inventory,** particularly if store and digital SKU assortment vary.

Opportunities that should be considered to determine the best course of action include:

- Establishing clear and simple return inspection standards
- Internal or third-party refurbishment programs for disposing of gently used or out-of-package returns
- Liquidation channels for aged, used, or damaged items
- Evaluating high-return products for return-to-vendor opportunities
- Directing return packages to a location with congruent inventory, providing a greater chance to resell at full price

F. Analytics ties it all together

Retailers, who are seeing 8 percent of their supply chain cost going to reverse logistics, recognize that their return policy has an impact on purchasing behavior.[12] Once the strategic decisions on return policies and processes best suited to the specific retailer have been designed, you need to leverage the insights that capture every touchpoint in the returns life cycle to complement your supplier agreements to take the total cost of ownership into consideration.

Achieving informed analytics requires collecting and understanding data throughout the reverse logistics pipeline.

That step means creating centralized data lakes that import structured and unstructured returns activity in real time.

That data in turn must be analyzed to understand the reason behind those returns and how to address upstream drivers. In addition to optimizing the customer return experience, these learnings can then be leveraged to improve future sales conversion by identifying products that are less likely to be returned.

Turning data into action, however, calls for dashboards informed with predictive analytics that provide visibility into a single source of truth across reverse supply chain, recommend clear proactive action, and track clear indicators to ensure that performance is meeting standards.

Call to action:

"Traditional" approaches to managing returns as a lower priority within the value chain likely aren't good enough in today's retail environment. As customers shift their expectations to a more holistic shopping experience, retailers must adapt to building a cross-channel returns strategy that connects the purchase cycle from the earliest stages of assorting and buying goods through the consumer sales cycle. Integrating the returns strategy with your supply chain strategy can further enhance the value chain and generate better return on assets.

The returns management organization should be comprised of analytical experts and process SMEs with deep domain knowledge, people who understand supply chain business issues and customer behaviors. This group must be enabled with an insights and decision support platform that integrates and monitors transactional data from internal and external sources and automatically separates issues from the mass to generate insights and actions needed to improve the end-to-end process.

Endnotes

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How can Deloitte help?

As retailers transform and digitize their forward supply chains to meet changing customer demands, it is imperative that they consider moving from the traditional reverse logistics mentality of handling returns and transform that approach into a reverse strategy within their supply chain. Deloitte can help your organization convert your reverse supply chain into a strategic asset.

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